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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Sep-14-2007

Reported in : (2008)115TTJ(Delhi)165

Judge : N Vasudevan, B Kaushik

Appellant : Space Financial Services

Respondent : Assistant Commissioner of Income

Judgement :

1. This appeal has been filed by the assessee against the order dt. 4th Feb., 2005 of the learned CIT(A), The first and sixth grounds of appeal are general in nature.

2. The second ground of appeal is against the decision of the learned CIT(A) in upholding the action of the AO in making an addition of Rs. 1,70,70,000 by disallowing the claim of bad debts. The facts of the case are that the assessee firm is engaged in the business of trading investment, financing and bill discounting. During the year the assessee had sold and purchased units of mutual funds and earned dividend and commission as also profit on trading of shares. The assessee claimed bad debts of Rs. 1,70,70,000, which consisted of debts of Rs. 25,70,000 and Rs. 1,45,00,000 due from Solar Farmachem Ltd. (SFL) are Apollo Steel and Tubes Ltd. (ASTL) respectively. The detailed facts regarding claim of the bad debts of SFL have been discussed by the AO in paras 4.2 and 4.3 of the assessment order dt. 31st March, 2003 which are reproduced below: 4.2 As per the submissions filed by the assessee on 29th May, 1995 an agreement was

entered for bill discounting facility of Rs. 26,20,000 with SFL and SFL issued PDC No. 308024 dt. 1st Sept., 1995 for Rs. 26,20,000 drawn on Bank of Bahrain and Kuwait BSC Mumbai towards repayment of the monies against bill discounting facility in response thereto Space Financial Services (SFS) issued 3 cheques aggregating Rs. 25,06,315 towards the bill discounting facility. The amount of Rs. 25,06,315 was arrived at after deducting Rs. 1,13,685 from Rs. 26,20,000 @ 18 per cent per annum towards interest for the period of 90 days. On 15th Feb., 1996 SFS deposited the abovementioned cheques for Rs. 26,20,000 with its bankers which were returned unpaid for the reason 'not arranged for'. Subsequently, legal notices were issued to SFL and its directors demanding payments but in vain. Finally, a criminal complaint under Section 138 r/w Section 141 of the Negotiable Instruments Act was filed in the Court of Addl. Chief Metropolitan Magistrate, 37th Court, Esplanade, Mumbai and is still pending trial.

4.3 Thus, the assessee was further required to explain vide questionnaire dt. 10th Feb., 2003 as to why the debts amounting to Rs. 25,70,000 should be considered bad and written off when the suit for recovery of the debt is still pending in the Court. In response to the query the assessee stated that the suit for recovery of amount of dishonored cheques of Rs. 26,20,000 was filed in 1996 and notice for hearing on 2nd June, 1997 was served by the Addl. Chief Metropolitan Magistrate. There is no outcome of the suit till date whereas such cases are expected to be finalized in 2-3 years. The financial position of the defaulter is miserable and amount cannot be realized even if the assessee firm wins the Court case. Thus, the assessee had written off the amount outstanding as on 31st March, 2000 at Rs. 25,70,000.

3. The AO disallowed the claim of the assessee for the reason that the assessee had not exhausted all options to recover the debts in question and during pendency of Court cases it was premature for the assessee to write-off of the amount as bad debt. The AO also rejected the submission of the assessee that the defaulters were not in a position to pay the debts even if the outcome of the Court verdict was in favour of the assessee. The learned AO was of the opinion that if the party was not in a position to pay the debts, the assessee would not incur expenditure on legal proceedings for recovery of debt.

4. Similarly, the facts of the bad debt claim against the ASTL are discussed at paras 4.5 to 4.7 of the assessment order. The same are reproduced below: 4.5 As per the details submitted by the assessee it was stated that at the request of M/s Apollo Tube & Steel Industries Ltd. (ATSIL) a short loan of Rs. 1,00,00,000 for 180 days carrying interest @ 15 per cent per annum was given on 24th May, 1995 ATSIL forwarded PDC No. 962024 dt. 17th Nov., 1995 for Rs. 1 crore drawn on State Bank of Travancore, Mumbai main branch along with the other related documents. Later, another short loan of Rs. 50,00,000 was given for a period of 90 days carrying interest @ 15 per cent per annum on 11th Sept., 1995 and the due date for repayment of the loan was 7th Dec., 1995. ATSIL also forwarded PDC No. 962712 dt. 7th Dec., 1995 for Rs. 50,00,000 drawn on State Bank of Travancore, Mumbai main branch.

4.6 It was further stated by the assessee that as ATSIL was in severe financial difficulty, they requested the assessee for grant of some more time to repay the loan amount. Accordingly, MoU was signed on 11th March, 1996 wherein ATSIL admitted that the overdue interest of Rs. 16.50 lacs would be paid in three installments i.e.

Rs. 5,00,000 by 15th March, 1996, Rs. 5,00,000 by 15th April, 1996 and Rs. 6,50,000 by 15th May, 1996. However, ATSIL paid only the first installment of Rs. 5,00,000 and failed to pay the other amounts towards interest and principal as agreed. Thus, on 15th May, 1996 SFS deposited both the cheques amounting to Rs. 1.50 crores issued by ATSIL with its bankers, Global Trust Bank Ltd. Nariman Point, Mumbai for encashment and both the cheques were returned unpaid by the bankers of ATSIL for the reason 'Funds Insufficient.' 4.7 Subsequently, legal notices were sent to ATSIL and its directors demanding full payment but in vain. Thus, criminal complaint No. 323/S/1996 under Section 138 r/w Section 141 of the Negotiable Instruments Act r/w. Section. 420 of the IPC was filed in the Court of Addl. Chief Metropolitan Magistrate, 37th Court, Esplanade, Mumbai. The proceedings in the matter have been stayed by the Hon'ble High Court of Mumbai under Writ Petn. No. 2237 of 1991 on 21st Feb., 2000. The matter is still pending trial.

5. The AO rejected the claim of the assessee in this case also for the reason that since the Court proceedings were pending, it was premature to write-off the debts and the assessee had not exhausted all options for the recovery of the debts in question. He also observed that as per the provisions of Section 36, three conditions were required to be satisfied for allowing the claim of bad debt namely (i) the debt should have been incurred in the normal course of business, (ii) it should have become bad during the relevant accounting period and (iii) it should be written off in the books of accounts of the assessee. The AO perused the agreement of the assessee with the concerned parties and held that

(1) the assessee did not furnish copy of schedule of security and assets pledged against the amount of loan,

(2) in absence of copy of schedule it was not possible to verify whether the securities pledged against the loan were such as could not have been transferred by the assessee in its own name and the shares of the assessee (sic) companies had lost their value in the market and recovery of bad debt was not possible,

(3) the assessee had not promptly disposed of the securities and failed to exercise its right as per the terms of the agreement to recover the debt from the sale proceeds of the securities,

(4) the inherent checks to ensure recovery of loan were not exercised by the assessee,

(5) as per Clause 17 of the agreement the guarantors were under obligation to repay the debt due to the assessee but no action was taken either to recover the amount from the guarantors or take any action against them for the recovery of the amount,

(6) the cheque dt. 11th Sept., 1995 of ASTL was deposited in the bank on 15th May, 1996 i.e. after the expiry of six months and the cheque had become invalid,

(7) the assessee did not initiate legal proceedings for breach of contract but filed suit under Negotiable Instruments Act,

(8) the shares and securities pledged by the borrowers were kept by the assessee without any effort to sell the same or get the same transferred in its name. Thus, no meaningful action was taken by the assessee and there was no reason to believe that the debts amounting to Rs. 1,70,70,000 had become bad debt and were liable to be written off.

6. The learned CIT(A) confirmed the order of the AO and held for the reasons discussed in paras 4-9 of his order, that the assessee had not exploited all possible means for the recovery of the debts and since the recovery proceedings were still under consideration of the Courts, the view taken by the AO disallowing the claim of bad debts was correct and the appeal of the assessee on this issue was liable to be dismissed.

7. During the course of hearing before us the learned Counsel of the assessee submitted that (1) the lower authorities had ignored the explanation and evidence submitted by the assessee in support of its contention, (2) the debts written off during the year under consideration were bad debts and could not be recovered, (3) the learned CIT(A) erred in upholding the view of the AO that the assessee had not exhausted all remedies and it was premature to write off the debts, (4) the assessee had filed evidence in support of its claim, (5) the assessee had taken all steps to recover the debts and the amount was written off only when there was no possibility of any recovery, (6) no recovery has been made till date and the claim of the assessee was liable to be allowed.

8. The submissions taken before the lower authorities were also reiterated. It was contended that (1) the total amount of advance to SFL was Rs. 26,20,000 and after reducing Rs. 1,13,685 on account of interest at the rate of 18 per cent for the period of 90 days, the amount of bad debt of Rs. 25,06,315 was arrived at, (2) the cheque of SFL for Rs. 26,20,000 was not honoured by the bankers and, therefore, legal notice was issued to SFL and its directors, (3) finally the suit was filed in Mumbai Court which was pending but it could not be said that the action of the assessee in writing off the debts was premature because there was no hope of recovery, (4) in view of the financial position of the defaulter, no recovery was possible and the claim was wrongly rejected by the lower authorities, (5) similarly,

in the case of M/s ATSIL a short term loan of Rs. 1 crore at the rate of 15 per cent per annum for 180 days was given on 24th May, 1995, (6) The another short term loan of Rs. 50 lacs was given for a period of 90 days at the rate of 15 per cent per annum on 11th Sept., 1995, (7) the due date for repayment of the loan was extended as per MoU signed on 11th March, 1996 and installments were given for the over due interest of Rs. 16.5 lacs, but after payment of first installment of Rs. 5 lacs the ATSIL failed to pay the amounts towards interest and principal and the cheques of Rs 1.5 crores were returned as unpaid by the bankers for insufficiency of funds, (8) legal notices were sent to ATSIL and its directors and thereafter criminal complaint was filed and the matter was still pending but the notice could not be served by the Court, (9) even publishing of the notice was of no avail because the party did not respond and the amount of Rs. 1,45,00,000 was written off by the assessee as bad debt.

9. The assessee also contended that (1) every possible effort was made by the assessee to recover the debt, (2) the loans given in 1995 were written off in 1999-2000, (3) even if the assessee had a legal claim, there was no hope of recovery because of bad financial position of the parties, (4) the securities and shares pledged by the parties could not be sold because the parties had become bankrupt and there was no buyer of their shares, (5) an alert had been issued by the RBI in respect of these parties, (6) more than 6 years had passed since the amount was written off but no recovery has been made so far, (7) thus, the view of the AO that the debts were written off premature, was not correct and the debts have, in fact, become bad because the parties are not in a position to repay the debts.A.W. Figgis & Co. (P) Ltd. v. CIT (2002) 172 CTR (Cal) 635 : (2002) 254 1TR 63 (Cal) in support of its contention that looking to the reality of the situation, there was no possibility of recovery and the claim should be allowed.

11. The learned Counsel of the assessee during the course of hearing also contended that there was a change in law w.e.f. 1st April, 1989 and in view of this amendment the claim of bad debt was to be allowed in the year in which the same was written off and the AO was not entitled to disallow the claim of the assessee on the ground that it was premature. The learned Counsel of the assessee also relied on the following decisions:Shoban Led Jain v. Asstt. CIT (3) Swastik

Asbestos Products Ltd. v. Dy. CAT (2004) 89 TTJ (Pune) 393;CIT v. Girish Bhagwat Prasad 12. The learned Departmental Representative relied on the order of the lower authorities and reiterated that the claim of the assessee was premature and deserves to be rejected.

13. We have carefully considered the issue. In our considered opinion the debts in question have already been written off in the previous year relevant to the assessment year under consideration and in view of the amendment to Section 36(2) of the Act, the AO was not justified in rejecting the claim of the assessee merely on the ground that it was premature to write-off the debts in question. The decision of the learned CIT(A) on this issue cannot therefore, be sustained. This ground of appeal is allowed.

14. The next ground of appeal is against making an addition of Rs. 3,41,400 as interest accrued on loan advanced to M/s Solar Pharma Chem.

The AO observed that the assessee as per the agreement was entitled to 2 per cent additional interest per month on the entire loan for the period of default, from M/s SFL and M/s ASTIL. Relying on the decision of CIT v. Annapurani Veerappan (1992) 193 ITR 426 (Mad), the AO held that the assessee was in the business of money lending and it was required to provide for the interest of Rs. 3,41,000 on the loan of Rs. 1,70,70,000 due from the a fore stated SFL and ASTIL as penal interest at the rate of 2 per cent for their failure to make the payment in time. The AO therefore, made the addition of Rs. 3,41,000. The learned CIT(A) rejected the submission of the assessee that there was no certainty of realizing the principal amount itself and, therefore, there was no question of charging the penal interest. The learned CIT(A) therefore, held that the AO was justified in making the addition of Rs. 3,41,400 in view of the decision in the case of CIT v.Annapurani Veerappan (supra) because the interest has to be assessed on accrual basis.

15. The learned Counsel reiterated that in view of the detailed discussion regarding recoverability of debts in question, the action of the lower authorities was not correct. The learned Departmental Representative relied on the orders of the lower authorities.

16. We have carefully considered the issue. As discussed above there was no possibility of recovery of loan of Rs. 1,70,70,000 from SFL and ASTIL and we have therefore, allowed the claim of the assessee that the amount was required to be allowed as bad debt because the assessee has also written off the amount in view of the fact that the financial position of the aforestated two parties was very bad and there was no hope of recovery despite legal suit pending against them. We are, therefore, of the opinion that even if the assessee could have provided for the penal interest, the same was liable to be written off as irrecoverable. In our considered opinion, since the principal itself was not likely to be recovered the question of providing for penal interest did not arise and, therefore, the lower authorities were not correct in making addition of Rs. 3,41,400 on account of penal interest on accrual basis. The decision of the learned CIT(A) on this issue cannot, therefore, be sustained. The addition is deleted. This ground of appeal is allowed.

17. The fourth ground of appeal is against the confirmation of disallowance of Rs. 1,50,000 out of the total Court fees paid by the assessee for pursuing civil proceedings for the recovery of bad debts despite the fact that the same had been incurred wholly and exclusively for the purpose of the business of the assessee. The learned Counsel claimed that the lower authorities did not appreciate the fact that the expenditure was incurred during the course of business and was admissible expenditure under the Act. The learned CIT(A) observed that the AO had correctly disallowed Rs. 1,50,000 out of the total claim of Rs. 3 lacs for legal proceedings against SFL and ASTIL for the reason that the assessee had already written off the claim from its books of account and the expenditure claimed against amount written off was not admissible as business expenditure. The learned CIT(A) also observed that the facts of the claim of the expenditure were not clear and it was not possible to allow the same.

18. The learned Departmental Representative supported the decision of the lower authorities The learned Counsel reiterated that the expenditure was incurred for pursuing the suits of recovery and only because the assessee had written off the amounts as bad debt, the expenditure did not cease to be an expenditure for the purpose of business.

19. In our considered opinion, the expenditure has been incurred for filing the suit for recovery of debts before the amount was written off by the assessee, but the expenditure is not, admissible as business expenditure because the debts have been written off and the decisions of the lower authorities on this issue deserve to be sustained. This ground of appeal of the assessee is rejected.

20. The fifth ground of appeal of the assessee is against confirmation of disallowance of Rs. 3,31,408, as expenditure attributable to earning of dividend income. The assessee had claimed various expenses under the heads "Establishments, Administrative and Financial expenses" aggregating Rs. 7,96,743. The assessee had claimed dividend income of Rs. 49,11,930 as exempt under Section 10(33) of the IT Act. The AO considered that proportionate expenditure of Rs. 3,31,408 was attributable to the earning of the dividend income which was exempt from tax and, therefore, not allowable. He, therefore, added the amount by holding that the income to that extent from other sources exempt under Section 10(33) of the Act was liable to be reduced to Rs. 3,31,408. The learned CIT(A) observed that it could not be believed that no part of the various expenses incurred by the assessee related to the dividend income and certain expenditure was attributable to earning of the dividend income. He, therefore, upheld the proportionate disallowance made by the AO.21. The learned Counsel of the assessee submitted that the disallowance was arbitrary because no expenditure was incurred for earning the dividend income which was a passive income and only the expenditure directly relatable to the earning of such income could be disallowed.

He also submitted that the amount could not be disallowed under Section 14A of the IT Act, that the assessee had utilized its own capital for investment in shares and the expenditure was not incurred to earn dividend income.

22. We have carefully considered the issue. The amendment to Section 14A of the IT Act has been inserted by the Finance Act, 2006 w.e.f. 1st April, 2007 and the lower authorities were not correct in disallowing proportionate expenditure against the dividend income without establishing the nexus thereto. The addition is therefore, deleted.

This ground of appeal is therefore, allowed. As a result, the appeal of the assessee is partly allowed.

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