
(2008) 08 SHI CK 0010
In the High Court Of Himachal Pradesh

Suresh Gaggal

APPELLANT

Vs

Income Tax Officer

RESPONDENT

Date of Decision : 14-08-2008

Acts Referred:

Income Tax Act, 1961 — Section 36(1)(vii), 36(2), 36(2)(iii)

Citation : (2009) 221 CTR 96 : (2009) 180 TAXMAN 90

Hon'ble Judges : V.K. Ahuja, J;Deepak Gupta, J

Bench : Division Bench

Final Decision : Allowed

Judgement

Deepak Gupta, J.—This appeal has been admitted on the following substantial question of law:

Whether even after the amendment to Section 36(1)(vii) which after amendment provides that deduction on account of bad debt should be allowed once the same is established to have been written off in the books of accounts without proving anything else, the Tribunal was correct in law in upholding the disallowance on the ground that the assessee appellant had failed to prove that the debt had become irrecoverable?

2. In this case, we are concerned with the assessment year 1993-94. The provisions of Section 36(1)(vii) as existing for the assessment year in question reads as follows:

Section 36(1)(vii): Any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year....

Prior to its amendment, which came into effect on 1st April, 1989 Clause (vii) read as follows:

Subject to the provision of Sub-section (2), the amount of any debt, or part thereof which is established to have become a bad debt in the previous year.

3. It is apparent that prior to amendment, the assessee could claim deduction on account of bad debt, only if it was established that any debt or part thereof had become a bad debt in the previous year. The legislature in its wisdom chose to amend the Act and the amended provision is absolutely clear that once the assessee writes off any bad debt or any part thereof as being irrecoverable, the assessee is entitled to claim deduction for the same. The word "established" has been deleted from the amended provision. The intention of the legislature is absolutely clear that the assessee is no longer required to establish that the debt is bad. He has only to prove that he has written off the debt in his books of accounts as a bad debt. Once he writes off the debt as being irrecoverable, his claim for deduction cannot be rejected on the ground that debt has not been established to have become irrecoverable debt.

4. The aforesaid interpretation, which we are giving is supported by the amendment made to Section 36(2) of the Act, which also came into effect on 1st April, 1989. Section 36(2)(iii), which is relevant for the purpose, reads as follows:

Section 36(2)(iii) : any such debt or part of debt may be deducted if it has already been written off as irrecoverable in the accounts of an earlier previous year (being a previous year relevant to the assessment year commencing on the 1st day of April, 1988, or any earlier assessment year), but the AO had not allowed it to be deducted on the ground that it had not been established to have become a bad debt in that year.

This clause makes it clear that even if in the previous year, relevant to the asst. yr. 1988-89 or any previous assessment year the AO had not allowed any debt to be deducted on the ground that it had not been established that it had become a bad debt, then also after the amendment the assessee was entitled to claim deduction of the same in the next assessment year.

5. In view of the clear-cut language of the section and the distinction between the unamended and amended provisions, there is no manner of doubt that the intention of the legislature was that the assessee was entitled to claim deduction in case he, in his books of account, had written off the debt as a bad debt. In our view the language is crystal clear and brooks of no other interpretation.

6. Any doubt, if remaining, has been clarified by the Circular No. 551, dt. 23rd Jan., 1990 (1990) 82 CTR 325 issued by the CBDT. Clause 6.6 of the circular reads as follows:

6.6. Amendments to Sections 36(1)(vii) and 36(2) to rationalize provisions regarding allowability of bad debts.-The old provisions of Clause (vii) of Sub-section (1); r/w Sub-section (2) of the section laid down conditions necessary for allowability 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 allowability of bad debt in a particular year, because the bad debt was not necessarily allowed by the AO 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 year. In order to eliminate the disputes in the matter of determining the year in which a bad debt can be allowed and also to rationalize 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.

7. This circular makes it amply clear that once the assessee has written off the debt then it is not open to the AO to reject the claim of the assessee on the ground that the assessee has failed to establish that the debt has become a bad debt in the relevant assessment year. While taking the aforesaid view, we are fortified by a judgment of the Division Bench of the Delhi High Court in CIT v. Morgan Securities & Credits (P) Ltd. (2007) 210 CTR 336 (Delhi) : (2007) 292 ITR 339 (Del) in which it was held as follows:

It is our view that the Circular No. 551 see (1990) 82 CTR 325 : (1990) 183 ITR 7 leaves no scope for debate since it specifically notices the previous practice of having to establish that a debt had become bad in the previous year, which had generated enormous litigation on the question of allowability of bad debt in a particular year. The circular expressed the hope that this litigation would be eliminated by permitting a debt to be treated as a bad or irrecoverable no sooner it was written off in the books of the assessee concerned.

8. Ms. Kuthiala, learned Counsel for the Revenue has contended that even after the amendments the assessee is bound to establish that the debt has become bad. She submits that even though the assessee may not be required to prove this fact with the same degree of proof required earlier, he must prima facie show that the debt has actually become bad.

9. In support of her contention she has relied upon two judgments. The first is Travancore Tea Estates Co. Ltd. Vs. Commissioner of Income Tax, In our considered opinion this judgment has no application to the facts of this case since the assessment year in question in the said case was 1977-78 much prior to the amendment being made to Section 36(1)(vii) and also to Section 36(2). Reference has also been made to a judgment of the Rajasthan High Court reported in Kashmir Trading Co. Vs. Deputy Commissioner of Income Tax, wherein it has been observed that Sub-section (2) of Section 36 makes it abundantly clear that merely writing off a debt as a bad debt in the books of account irrecoverable does not ipso facto result in deducting the sum while computing the taxable income.

10. At first blush these observations appear to support the case of the Revenue. However, on closer and deeper scrutiny of the case, we find that the aforesaid observations have been made in totally different factual scenario. The facts of Kashmir Trading Co. case (supra) were that search and seizure operations were conducted. After these seizure operations were conducted the assessee claimed that some of the debts which had not been written off as bad debts In the books

of account of the assessee should be treated as bad debts In terms of Section 36(2) of the IT Act. It is in this context that the Rajasthan High Court held that before Section 36(2) is applied the debt must be shown to be a bad debt. The observations of the Rajasthan High Court, in fact, are that the assessee should have first written off all these debts as bad debts in his books of account. Since this was not done, the ITO could not declare these debts to have (become) bad and could not hold any inquiry for deciding this fact. Therefore, we are of the opinion that this judgment has no application to the facts of this case.

11. As per the amended provisions of the IT Act, 1961 once the debt has been written off as a bad debt, it is not the requirement of law that the assessee should establish that the debt has in fact become bad. The reason behind this is that after amendment to Section 36(2), in case the assessee recovers any part of the debt the same is assessable as his income in the year when the debt is recovered.

12. In view of the above discussion, the question is answered in favour of the assessee and against the Revenue. Appeal filed by the assessee is allowed and disposed of accordingly.