IN THE HIGH COURT OF DELHI

ITA No. 682/2011

ALL GROW FINANCE AND INVESTMENT PVT LTD

Vs

COMMISSIONER OF INCOME TAX

A K Sikri and M L Mehta, JJ

Dated: June 03, 2011

JUDGEMENT

Per: M L Mehta:

1. The assessee is in appeal before us against the impugned order dated 29th October, 2010 passed by the Income Tax Appellate Tribunal (in short „Tribunal") in respect of the assessment year 2000-01.

2. This appeal was admitted on the following question of law:

(i) Whether on the facts and circumstances of the case, the Tribunal was justified in holding that the bad debt amounting to Rs.34,95,000/- were not allowable under Section 36(1)(vii) read with Section 36(2) of the Act.

(ii) Whether on the facts and circumstances of the case, the Tribunal misdirected itself in holding that the conditions of Section 36(2) of the Act were not fulfilled in a case where the advance/debt itself was not shown as income in the profit and loss account."

3. The assessee is a non-banking financial company. It derives its income from interest on money lent to various parties as a part of its money lending business. On 16th April, 1999 it lent Rs. 60 lakhs to M/s Bhav Portfolio. After deducting opening credit balance of Rs. 3.10 lakhs, a sum of `56.90 lakhs became due to be recovered. However, this amount could not be recovered even after several requests, reminders and legal notice. Ultimately, Rs. 28.45 lakhs (50% of amount due) was written off in assessment year 2000-01. The balance amount was also written off in the year 2004-05 and the same stand allowed in the assessment made under Section 143(1) of the Income Tax Act (for short 'the Act'). Similarly, Rs. 6,50,000/- (being 50% of the amount due) was written off in the case of M/s Gallery in the relevant assessment year.

4. The Assessing Officer disallowed assessee's claim for bad debts holding that under Section 36(2), to write off any bad debt, same has to be included in the income for earlier years which was not done in the case of assessee.

5. The findings of the Assessing Officer were confirmed by both CIT(A) as well as Tribunal. The Tribunal also observed that the advances made by the assessee were without collateral security or any other type of security. Such non-compliance of safety measures in respect of security of debt shows that the advance was not made in the ordinary course of business. The Tribunal also observed that since the assessee failed to prove that the amount which has been advanced was ever shown as income in any of the previous years, therefore, conditions set out under Section 36(2) are not fulfilled.

6. The main contention of the learned counsel for the appellant/assessee is that writing off the bad debt by itself is enough to claim the deduction of bad debt under Section 36(2) of the Act. He submitted that this section does not require that the entire money lent, which has become irrecoverable, need to be shown as income in the case of a non-banking money lending business. He submitted that the only requirement is that the money should have been lent in the ordinary course of business in the hope of earning interest. On the other hand, learned counsel for the revenue submitted that the debt or part thereof was not shown as income in the previous year in which the amount of such debt or part thereof was written off and so conditions under sub–section (2) of section 36 are not fulfilled and therefore, the amount could not be taken as bad debt. The contention raised by both the learned counsel centered around the interpretation of sub-section 2(i) of section 36, which reads as under:-

"(2) In making any deduction for a bad debt or part thereof the following provisions shall apply-

[(i) No such deduction shall be allowed unless such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year, or represents money lent in the ordinary course of business of banking or money-lending which is carried on by the assessee;]"

(emphasis supplied)

7. Learned counsel for the appellant/assessee has tried to interpret the section in two parts. He submitted that the requirement of the first part of the section would not be applicable to the second part of the section which relates to money lent in the ordinary course of business of banking or money lending carried on by the assessee. The second part of the section, as pointed out, has been highlighted by us in the clause (i) of sub-section (2) which has been reproduced above.

8. For the time being, without going in to this interpretation of two parts of clause (i) of sub-section (2), it may be stated that the provision of section 36(1)(vii) read with section 36(2)(i) of the Act would come into play only if; firstly the amount of loan or part thereof which is claimed as deduction should be established to have become bad debt and secondly, the amount should have been shown to have become irrecoverable and written off from the accounts of the assessee or from the account in which the claim is made.

9. The division bench of our High Court in the case of *CIT v. Morgan Securities and Credits (2007) 292 ITR 339*, while interpreting section 36(1)(vii) and 36(2)(i) observed as under:-

5. A conjoint reading of Section 36(2) and Section 36(i)(vii) makes it clear that the assessed would be entitled to a deduction of the amount of any bad debt which has been written off as irrecoverable in its Accounts for the previous year. Any lingering doubt would vanish on a careful reading of Circular Number 551 dated 23.1.1990, the relevant portion of which reads as follows:

6.6 The old provisions of Clause (vii) of Sub-section(1) read with 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 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 the 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 assessed.

6.7 Clauses (iii) and (iv) of Sub-section (2) of the section provided for allowing deduction for a bad debt in an earlier or later previous year, if the Income Tax Officer was satisfied that the debt did not become bad in the year in which it was written off by the assessed. These clauses have become redundant, as the bad debts are now being straightway allowed in the year of write off. The Amending Act , 1987 has, Therefore, amended these clauses to withdraw them after the assessment year 1988-89.

7. It is our view that the Circular Number 551 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 recoverable no sooner it was written off in the books of the assessed concerned.

10. There is no dispute with regard to the above mentioned proposition of law as interpreted by the decision of our High Court in the case of Morgan Securities (supra). However, the present case relates to assessee which is undisputedly a NBFC and is in the business of money lending and has been making advances to different concerns, two of them being those to whom advances were made and which are claimed as bad debts as noted above. In the manner the learned counsel for the appellant has interpreted clause (i) of sub-section (2), he states that the second part of this clause starting from 'or represents money lent … by the assessee' as highlighted by us deals with the different types of activities, not at all related to those with the first part of business activities. In other words, his submission was that in the case of advances/loans made by any concern doing the business of banking or money lending, it was not obligatory that such advances/loans or part thereof should be shown to have become irrecoverable and consequently written off in the accounts of the assessee in the previous year. This manner of interpretation was not acceptable to the learned counsel for the revenue who submitted that for claiming deduction of any amount as bad debt it was necessary to establish that the amount has become not only bad debt, but the same was also shown to have

become irrecoverable and written off in the accounts of the assessee for the previous year. The interpretation of section 36(2) clause (i) came before the Division Bench of Madras High Court in the case of *P.C.Dharmalinga Mudaliar v. Commissioner of Income Tax (1985) 152 ITR (Mad)*. Relying upon the famous judgment of *Rowlatt J., in Curtis v. J. & G. Oldfield Ltd. [1925] 9 TC 319*, the Division Bench held as under:-

"The first limb of s. 36(2)(i)(a) of the present Act only incorporates Rowlatt J.'s principle; that limb exacts very clearly that no deduction shall be allowed for a bad debt, unless such debt has been taken into account in computing the income of the assessee for the previous year or for an earlier previous year. It is implicit in this express condition that the debt should have arisen in the course of carrying on his business. In the second limb of s. 36(2)(i)(a), this condition is not repeated, for the simple reason that the second limb deals with money-lending and banking business in which the money itself is regarded as a stock-in-trade and, therefore, the money lent would certainly come into the revenue account, and, hence, it was perhaps thought to be unnecessary to emphasise the obvious by saying that money lent in a money-lending or banking business must have been taken into account in the computation of money lending or banking business. The only requirement which was worthwhile to make mention of in a banking or money-lending business is that it must have been money lent in the course of the business of the assessee. Therefore, taking the provision in s. 36(2)(i)(a) as a whole, it is necessary in every case to find if a debt in a money-lending or banking business or a debt in a non-money-lending or a non-banking business must have been incurred in the course of the assessee's business. The second limb is that in the case of non-money-lending or non-banking business, a debt in order to be a bad debt must have been taken into account in the computation of the income of the assessee. This particular requirement takes care to exclude what may be called capital debts from qualifying for write-off as bad debts."

11. In the present case there is no dispute that the amounts of debts in question were advanced by the assessee in the ordinary course of money lending. The question for consideration would be as to whether the condition prescribed in the first limb for taking the debt into account while computing the income can be read in the second limb also and whether that can be done despite the construction of the second limb in the manner which is separated from the first limb by use of "comma" preceding the word "or" which clearly divides the provision in two parts, viz., (i) first part, dealing with non-money lending business; and (ii) second part, dealing with money lending business alone and the division is intended to ensure the fulfillment of conditions for allowance of bad debts peculiar to each limb concerned.

12. The controversy that has arisen from the order of the Tribunal is whether the amount of debt itself should be shown as income before the debt qualifies for claim as a bad debt. It is seen that the controversy before the Madras High Court in the case of P.C. Dharmalinga (supra) was whether money advanced to a transport company from cloth and yarn business be treated as money advanced in the ordinary course of cloth and yarn business. The Madras High Court's emphasis as required by the second part was that it may be admittedly in relation to money lending business that debt is advanced in ordinary course of business and if the debt is not advanced in the ordinary course of business, it would not qualify for deduction as a bad debt. Thus, according to Madras High Court itself money lent as part of money lending business being stock-in-trade automatically comes into revenue account. In other words, it need not be taken into account in computing the income as required in the first limb in relation to non-money lending business to prove that it

is on revenue account. Madras High Court correctly emphasizes as required as per second limb that it should be found out in relation to money lending business that debt is advanced in the ordinary course of money lending business. If the debt is not advanced in the ordinary course of business, it would not qualify for deduction as a bad debt.

13. We are of the view that the only condition laid down in second part of sub-section 2 of Section 36 of the Act is that the amount should be advanced in the ordinary course of business which by itself proves its revenue nature and no further conditions are required to be satisfied which are only applicable with regard to debt qualifying as bad debt in the first part of sub-section 2 in the manner as interpreted above.

14. For the aforesaid reasons, we are in agreement with the submissions of learned counsel for the appellant/assessee as regards the interpretation of sub-section 2(i) of Section 36 and that being so, we are of the view the authorities below are not justified in holding that the amount of Rs.34,95,000/- was not allowable as bad debt under Section 36(1)(vii) read with Section 36(2) of the Act.

15. In view of this, the additional/alternative plea raised by the learned counsel for the appellant for allowing said deduction as business loss under Section 37 of the Act, does not require any consideration. In fact this additional ground was raised by the assessee before the CIT(A) which was disallowed, and for which the matter was remanded by the Tribunal. So, this ground does not require any further consideration in view of our findings in favour of the assessee as noted above.

16. Consequently, we answer the questions in favour of the assessee and against the revenue and allow the appeal of the assessee