
(2007) 03 MAD CK 0364

In the Madras High Court

Case No : Writ Petition No. 22676 of 2007 and M.P. No. 1 of 2007

Fire Challenger

APPELLANT

Vs

The Assistant Commissioner of Income Tax

RESPONDENT

Date of Decision : 12-03-2007

Acts Referred:

Income Tax Act, 1961 — Section 147, 148, 152(2), 246, 271(1)

Citation : (2007) 03 MAD CK 0364

Hon'ble Judges : K. Chandru, J

Bench : Single Bench

Advocate : A. Thiagarajan, SC for S. Janarthanam, for the Appellant; J. Narayanasamy, for Pushya Sitaraman, for the Respondent

Final Decision : Dismissed

Judgement

K. Chandru, J.—Heard the arguments of Mr. A. Thiagarajan, learned Senior Counsel leading Mr. S. Janarthanam, learned Counsel appearing for the petitioner and Mr. J. Narayanasamy representing Mrs. Pushya Sitaraman, learned Standing Counsel representing the respondent and have perused the records.

2. The challenge in this writ petition is to the Demand Notice dated 22.5.2007 issued by the respondent Assistant Commissioner of Income Tax wherein and by which the petitioners were given an Assessment Order assessing the liability of the tax payable at Rs. 1,65,10,039/- and also with liberty to proceed to take penal action in terms of Section 271(1)(c) of the Income Tax Act [for short, "I.T. Act"]. The petitioners, though have a remedy by way of appeal to the Commissioner of Income Tax, have not availed the same on the ground that there has been a gross violation of laws and legal principles by the authorities under the power of the Appellate Commissioner u/s 246(a) of the I.T. Act. was also restricted.

3. In the writ petition, notice was given to the respondents and interim stay was granted on 04.7.2007 by this Court. Though it was extended subsequently, there

was no further extension beyond 12.11.2007. However, the respondents have appeared and filed a counter affidavit dated 25.7.2007 and with the consent of the parties, the main writ petition itself was taken up for hearing.

4. The petitioner earlier moved this Court in W.P. No. 1361 of 2006 seeking to challenge the notice dated 28.3.2005 made for the assessment year 1998-99 and this Court granted an interim stay of further proceedings on 21.01.2006. Subsequently, this Court directed that since the assessment proceedings have been reopened and the reasons were not disclosed, the respondents were directed to disclose the reasons. The operative portion of the order found in Paragraph 2 reads as follows:

Learned Counsel for the respondents submits that without waiting to receive the copy of the reasons which the petitioner has sought for, the petitioner rushed to this Court and obtained interim relief. He further submits that the department is willing to furnish the copy of the reasons recorded to the petitioner. The said statement is recorded and the writ petition is disposed of, with a direction to the respondents to serve a copy of the reasons recorded, before the issue of the notice within two weeks from the date of receipt of a copy of this order and proceed in accordance with law after service of the copy of the reasons.

5. In obedience to the orders passed by this Court, the respondents by a proceedings dated 22.02.2007 furnished the reasons for reopening the assessment. It is useful to extract the said communication in extenso for the purpose of better appreciation of the facts involved in the case:

The assessee is a partnership firm. The assessee filed its return of income for the year A.Y. 1998-99 on 1st July 1998 declaring loss of Rs. 50,25,668/-. In the P&L a/c enclosed to the return of income, the assessee has claimed Bad debts of Rs. 2,66,72,880/-. Shri T. Devanathan, a partner in the above firm was asked to explain the basis of such a claim. He has stated in the sworn statement recorded from him on 28.2.2000 that the U.P. Government had paid him only Rs. 89,34,120/- against the total sale price of Rs. 3,56,07,000/- made to the UP Government by M/s Fire Challenger. Shri T. Devanathan has stated that some arbitration was going on between the assessee firm and the Government of Uttar Pradesh. It is not known whether the settlement has been arrived at as a result of such arbitration or the same is yet to come. In the circumstances, since the matter relates to A.Y. 98-99, it is considered expedient to keep the matter alive by re-opening the assessment u/s 148.

The assessee has filed the Audit report along with the return of income stating the method of accounting adopted is Mercantile. However, the assessee may also take a stand that since the accounts are mercantile, the claim of bad debts was made in A.Y 1998-99 and the reward received as a result of arbitration also relates only to the assessment year. Hence, the same cannot be taxed on receipt basis.

It is seen from the records that the reasons for issue of notice u/s 148 for the

assessment year 98-99 had been communicated to you already vide this office letter dated 5.1.2006.

6. Mr. A. Thiagarajan, learned Senior Counsel, after referring to the impugned order, more particularly to paragraph 7, submitted that the verification of profit and loss account has shown that the petitioners have claimed several amounts under the heading advertisement and business promotion, communication expenses, salaries and allowances and travelling and conveyance. The petitioners had given details with reference to the expenditure incurred by their reply dated 21.5.2007 and the same was also not considered. They have also enclosed several documents to show the justification of the expenditure incurred by them. He also made heavy reliance upon the arbitration proceedings in A.P. No. 4870 of 1998 before the District Judge, Kanpur wherein the Award passed by the arbitrators was set aside. The amount for which queries were made, viz., Rs. 2,66,72,880/- was shown as bad debts in the profit and loss account filed along with the Income Tax Return for the year 1998-99 and in the same assessment, the authorities have taken the stand that it was shown as prevailing dispute and not as bad debts. It was contended that to label it as a wrongful claim and consequently, labelling as income chargeable to tax as escaped assessment, is impermissible. It was further submitted that by mere change of opinion on the same facts without there being any additional material, the authorities cannot proceed to reopen the assessment by invoking the power u/s 148 of the I.T. Act.

7. The learned Senior Counsel referred to the judgment of the Gujarat High Court in SARANGPUR COTTON MANUFACTURING CO. LTD. Vs. COMMISSIONER OF Income Tax, GUJARAT-I., and stated that there are four conditions for grant of deductions in respect of bad debts in terms of Clause (vii) of Section 36(1) of the I.T. Act and they are as follows:

Four conditions govern the grant of deduction under Clause (vii) of Section 36(1), namely:

- (i) the debt or loan should be in respect of a business which is carried on by the assessee in the relevant accounting year;
- (ii) the debt should have been taken into account in computing the income of the assessee for the accounting year or for an earlier accounting year or should represent money lent in the ordinary course of his business of banking or money-lending;
- (iii) the amount of debt or loan, or part thereof which is claimed as a deduction should be established to have become bad in the accounting year; and
- (iv) the amount should be written off as irrecoverable in the accounts of the assessee for that accounting year in which the claim for deduction is made for the first time.

8. It is relevant to note the following passage found in page 178 in the aforesaid judgment:

In spite of the efforts made by the assessee-company, it was not able to recover a single paisa towards the amount due to it by the end of 1970. That itself was sufficient to justify writing off of the amount due. What is required is honest judgment of the assessee at the time of writing off the debt in the light of events up to that stage. Having regard to the facts and circumstances of the case, it cannot be said that the decision of the assessee-company was not honest. Events and circumstances subsequent to the stage of writing off which are not irrelevant also amply justify the action of the assessee-company. The assessee-company has satisfied us that the conclusion reached by the Tribunal is vitiated by a gross error or refusal to take into consideration material evidence.

9. Thereafter, the learned Senior Counsel relied upon the judgment of the Gujarat High Court in the Commissioner of Income Tax Vs. Girish Bhagwat Prasad, wherein similar observations have been made by the Division Bench. It is relevant to extract the following passage found in that judgment.

...The genuineness of such a claim made by the assessee was not in doubt. Therefore, all that the Tribunal has done is to uphold the first appellate authority's decision, applying the provisions of the amended Section 36(1)(vii) of the Act, and no question of law arises in the matter from such application of the provision to the facts of the case.

10. The learned Senior Counsel also drew the attention of this Court to the circular dated 23.01.1990 issued by the Central Board of Director Taxes [for short, "CBDT"] and more particularly, to Paragraph 6.6 of the circular, which reads as follows:

Amendments to Sections 36(1)(vii) and 36(2) to rationalise provisions regarding allow ability of bad debts. The old provisions of Clause (vii) of Sub-section (1) read with Sub-section (2) of the section laid down conditions necessary for allow ability of bad debts. It was provided that the debt must be established to have become bad in the previous year. This led to enormous litigation on the question of allow ability of bad debt in a particular year, because the bad debt was not necessarily allowed by the Assessing officer in the year in which the same had been written off on the ground that the debt was not established to have become bad in that yea. In order to eliminate the disputes in the matter of determining the year in which a bad debt can be allowed and also to rationalise the provisions, the Amending Act, 1987, has amended Clause (vii) of Sub-section (1) and Clause (i) of Sub-section (2) of the section to provide that the claim for bad debt will be allowed in the year in which such a bad debt has been written off as irrecoverable in the accounts of the assessee.

11. Per contra, the learned Standing Counsel representing the Revenue referred to the judgment of the Rajasthan High Court reported in Hiralal Vs. Commissioner of Income Tax, and contended that for invoking Section 147 of the I.T. Act, the word "such income" will be referable to income which is chargeable to tax but as escaped assessment. It is also stated that where reassessment is

made in that Section in respect of income which has escaped tax, the Income Tax Officer's jurisdiction under the Section is confined to such income which has escaped tax and does not extend to revising, reopening or reconsidering the whole assessment. The said view was considered by the Supreme Court in the decision reported in Commissioner of Income Tax Vs. M/s. Sun Engineering Works (P.) Ltd., and submitted that the earlier judgment of the Rajasthan High Court in Hiralal case (cited supra) was not found acceptance.

12. The learned Counsel stated that the Supreme Court did not agree with the view of several High Courts and referred to page 320 of the judgment of the Supreme Court, which reads as follows:

As a result of the aforesaid discussion, we find that in proceedings u/s 147 of the Act, the Income Tax Officer may bring to charge items of income which had escaped assessment other than or in addition to that item or items which have led to the issuance of notice u/s 148 and where reassessment is made u/s 147 in respect of income which has escaped tax, the Income Tax Officer's jurisdiction is confined to only such income which has escaped tax or has been under-assessed and does not extend to revising, reopening or reconsidering the whole assessment or permitting the assessee to reagitate questions which had been decided in the original assessment proceedings. It is only the under-assessment which is set aside and not the entire assessment when reassessment proceedings are initiated. The Income Tax Officer cannot make an order of reassessment inconsistent with the original order of assessment in respect of matters which are not the subject-matter of proceedings u/s 147. An assessee cannot resist validly initiated reassessment proceedings under this section merely by showing that other income which had been assessed originally was at too high a figure except in cases u/s 152(2). The words "such income" in Section 147 clearly refer to the income which is chargeable to tax but has "escaped assessment" and the Income Tax Officers' jurisdiction under the section is confined only to such income which has escaped assessment. It does not extend to reconsidering generally the concluded earlier assessment. Claims which have been disallowed in the original assessment proceeding cannot be permitted to be reagitated on the assessment being reopened for bringing to tax certain income which had escaped assessment because the controversy on reassessment is confined to matters which are relevant only in respect of the income which had not been brought to tax during the course of the original assessment. A matter not agitated in the concluded original assessment proceedings also cannot be permitted to be agitated in the reassessment proceedings unless relatable to the item sought to be taxed as "escaped income". Indeed, in the reassessment proceedings for bringing to tax items which had escaped assessment, it would be open to an assessee to put forward claims for deduction of any expenditure in respect of that income or the non-taxability of the items at all. Keeping in view the object and purpose of the proceedings u/s 147 of the Act which are for the benefit of the Revenue and not an assessee. An assessee cannot be permitted to convert the reassessment proceedings as his appeal or revision, in disguise, and seek relief in respect of

items earlier rejected or claim relief in respect of items not claimed in the original assessment proceedings, unless relatable to "escaped income", and reagitate the concluded matters. Even in cases where the claims of the assessee during the course of reassessment proceedings relating to the escaped assessment are accepted, still the allowance of such claims has to be limited to the extent to which they reduce the income to that originally assessed. The income for purposes of "reassessment" cannot be reduced beyond the income originally assessed.

13. The learned Counsel contended by referring to Section 36(1)(vii) of the I.T. Act wherein it is clearly stated that it is a bad debt written off as irrecoverable of the assessee in the previous year and as per the explanation, it does not include provision for bad debts or doubtful debts made in the account of the assessee.

14. In the present case, when the documents were called for regarding the said claim, the same were not furnished and it is not as if, the arbitration proceedings have become final and that an appeal was also filed before the Allahabad High Court. Therefore, it has not become irrecoverable as provided in the statute. As noted already, though the petitioner is a partnership firm, since the certificate issued by the auditors have shown that there is a prevailing dispute which are referable to the Court, inclusion of the bad debt account for 1998-99 is clearly impermissible and for this purpose, notice was issued to the petitioner for reopening the assessment and no exception can be taken to the same. The decisions cited by the learned Senior Counsel for the petitioner are not appropriate to the facts of the case.

15. In view of the above, there is no illegality or irregularity in the impugned order passed by the respondent. Accordingly, the writ petition will stand dismissed. No costs. Connected Miscellaneous Petition is closed.