Income Tax Appellate Tribunal - Mumbai
Jitpan Holdings (P.) Ltd. vs Assistant Commissioner Of ... on 13 September, 1993
Equivalent citations: 1994 48 ITD 369 Mum
Bench: N Prabhu, R Agrawala
ORDER R.D. Agrawala, Judicial Member 1 - Assessee is a private limited company. It follows Mercantile system. They held a significant bloc of equity shares of Orkay Silk Mills Limited. Their accounting period under consideration ended on 31st March, 1989.

2. The assessee-appellant entered into an agreement on the 1st day of August 1986, with Devang Exports (P) Ltd. of Bombay, to enable the latter to invest in the shares of M/s. Orkay Silk Mills (P.) Ltd. for ensuring that the shares continued to be treated in the market at reasonable levels - both in respect of the volume of trading and their prices.

3. The salient features of this agreement which is in the form of a communication and has been placed in the paperbook (at pg. 1 & 2} are that the assessee were to provide to the other party intercorporate deposits up to an aggregate of Rs. 16.50 crores, such deposits were not to carry any interest for a period of two years from the date of deposit; the interest was to be charged on or after 1st of October 1988 (no rate prescribed) and that the deposits made by the assessee were to be utilised only for the investment in the shares of Orkay Silk Mills. Ltd.

4. Devang Exports, incurred huge losses and could not pay back even the principal amount advanced by the assessee to them by 30th September, 1986.

The Assessing Officer took the view that as envisaged by the contract between the assessee and M/s. Devang Exports interest was chargeable on the advances with effect from 1st October 1988, and the assessee following Mercantile system of accounting interest at an amount of Rs. 84,81,300 accrued to them for the period 1-10-1988 to 31-3-1989 i.e., the remainder period of the accounting year. As stated, although no rate of interest was provided in the contract between the parties, the Assessing Officer calculated the interest @ 12 per cent.

In all, the assessee made advance aggregating to Rs. 14,13,55,000 to M/s. Devang Exports which remained unpaid. On their part, M/s. Devang Exports asked for full performance from the assessee, namely, the advance of the remainder of Rs 16.50 crores in terms of the agreement referred to supra. The dispute was eventually referred to the arbitration of one Sri J.C. Kapoor, who finally awarded an amount of Rs. 125 lakhs to M/s. Devang Exports from the assessee. The award was accepted, and a provision of Rs.125 lakhs was made by the assessee in their books as a business expenditure.

5. In the Directors Report as at 31st September 1987, available at p. 6 to 8 of the paperbook, the following report was made by the Directors at sl. no. 4:

4. Loan to Devang Exports Put. Ltd.:

The company has advanced loans to Devang Exports Pvt. Ltd which will not carry interest for a period of two years to invest in the shares of Orkay Silk Mills Ltd. to ensure that the shares continue to be traded in the market at reasonable levels both as to the volume of trading and as to the price at which they are traded. Due to delay in advancing the loans as per the terms agreed upon, Devang Exports Pvt. Ltd has suffered losses and has made a claim on the company for Rs. 250.00 lakhs. Due to dispute over the said claim amount, the matter was referred to a Sole Arbitrator Sri J.C. Kapoor. The Arbitrator has awarded to pay compensation of -Rs. 125.00 lakhs which has been accepted in full and final settlement by both the parties. The said Award amount has been provided in the books as Business Expenditure.

Subsequent to the date of Balance-sheet, the Company has not realised any money till date in view of the losses suffered by Devang Exports Pvt. Ltd. the company has made a provision of doubtful debts of Rs. 14,13,55,000 being the full value of the loan.

Incidentally, the compensation of Rs.125 lakhs awarded by the Sole Arbitrator Sri Kapoor was disallowed by the Assessing Officer as collusive.

Aggrieved, when the matter went before the Commissioner (Appeals), he has remanded the same for further inquiry which is still pending with the Assessing Officer but there is no quarrel to the submission that this issue has no relevance for the disposal of the present appeal.

6. Assessee's case is that since M/s. Devang Exports suffered huge losses as on 30 th June 1987, which fact was established from their Balance-sheet and allied papers available at pg.48 onwards of the paperbook, they came to the conclusion that the amount had become irrecoverable Elucidating, we were taken to pg. 51 of the paper book which shows the loss of Devang Exports as on the aforesaid date in their balance-sheet Rs.42,61,16,329 which included a loss of Rs. 14,53,14,039 from share trading, the balance sheet also reflects that Devang Exports had to pay unsecured loan to the extent of Rs. 40,70,20,903 to several parties including the assessee before us. In their submission, since there was not even a freak ray of hope of the realisation of even the principal amount from Devang Exports whose Authorised Capital was as meagre as a sum of Rs. 3,000, interest on the arrears could not be calculated and said to accrue which would be purely hypothetical, besides, being artificial and unrealistic. It was also contended that the assessee created provision for doubtful debts amounting to - Rs. 14,13,55,000 in their Profit & Loss account on the premises that they had not received any part of this amount from Devang Exports; the whole of which had become irrecoverable.

7. Both the Assessing Officer and the CIT (Appeals) have proceeded on the basis that since the assessee is following Mercantile system of accounting, therefore, the interest did accrue to them in terms of the agreement between M/s. Devang Exports making them liable to offer the same for taxation during the assessment year 1989-90. The Assessing Officer also observed that there was a collusion between the assessee and Devang Exports with a view to deprive the Revenue of their rightful dues. Both the Authorities have strongly relied on the report of the Auditors of the assessee-company (copy available at p. 12 of the paperbook), relevant portion of which is reproduced below:

3. The company has given loans and advances in the nature of loans to a party. The amount of principal is recoverable on demand with moratorium of two years for interest. In absence of records of steps taken for recovery of loans and interest, we are unable to comment on recoverability of such loans and whether reasonable steps are being taken for recovery of loans and interest thereon.

8. Before us, the assessee's learned Counsel strongly assailed the action of the authorities below in calculating the interest on hypothetical basis principally on the ground that once it was found that Devang Exports had suffered huge losses and there was no chance of the recovery even of the principal amount due from them in respect of which a provision as 'doubtful debts' had already been made by the assessee in their Profit & Loss account for the year ending 30th Sept. 1987, there were no premises, legal or commercial, on the basis of which interest could have been charged. He also referred to the Balance-sheet of Devang Exports as on 31st March 1989 (available at pg. 68 and onwards) to show that the position in respect of their financial status did not undergo any favourable change whatsoever.

9. As against this, the learned Departmental Representative forcefully urged that there was no material on record to show that any steps, much less, effective ones were taken by the assessee in realising their dues from M/s. Devang Exports which lapse was also supported from the Auditor's report, relevant portion reproduced hereinbefore and that the assessee's account books still showing the debit of the dues from M/s. Devang Exports went a long way to strengthen the Department's case that the amount in question was recoverable together with interest in terms of the agreement between the parties referred to supra. This, it was contended, fully justified the action of the Assessing Officer in calculating the interest on the advances made by the assessee-company which following the Mercantile system of accounting fell due to them.

10. In reply, the learned Counsel for the assessee, submitted that the balance sheet of M/s. Devang Exports itself was enough to justify the drawing of an inference by the assessee that nothing was recoverable from them and as such there was no point in wasting good money after a bad one and chasing the issue with no point of return.

11. We have considered the matter carefully. As far as the facts with regard to the advance made by the assessee to Devang Exports and the losses as reflected in the latter's accounts are concerned, there does not appear to be any quarrel. Incidentally, the assessee also filed before us copy of an order dated 28th February 1992, rendered by the CIT (Appeals) in the case of M/s. Mamnu Holdings Pvt. Ltd. wherein the issue of payment of Rs. 2 crores by them to M/s. Devang Exports as compensation in similar circumstances and arising out of the same Award given by Sri J.C. Kapoor came up for consideration and it was held that the transaction was not sham or collusive in nature, although the learned CIT (Appeals) qualified to say that the entire amount of compensation was not allowable as a business loss incurred by M/s. Mamnu Holdings as a trader. Before we proceed to examine the matter further, we may also point out here the submission that if the smallness of the authorised capital of M/s. Devang Exports at Rs. 3,000 was not relevant for the purposes of entering into a contract for giving loan of Rs.16.50 crores, the same should not have mattered in the realisation of the assessee's dues from them. Though there may be some force in this submission, but in fact in our considered opinion, nothing turns on it. True, that the assessee agreed to advance

a huge sum of Rs.16.50 crores to M/s. Devang Exports who had an abysmally low authorities capital of Rs. 3,000, but it is for them to have taken this factor into consideration, and the issue before us does not have a direct bearing on it. Here, the plain question is as to whether in facts and circumstances of the case that were obtainable, interest on the loan advanced by the assessee to M/s. Devang Exports in respect of which a provision had already been made by the assessee and incidentally which loss had been allowed in the hands of the debtors i.e., M/s. Devang Exports, could be charged or not. The provision for bad debts of Rs. 14,30,55,000 made in the P & L a/c. for the year ended 30th September, 1987, i.e., during the assessment year 1988-89 made by the assessee interestingly was not challenged, and that being so, for all substantial purposes, the principal amount stood written off. This being the position, it appears difficult to subscribe to the action of the Department to the charging of interest on such an amount.

12. Dealing with the Department's objection that no entry was passed by the assessee in respect of M/s. Devang Exports i.e, in whose name a debit balance stood in the assessee's books of account, reference could be made to the celebrated decision of the Supreme Court in the case of State Bank of Travancore v. CIT [1986] 158 ITR 1021 wherein Their Lordships of the apex court approved the view taken by the Punjab & Haryana High Court in the case of CIT v. Ferozepur Finance (P.) Ltd. [1980] 124 ITR 619 4 Taxman 439., wherein it was held that even in Mercantile system of accountancy, an assessee could forego the whole or part of a debt which was irrecoverable.

Laying down the law, to be applied in the situations like the present ones, the Hon'ble Supreme Court observed as under:

An acceptable formula of co-relating the notion of real income in conjunction with the method of accounting for the purpose of the computation of income for the purpose of taxation is difficult to evolve. Besides, any strait-jacket formula is bound to create problems in its application to every situation. It must depend upon the facts and circumstances of each case. When and how does an income accrue and what are the consequences that follow from accrual of income are well-settled. The accrual must be real taking into account the actuality of the situation. Whether an accrual has taken place or not must, in appropriate cases, be judged on the principles of real income theory.

After accrual, non-charging of tax on the same because of certain conduct based on the ipse dixit of a particular assessee cannot be accepted. In determining the question whether it is hypothetical income or whether real income has materialised or not, various factors will have to be taken into account. It would be difficult and improper to extend the concept of real income to all cases depending upon the ipse dixit of the assessee which would then become a value judgment only. What has really accrued to the assessee has to be found out and what has accrued must be considered from the point of view of real income taking the probability or improbability of realisation in a realistic mariner and dovetailing of these factors together but once the accrual takes place, on the conduct of the parties subsequent to the year of closing an income which has accrued cannot be made 'no income'.

Assessee's contention appears to carry force that in the case in hand, material was available to show that due to the huge losses suffered by their debtor and other circumstances enumerated by us

above there were absolutely no chances of recovery of any part of the outstandings. This fear of the assessee also got strengthened by the fact that till date, as was submitted before us, nothing was recovered. Further, it was submitted that no accounting entry in the ledger account of M/s. Devang Exports was recorded as in that event, the matter qua the debtor in respect of the recovery of the amount would have been shut once for all and the assessee could not have even put any sort of pressure in the realisation of the dues. In support of this, reliance was rightly placed on a decision of the jurisdictional High Court in the case CAT v. Jwala Prasad Tiwari [1953] 24 ITR 537 (Bom.) wherein although the assessee had debited the two sums constituting the debt to the P & L a/c. and credited them to the doubtful debts and suspense a/c. but without crediting the individual accounts of the debtors, it was held by the High Court of Bombay that the two debts had actually been written off in the assessee's books within the meaning of Section 10(2)(xi) of the I.T. Acter, 1922. The issue was also examined by the High Court of Gujarat keeping in view the provisions for bad debts in the 1961 Act in the case of Vithaldas H. Dhanjibhai Bardanwala v. CIT [1981] 130 ITR 95 wherein it was held that the provision in the existing Act was akin to that of the 1922 Act and it was not imperative to post corres-ponding entries in the Ledger a/c of the concerned parties and closed their account. Obvious as it is, the underlying idea behind the ratio is that if apart from making entries in its account books, a creditor also credits the amount in the ledger a/c. of its debtors, he cannot have any recourse - legal, moral or otherwise in even claiming the outstanding from the debtor. This will also find support from a decision of the Tribunal in the case of D.R.D. Tata v. ITO [IT Appeal Nos. 6633-6634 (Bom.) of 1983] wherein after going through the various case laws, the Tribunal took the view in a case where although the debtor did not refuse to pay the principal interest, but it had no capacity to pay even the principal amount, it was futile to hold that the interest continued to accrue.

Similar is the view taken by the High Court of Madras in the case of CIT v. Motor Credit Co. (P.) Ltd. [1981] 127 ITR 572 1. 6 Taxman 63.

13. Before we pass on to our final conclusion by applying the various case laws on the facts of the case in hand, it appears necessary to refer hereto the ratio of a decision of the Bombay High Court in the case of Jethabhai Hirjiand Jethabhai Ramdas v. CIT [1979] 120 ITR 792, oft relied on behalf of the assessee wherein Their Lordships of the Bombay High Court held that a debt becoming bad would depend on the facts of each case. No infallible proof was essential. Date on which assessee wrote off debt is a material circumstance but not conclusive. Effect on subsequent conduct of the assessee was also material and even the institution of a suit to recover such debt did not necessarily mean that the debt was not bad.

14. If we take stock of the entire gamut of facts and materials placed before us, it would be seen that no doubt the agreement between the parties envisaged the charge of interest with effect from 1st October 1988, yet it remains a fact that the assessee made a provision for doubtful debts in a sum of Rs. 14,13,55,000 in their P & L a/c. for the year ended 30th September 1987. Let alone this being disputed even in the Devang's hands, the loss of Rs. 42 crores which prompted the assessee to make the aforesaid provision has not been disputed. That being so, it appears to us once the principal amount had been written off, it would be both incongruous and incompatible and so out of place to permit the Department to attribute the accrual of interest to the assessee from M/s. Devang Exports for the assessment year 1989-90. The report of the Auditors strongly relied on by the Department

for patent reasons does not come to their rescue as the various other factors cumulatively taken into consideration as discussed by us clearly demonstrate the disgusting financial health of M/s. Devang Exports. The mere fact that the ledger a/c. of M/s. Devang Exports had not been credited and squared up, would not militate against the otherwise logical conclusion that the amount in question had been found to be irrecoverable and therefore written off by the assessee. The ledger account of M/s. Devang Exports in the assessee's books still show the outstanding only in the bleak hope that the whole or any part thereof may be recovered at a future date, and its close does not stand as a refrain to its recovery. It cannot be gainsaid that sufficient provisions exist in the Income-tax Act to garner tax on any such receipt.

15. In the result, we are sanguine that the amount of Rs. 94,81,300 could not be added to the income of the assessee and the same deserves to be deleted. We order accordingly.