

(1963) 03 MAD CK 0035

In the Madras High Court

Case No : Tax Case Petitions No"s. 26 and 27 of 1962

Devi Films Ltd.

APPELLANT

Vs

Commissioner of Income Tax, Madras.

RESPONDENT

Date of Decision : 11-03-1963

Acts Referred:

Income Tax Act, 1922 — Section 10(2)(xi), 10(2)(xv), 66(1), 66(2)

Citation : (1963) 49 ITR 874

Hon'ble Judges : Jagadisan, J

Bench : Single Bench

Judgement

Jagadisan, J.—Messrs. Devi Films (Pte.) Ltd., referred to as the assessee in this judgment, is the applicant in these two petitions filed u/s 66(2) of the Indian Income Tax Act. It is carrying on business as financier of production of motion pictures and as dealer in cinematographic machines and spare parts. Before setting out the question of law sought to be referred, the facts giving rise to these petitions will have to be stated. They are as follows :

The assessee entered into an agreement on 6th July, 1955, with a certain Dinshaw K. Tehrani who had ventured upon the production of a cinema film called Raja Rani. Under this agreement the assessee agreed to lend Tehrani a sum of Rs. 3,80,000. The money was lent as per the terms of the agreement, but Tehrani could not complete the production due to lack of funds. The assessee entered into a further agreement with Tehrani on 31st January, 1956, and agreed to provide him with further funds to the extent of Rs. 1,50,000. In all, the assessee advanced to Tehrani the sum of Rs. 5,57,022-10-1 in pursuance of the two agreements aforesaid. The picture, after release, proved to be a flop and the expectations of the assessee to make profit out of the financing agreements failed. The assessee was, however, able to realise by collections from exhibitions and by sale of distribution rights, in all a sum of Rs. 4,91,071-12-3. There remained a balance of Rs. 65,950-13-10 due and payable by Tehrani to the assessee. It appears that this Tehrani was not a person of large means. He had a

house in the city of Madras, purchased in the name of this wife. He held 100 shares in Newtowne Studios Ltd., of the face value of Rs. 10,000. Notwithstanding the indebtedness of Tehrani to the assessee and possibly to several others, his resourcefulness and enthusiasm to produce pictures did not come to an end. The assessee entered into an arrangement with Tehrani on 1st April, 1957, by which Tehrani pledged his shares in Newtowne Studios as security for a sum of Rs. 10,000, on condition of the assessee waiving the balance of Rs. 55,950-13-10. As stated already, Tehranis total liability to the assessee on that date was Rs. 65,950-13-10.

In the year of assessment 1957-58, in respect of the previous year ended 12th April, 1957, the assessee wrote off this sum of Rs. 55,950-13-10 as bad and doubtful debts and claimed it as a proper deduction u/s 10(2)(xi) of the Indian Income Tax Act in computing his income. The Income Tax Officer rejected the assessee's claim holding that the assessee had not taken any legal proceedings for the recovery of the amount, that he had not exhausted his remedies for the recovery of the debt and that it was premature to write off the debt as a bad debt. The assessee, nevertheless, reiterated his claim for deduction of this amount as a bad debt for the subsequent assessment year 1958-59. Again, the officer rejected his claim. He observed as follows :

"The gross collections from the picture over which the assessee holds right indefinitely for a number of years is Rs. 5,586. Since the Collections are coming in and are not absolutely stopped and since the security on the basis of which the loan was granted has not become quite useless, I consider that the claim for bad debt is premature."

2. The assessee preferred appeals to the Appellate Assistant Commissioner from the disallowance in respect of both the years. The appeals were heard together and disposed of by a common order. It is not necessary to refer to the reasoning of the Appellate Assistant Commissioner; suffice it to say that he found himself in agreement with the view taken by the Income Tax Officer. There were further appeals by the assessee to the Income Tax Appellate Tribunal. These appeals were also unsuccessful.

3. In the view of the Tribunal there was no satisfactory proof that the debtor (Tehrani) was completely devoid of means to pay the debt and that there was evidence to show that the assessee could not have bona fide entertained the belief that the debt had become bad. The Tribunal pointed out that within six months after the date of writing off, which was 12th April, 1957, the assessee made a further advance of Rs. 25,000 to Tehrani for the production of another picture. The Tribunal also pointed out that the debtor owned a house both at Madras and in Ootacamund and that though the house in Madras stood in the name of the debtors wife, the debtor himself had treated the income from the house as his own income in submitting his Income Tax returns. The Tribunal took into account the fact that, even as late as 1961, the debtors account was credited by the assessee with the sum of Rs. 5,000 and odd, being the sale

proceeds of an impression of the film Raja Rani. The Tribunal, therefore, affirmed the view taken by the department and held that the claim of the assessee to write off could not be sustained in law. The assessee's applications u/s 66(1) of the Act for reference of questions of law to this court failed before the Tribunal and hence these applications have been preferred. The question sought to be referred is this : "Whether, on the facts and in the circumstances of the case, the sum of Rs. 55,951 is allowable as a deduction from its profits under sections 10(2) (xi) or section 10(2)(xv) of the Act."

4. Learned counsel for the assessee did not very properly submit that the deduction would fall u/s 10(2) (xv).

5. The only short question which arises for consideration is whether the assessee's claim to write off this sum of Rs. 55,950-13-10 on 12th April, 1957, is well founded. If the debt due by Tehrani to the assessee had become a bad and doubtful debt, the assessee's claim would be permissible. If, however, there was evidence before the Tribunal to establish that the debtor was not financially so bad as to create any misgivings in the mind of the assessee regarding the recoverability of the debt, then the assessee must fail.

6. The claim of the assessee to write off is based on section 10(2) (xi) of the Indian Income Tax Act. To the extent relevant for the present case, the provision may be extracted :

"10(2) (xi). When the assessee's accounts in respect of any part of his business.... are not kept on the cash basis, such sum, in respect of bad and doubtful debts, due to the assessee in respect of that part of his business... as the Income Tax Officer may estimate to be irrecoverable but not exceeding the amount actually written off as irrecoverable in the books of the assessee :

Provided that if the amount ultimately recovered on any such debt for loan is greater than the difference between the whole debt or loan and the amounts so allowed, the excess shall be deemed to be a profit of the year in which it is recovered, and if less, the deficiency shall be deemed to be a business expense of that year."

7. The expression "bad and doubtful debt" is descriptive of a debt which cannot reasonably be expected to be realised. It would not do for the assessee to say that he became pessimistic about the prospects of recovery of the debt in question. He must feel honestly convinced that the financial position of the debtor was so precarious and shaky that it would be impossible to collect any money from him. There is no acid test to ascertain whether a debt has become bad and doubtful, and if so, when. A time-barred debt can be assumed to be bad, but is not necessarily bad because of the bar of time. The insolvency of the debtor is not conclusive proof that the debt has become bad. Nor does the fact that the debtor has managed to keep outside bankruptcy proceedings constitute evidence of the debt being good. The question is really one of fact depending upon congeries of facts and diverse circumstances bearing on the debtors

pecuniary position, his commitments and obligations, and the natural apprehensions that would be caused in the minds of the creditors regarding recovery of their dues. While the onus of establishing that the write off of the alleged bad debt is proper and permissible in the circumstances of the case is undoubtedly upon the assessee, the department cannot insist on demonstrative proof which is quite infallible.

8. What then is the present position and what are the facts proved or admitted? The debtor is still active in the pursuit of his business, profession or vocation. The assessee himself did not treat the debtor as one financially broken as even during the year 1957, six months after writing off of the present debt, he thought him creditworthy for being lent a further sum of Rs. 25,000. Admittedly, the debtor owns immovable properties both in Madras and in Ootacamund. He is holding shares in a film producing concern. To the outside world the debtor is certainly not a person without credit verging on insolvency. His indebtedness to others under decrees of court is only one side of the picture. It is impossible to assume that the assessee, in these circumstances, could have honestly thought that the sum of Rs. 55,950-13-10 became a bad debt on 12th April, 1957.

9. Mr. Swaminathan, learned counsel for the assessee, strenuously contends, basing himself on the decision of this court in *Kamakshi Chettiar v. Commissioner of Income Tax*, that the agreement between the assessee and his debtor to waive Rs. 55,950-13-10 after taking security of the shares in *Newtone Studios Ltd.*, of the value of Rs. 10,000, would itself be sufficient proof of the debt having become bad on the date of write-off. In the case cited, the assessee had advanced a sum of Rs. 35,000 in the course of his money-lending business on an usufructuary mortgage effected on 29th January, 1944. The assessee and the debtor entered into an agreement in 1949-50, whereby the amount of debt was worked out in accordance with the scheme of the provisions of the *Madras Agriculturists Relief Act, 1938*. The assessee accepted the sum of Rs. 12,875 in cash and a promissory note for Rs. 16,000, in full discharge of the debtors liability under the mortgage. The assessee wrote off the balance of Rs. 6,125 as an irrecoverable bad debt and claimed it as a deduction u/s 10(2) (xi) of the Act. It was held that the requirements of section 10(2) (xi) were satisfied and that the assessee was entitled to claim the sum of Rs. 6,125 as an irrecoverable bad debt. The following passage from the judgment of *Rajagopalan J.* is relied upon by learned counsel :

"The write-off was really based on a fresh agreement between the parties superseding the old contract. Under the fresh agreement, the assessee became entitled to receive Rs. 6,125 less, and it was this sum that was treated as irrecoverable. There can be no doubt that after the fresh contract was concluded, the old contract was not enforceable, and in that sense Rs. 6,125 was irrecoverable. The irrecoverability having been established independently of the solvency or otherwise of the debtor and the genuineness of the transaction not being in issue, we fail to see how the assessee's right based on section 10(2) (xi)

of the Act could be denied."

10. The context in which these observations were made should not be overlooked. The debtor in that case was entitled to the benefit of the scaling down of the debt under the Madras Agriculturists Relief Act. On that basis the debtor would be entitled to proportionate reduction of the principal in proportion to the period during which the mortgagee-assessee had already been in possession. The creditor and the debtor sat together and worked out their respective rights and obligations in accordance with the terms of that Act. The deficiency of the sum of Rs. 6,125 that was caused in the matter of realisation of the debt was certainly not the direct result of the agreement between the parties, but was only because of the operation of the statute. We do not think that the learned judges meant to lay down as a proposition of law that wherever and whenever a creditor chooses to receive from the debtor not the fully amount of the debt, but only a portion thereof, the portion waived and not realised should be available to the creditor as being treated as a bad and doubtful debt. It would always be open to a creditor to show concessions to the debtor, due to various reasons and one cannot say that a creditor would not give up any portion of the recoverable dues unless the debtor was not in a position to pay. There are cases in which, having regard to the mutual relationship between the parties, or in view of future business transactions between them, the creditor and debtor might adjust a particular debt in a particular manner. We are not inclined to accept the observations quoted above as laying down an inflexible rule of law that a waiver by a creditor of a portion of his debt would amount to proof positive of the debt, or any portion thereof, having become bad and doubtful. What the statute permits is scoring out unrealisable debt credits and treating them as revenue losses and not turning to advantage the forgoing of outstandings out of business motives or sympathetic considerations.

11. Mr. Swaminathan next contends that it was wrong on the part of the Tribunal to have taken into account the fact of further lending of Rs. 25,000 to the debtor after the writing off of the debt and submits that if there were materials for the assessee to write off the debt as a bad debt when it was written off, subsequent events should not be taken note of in order to disprove the assessee's state of mind when he treated the debt as a bad debt. In support of this proposition reliance is placed upon the observations of Rowlatt J. in *Anderton and Halstead Ltd. v. Birrell*. In that case the appellant company wrote off in its accounts for the years 1921 and 1922 portions of a debt due from another company in which the former company held a majority of the shares. The Inspector of Taxes allowed as deduction in computing the company's profits the amounts so written off. The company continued after 1922 to trade with the debtor company and extended it further, increasing credits while its indebtedness to other creditors was diminished. Having regard to these facts the Inspector took action in 1929 and made additional assessments to neutralise the effect of the deductions allowed in computing the profits in respect of the years 1921 and 1922. The additional assessment were confirmed on appeal by the General Commissioners, who held

that no part of the debt in question had been proved to be bad. The High Court held that there was no evidence that the deductions were wrongly allowed by reference to the circumstances at the time of the allowance and that the additional assessments were not justified. At page 209 Rowlatt J. observed as follows, and it is this observation which is strongly relied upon by Mr. Swaminathan :

"What the statute requires, therefore, is an estimate to what extent a debt is bad, and this is for the purpose of a profit and loss account. Such an estimate is not a prophecy to be judged as to its truth by after events, but a valuation of an asset *de praesenti* upon an uncertain future to be judged as to its soundness as an estimate upon the then facts and probabilities. It is not overthrown as an estimate in 1923 and 1924 by coming to the conclusion, as the Commissioners have done, that in 1930, it had not been proved that the debts were to any extent bad."

12. The principle of this decision is that if a debt is written off as bad and is treated as such for tax purposes, the account for the previous period cannot be reopened for the purpose of bringing in the debt as a trading receipt merely because in a subsequent accounting period it is found to be a good debt. It is true that what all is required is an honest judgment on the part of the assessee at the time when he makes the write-off in the light of events up to that stage and not in the light of later happenings. But it cannot be said that in order to determine the question whether the assessee could have believed that the debt was made on a particular date his subsequent conduct, treating the debtor as solvent and sound, would be irrelevant or inadmissible.

13. In our opinion, the principle of the decision in *Anderton and Halstead Ltd. v. Birrell* and the observations of Rowlatt J. in that case should be confined to a case where the department attempts to cancel a deduction once granted by levying an additional assessment either by taking action u/s 34 or under some other provision of law. In our opinion, the said principle cannot have an application to the facts and circumstances of this case. We hold that the department and the Tribunal reached the correct conclusion in holding that the assessee was not entitled to write off the debt. These petitions are dismissed with costs in T. C. P. No. 26 of 1962 only. Counsels fee Rs. 150.