

(1969) 04 MAD CK 0022

In the Madras High Court

Case No : Tax Case No. 38 of 1966 (Reference No. 18 of 1966)

Devi Films Private Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 21-04-1969

Acts Referred:

Income Tax Act, 1922 — Section 10(2)

Citation : (1970) ILR (Mad) 80 : (1970) 75 ITR 301

Hon'ble Judges : Veeraswami, J; Ramaprasada Rao, J

Bench : Division Bench

Advocate : S. Swaminathan and K. Ramagopal, for the Appellant; V. Balasubrahmanyam and J. Jayaraman, for the Respondent

Judgement

Veeraswami, J.—This is rather an unfortunate case but eventually we have come to the conclusion that the question referred to us should be

answered against the assessee. It refers to the assessment year 1959-1960. The assessee is a private limited company engaged, during the relevant

years, in the business of financing production of motion pictures and in the purchase of cinematograph machines and spare parts, with one Dinshaw

K. Tehrani, a film producer. It entered on January 25, 1954, into an agreement to advance to him a sum of Rs. 1,50,000 on terms of royalty of Rs.

40,000 in favour of the creditor and that the amount lent should be returned within 8 months with the stipulated interest. This agreement was

substituted by another dated July 6, 1955, by which it was agreed that the creditor should advance Rs. 3,80,000 of which Rs. 2,06,883, owing

under the earlier agreement, was to be adjusted against the sum agreed latterly to be advanced. The picture for which the money was advanced

was released on February 24, 1956. In the meantime, there was yet another

agreement dated January 31, 1956, whereby the assessee agreed to provide further finances to the extent of Rs. 1,50,000. After repayment towards the loan as on March 31, 1957, there was still outstanding from Tehrani a sum of Rs. 65,950-13-10. On 1st April, 1957, there was an arrangement come to between the two, the terms of which are to be found in a letter of that date passed by the debtor. It appears from it that the debtor was not in a position to repay the outstanding. He, therefore, requested the assessee to reduce the indebtedness to Rs. 10,000 and waive the balance treating it as a rebate given to him. The letter also added that as a security for repayment of the sum of Rs. 10,000 he handed to the assessee 100 shares of the face value of Rs. 100 each in Newtowne Studios Ltd., together with blank transfer forms duly signed by him. A time of 60 days was stipulated in the letter for repayment of the sum of Rs. 10,000. This would appear to have been accepted by the assessee as "was evident from his subsequent conduct. For the year 1957-1958 the assessee claimed deduction of a sum of Rs. 55,950-13-10 as a bad and doubtful debt u/s 10(2)(xi) of the Income Tax Act, 1922. This claim was rejected. The claim was reiterated for the next year too but with the same result. As a matter of fact, it was pursued on behalf of the assessee by a petition u/s 66(2) of the Income Tax Act, which however failed even at the outset, for this court considered that there was no case for asking for a reference. For the third time the claim was raised. The Income Tax Officer, as before, rejected it but the Appellate Assistant Commissioner allowed it. On a departmental appeal the Tribunal restored the first order. At the direction of this court the following question has been referred :

Whether, on the facts and in the circumstances of this case, the sum of Rs. 55,051 is allowable as a deduction from its profits for the year ending April 12, 1959?

2. The reasons which prompted the revenue as well as the Tribunal on the earlier occasion in rejecting the claim for deduction are briefly these. So soon after the settlement dated April 1, 1957, the assessee made a further advance on October 24, 1957, of a sum of Rs. 25,000 to Tehrani. Tehrani owned a house at Ootacamund and another in College Road, Madras, though, they stood in the name of his wife. For purposes of assessment to Income Tax he had included income from the properties with the

income from other property of his. It was observed that, since April 1, 1957, Tehrani, who was indebted to certain other creditors in large sums, had reduced the liability by repayment of large sums. Though the film, for the production of which the assessee had advanced Rs. 1,50,000, proved to be a failure, collections came in by exhibition of this picture from April 13, 1958, to March 14, 1961, and as a result not only the sum of Rs. 10,000 owing to the assessee under the settlement dated April 1, 1957, was wiped out but the accounts of the assessee showed a credit of Rs. 10,554 in favour of Tehrani which the assessee paid to him by a cheque on March 8, 1961.

3. The Appellate Assistant Commissioner in allowing the appeal, thought that the fact that the assessee returned the excess credit of Rs. 10,554 by cheque which was cashed through bank, showed that the debt to the extent of Rs. 55,951 had definitely become bad and it should, therefore, be allowed. When it came before the Tribunal, by way of an appeal by the department, it was doubtful whether the terms contained in Tehrani's letter of April 1, 1957, amounted to an agreement at all. In its opinion it was but a request to scale down the debt and did not have the status of a contract. Its further reasoning was that, though the debtor undertook to pay the sum of Rs. 10,000 within a specific period, he did not actually do so, and, further, the assessee also did not put the sum of Rs. 10,000 in a separate account. But he went on crediting subsequent realisation to the same account. The Tribunal also observed that when the assessee paid the sum of Rs. 10,554.76, he returned the 100 shares held by him as security against the original debt of Rs. 10,000. In the opinion of the Tribunal, all this indicated that the letter, the collections, credit in favour of Tehrani, and the later transactions, were all part of the original transaction and it was unable to conclude that the sum of Rs. 55,950-13-10 became a bad debt. The Tribunal also relied in support of its conclusion on the other fact that while other financiers deemed it worthwhile to file suits against Tehrani for recovery of sums due from him, it could not be appreciated how the assessee thought it prudent to settle the debt at Rs. 10,000.

4. Mr. Swaminathan, for the assessee, with his usual dexterity, appealed to our sympathy and contended that this was a case of a bad debt

amounting to a trading loss and that in view of the attitude taken up by the department in the earlier years with regard to the claim for deduction, it should be allowed for the year in question. The argument advanced to us in this regard appeared to us in the first instance to be attractive but on a careful consideration we think it cannot be admitted. The claim clearly does not fall within the ambit of Section 10(2)(xi). Mr. Swaminathan does not contend to the contrary. But he rightly points out that the statutory provision is not exhaustive. A debt becomes bad for purposes of deduction in the computation of total income if facts objectively considered reasonably point to an inference that, having regard to the circumstances of the debtor, it has become difficult or impossible of recovery. Whether a debt is of such a nature is always a question of fact, which has to be determined in the light of the evidence and circumstances of each case. There is no presumption in that matter and it is for the assessee to establish it. So much was pointed out by this court in T. S. PL. P. Chidambaram Chettiar (By Legal Representatives) Vs. Commissioner of Income Tax, Madras., . There may be a bad debt of the character we mentioned which may not fall within the purview of Section 10(2)(xi), but may well be regarded as one eligible to deduction in the computation of the net profits chargeable to tax. That is because, in computing net profits, necessarily such bad debts will have to be taken into account on the side of debit which will reduce the net profits. But whether allowance can be given in that way may sometimes depend on whether the outgoing or what is regarded as bad debt resulting in a loss is on the capital or revenue account. Most trading losses incurred in the course of carrying on of business in a particular year will also come under that category and will naturally enter into computing the net total income.

5. A trading loss, as it appears to us, has a wider connotation than a bad debt. A bad debt may also be a trading loss but a trading loss need not necessarily be a bad debt. The real profits chargeable to tax cannot be arrived at without setting off legitimate trading loss. This is inherent in the operation of Section 10(1) : AIR 1932 178 (Privy Council) .

6. If, as we said, the instant case is not a bad debt but a trading loss in the sense that, in the course of the business of the assessee, he, having regard to all the circumstances, bona fide thought that the entire outstanding

could not be recovered and it was, therefore, necessary to arrive at a settlement with the debtor reducing the debts to Rs. 10,000 and entering into an arrangement providing for security for repayment of this sum, and also stipulating a time therefor, the question then is whether the waiver and writing off of the debt, of which deduction is sought, can be allowed as a deduction in the year in question ? We are unable to agree with the Tribunal that the terms contained in the letter of Tehrani dated April 1, 1957, did not amount to a contract. There is no question that it was a bona fide arrangement, and it is clear that, under that arrangement, binding as it was on both the assessee and the debtor, the assessee thereafter could not legally recover what he had already waived. His right, after the arrangement had been entered into, was confined to its terms and we do not think that the revenue can ever overlook this aspect. The circumstances relied on by the revenue on all the occasions, as well as the Tribunal, for treating the debt as not having become bad do not seem to us to weigh against the assessee, regarding the settlement of April 1, 1957, as resulting in a trading loss, with the consequence that, pursuant to the waiver, the assessee had to write off a sum of Rs. 55,950-13-10 as irrecoverable. We do not think that the fact that the debtor failed to repay a sum of Rs. 10,000 within the stipulated time or the fact that the creditor had the collections coming in to the credit of the debtor, and that on a particular day there was as much as Rs. 10,554.76 lying to the credit of the debtor would derogate from the legal effect of the arrangement of April 1, 1957. As we said neither party can go behind it and any action to recover could only be founded on it, not on the earlier occasion based on the first agreement or even those following it.

7. As a trading loss, however, the assessee meets with an insuperable difficulty in getting it allowed as a deduction in the computation of the net

total profits for 1959-60. As observed by the Privy Council in *Chitnavis* case :

""What are chargeable to Income Tax in respect of a business are the profits and gains of a year; and in assessing the amount of the profits and

gains of a year, account must necessarily be taken of all losses incurred, otherwise you would not arrive at the true profits and gains. But the losses

must be losses incurred in that year. You may not, when setting out to ascertain the profits and gains of one year, deduct a loss which had in fact

been incurred before the commencement of that year. If you did, you would not arrive at the true profits and gain's of the year.

8. It follows from it that if a trading loss had been incurred in an earlier year, but by some reason it was not allowed, it is clearly not eligible for

deduction in any subsequent year in the computation of net profits of that year. In order to get over this situation, Mr. Swaminathan's attempt was

to suggest that the rigour of this rule should be relaxed in favour of the assessee, because of the attitude taken by the department itself for the

preceding years, 1957-58 and 1958-59. He argues that, so far as the assessee was concerned, it had placed all the facts before the revenue and it

was its duty to assess their legal effect and allow deduction in the proper year treating the sum in question either as a bad debt or as a trading loss,

but the revenue having not done that, in such a case, the strict rule that a trading loss is eligible for allowance only for the year in which it occurred,

should not be insisted upon. It may be seen that the argument is really not founded on the provisions of the statute, but on the attitude or conduct of

the revenue in making assessments for the previous year and disposing of the very facts before us in the previous years. In support of this principle,

as learned counsel would term it, he had relied on *Karamsey Govindji, Bombay Vs. Commissioner of Income Tax, Bombay City, , Indore Malwa*

United Mills Ltd., Indore Vs. State of Madhya Bharat and Others, and Associated Banking Corporation of India Ltd. Vs. Commissioner of

Income Tax, Bombay-1, . Having given our best attention to these cases we are of opinion that they do not assist us to uphold the principle

contended for. *Karamsey Govindji v. Commissioner of Income Tax Concerned* itself with the deductibility of a bad debt, a sum of Rs. 70,000. It

was not concerned with a trading loss or a bad debt of one year being allowed to be deducted in the assessment for another year. That was a case

where the Bombay High Court sustained the view of the revenue that the debt had not become bad in the year in which it was claimed by the

assessee. But in the course of expressing that view, Chagla C. J. pointed out at page 958 :

..... .the present Income Tax law with regard to bad debts makes the position of the assessee extremely difficult. He may write off a debt in a

particular year and may claim it and the claim may be disallowed. In the next year he cannot make that claim because it would be urged against him

that he did not write off the debt in that year. Therefore, the assessee always finds himself on the horns of a dilemma and it is the duty of the

department to take a sympathetic view of the matter if in fact the debt was never recovered. Therefore, if the debt was not allowed to the assessee

in the year of account, there is no reason why the department should not consider allowing him this debt in the next year when admittedly the debt

became irrecoverable, although the assessee may not have written it off in that year.

9. We can see in these observations nothing favourable to the assessee in the case before us. The learned Chief Justice did not say that if the debt

became a bad debt in a particular year, it could nevertheless be allowed as a deduction in a subsequent year. He only pointed out that whether a

debt was written off or not by the assessee, it was the duty of the revenue to consider the facts and then allow the debt as bad debt or not in

accordance with the findings. If the assessee claimed a debt to be a bad debt in a particular year, but the claim was disallowed, but admittedly the

debt became irrecoverable in the following year there was then no reason why although the assessee might not have written it off in the previous

year for the following year it should not be allowed. *Karamsey Govindji v. Commissioner of Income Tax* does not go any further.

10. *Indore Matwa United Mills Ltd. v. State of Madhya Pradesh* was a case of trading loss which a company claimed as a deduction. It was

carrying on business in the manufacture of cloth and in accordance with the articles and memorandum of association it could invest its funds in

giving loans to others. The managing agents borrowed on behalf of the company large sums of money from outsiders, entered them in its books of

accounts, with, drew the sums and utilised them for their own purposes. The managing agents went into liquidation in a particular year. In

computing the company's profits for the purpose of industrial tax under the *Indore Industrial Tax Rules, 1927*, for the assessment year 1941, the

company claimed deduction of the sums which could not be recovered from the managing agents as bad debts and trading loss. The Supreme

Court held that the money borrowed by the managing agents had become irrecoverable and it was allowable as a deduction as a trading loss in

computing the profits of the managed company in the assessment year. It may be seen that, although the managing agents went into liquidation in

1933 and the assessment related to a subsequent year, nevertheless the trading loss claimed as a deduction was allowed. This is perhaps on the view that it is only in the year of assessment the assessee actually came to know of the misconduct on the part of the managing agents and the full facts resulting in a trading loss to the managed company.

11. Associated Banking Corporation of India Ltd. v. Commissioner of Income Tax was a case of embezzlement and it was held that, although the embezzlement occurred in a particular year resulting in loss to the assessee there, nevertheless it could be allowed as a deduction as a trading loss in the year in which the assessee came to know of the embezzlement. The view was supported not merely on the date of the knowledge of the embezzlement but also on the fact that the amount misappropriated could be treated as a loss only if and when it is known to the assessee that it is no longer recoverable by any means. Mr. Swaminathan, referring to these cases, argues that the principle of these cases should be extended to a case like this where due to the wrong attitude, as he describes it, of the revenue taken towards the claim in the earlier years, the assessee has been prejudiced. As we said, persuasive as the argument is, we do not think we can uphold it. For, once we do that, we do not see where the line can be drawn.

12. It seems to us that it tends towards certainty of the law and even the convinces (sic) of the revenue as well as of the assessee that there is strict adherence to the statutory provisions. The trading loss occurred in this case when the assessee wrote off the amount claimed as deduction on April 1, 1957. That writing off was irrevocable and binding on both sides. The amount was, therefore, eligible for deduction as a trading loss in the assessment year 1957-58. But, unfortunately, the assessee did not put forward the claim for deduction on the ground that it was a trading loss but took up the position that it was a bad debt, with the result the revenue, having regard to the several subsequent circumstances, considered that it had not become a bad debt in the previous years or even in the year in question.

13. Notwithstanding our sympathies to the assessee, we are, therefore, constrained to answer the question against the assessee with costs.

Counsel's fee Rs. 250.