

IN THE HIGH COURT OF KARNATAKA AT BENGALURU

ON THE 19TH DAY OF NOVEMBER, 2018

BEFORE

THE HON'BLE MR. JUSTICE RAVI MALIMATH

AND

THE HON'BLE MR. JUSTICE K. NATARAJAN

INCOME TAX APPEAL No.734 of 2009
c/w

INCOME TAX APPEAL No.735 of 2009

BETWEEN

1. THE COMMISSIONER OF INCOME-TAX,
C R BUILDING, QUEENS ROAD,
BANGALORE.
2. THE ASSISTANT COMMISSIONER OF
INCOME-TAX,
CENTRAL CIRCLE-1(4),
C R BUILDING, QUEENS ROAD,
BANGALORE.

... APPELLANTS
(Common in both appeals)

(BY SRI E I SANMATHI AND
SRI K V ARAVIND, ADVOCATES)

AND

1. M/S. MILLENNIA DEVELOPERS (P) LTD.,
THE MELLEENIA, 12TH & 14TH FLOOR,

TOWER B, No.1 & 2,
MURPHY ROAD, ULSOOR,
BANGALORE – 560 008.

... RESPONDENT
(Common in both appeals)

(BY SRI A SHANKAR, SENIOR ADVOCATE
A/W SRI M LAVA, ADVOCATE)

THE INCOME TAX APPEAL No.734/2009 IS FILED UNDER SECTION 260-A OF I.T.ACT, 1961, ARISING OUT OF ORDER DATED 05.06.2009 PASSED IN I.T.A No.725/BANG/2008, FOR THE ASSESSMENT YEAR 2003-2004, PRAYING TO FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED THEREIN AND ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE INCOME-TAX APPELLATE TRIBUNAL, BANGALORE IN ITA No.725/BANG/2008, DATED 05.06.2009, CONFIRMING THE ORDER OF THE APPELLATE COMMISSIONER AND CONFIRM THE ORDER PASSED BY THE ASSISTANT COMMISSIONER OF INCOME-TAX, CENTRAL CIRCLE-1(4), BANGALORE.

THE INCOME TAX APPEAL No.735/2009 IS FILED UNDER SECTION 260-A OF I.T.ACT, 1961, ARISING OUT OF ORDER DATED 05.06.2009 PASSED IN I.T.A No.726/BNG/2008, FOR THE ASSESSMENT YEAR 2004-2005, PRAYING TO FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED THEREIN AND ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE INCOME-TAX APPELLATE TRIBUNAL, BANGALORE IN ITA No.726/BNG/2008, DATED 05.06.2009, CONFIRMING THE ORDER OF THE APPELLATE COMMISSIONER AND CONFIRM THE ORDER PASSED BY THE ASSISTANT COMMISSIONER OF INCOME-TAX, CENTRAL CIRCLE-1(4), BANGALORE.

THESE INCOME TAX APPEALS COMING ON FOR FINAL HEARING THIS DAY, RAVI MALIMATH, J., DELIVERED THE FOLLOWING:

J U D G M E N T

The assessee is a private limited company carrying on the business as a developer/builder. It commenced a project known as 'woodsvage' at Nandidurga Road, Bangalore. It constructed 25 flats. The total consideration for sale of the flats was Rs.12,53,30,150/- In respect of the Assessment Year 2003-2004, the assessee filed the return of income claiming a sum of Rs.6,03,08,000/- as 'bad debts', which are written off. The Assessing Officer disallowed the claim for bad debts. Aggrieved by the same, an appeal was filed before the CIT (Appeals)-VI, Bangalore, which was allowed. The claim of the assessee was allowed and the addition was deleted. Aggrieved by the same, the Revenue filed the appeal before the Tribunal, wherein the appeal was dismissed. Hence, the present appeal.

2. ITA No.734 of 2009 is for the Assessment Year 2003-2004 and ITA No.735 of 2009 is for the Assessment Year 2004-2005.

3. By the order dated 02.06.2010, ITA No.734 of 2009 was admitted to consider the following two substantial questions of law:

- i) *Whether the Appellate Authorities were correct in holding that the sale consideration of Rs.6,03,08,000/- for transfer of eight flats by the assessee company (total consideration of Rs.12,53,30,150/- for 25 flats) should be treated as bad debt when the sale is registered in the name of the purchasers (share holders relatives) in the year 2004, due to the fact that the share holders of the assessee company and the eight purchasers who are relatives of the share holders enter into family arrangement and partition (recognised u/s. 171 of the Act), where this amount is settled among the HUF members,*

when the assessee company is a separate entity from that of the share holders?

- ii) *Whether the Appellate Authorities were correct in accepting a family arrangement and partition among the share holders and their relatives vis a vis the assessee company and four accounting entries on 31.3.2003 i.e., "crediting sales account", "debiting family members account", "debiting bad debt account", and crediting family members account" by an amount of Rs.6,03,08,000/- entered in the assessee's books for writing off the said amount as a bad debt ignoring the entire scheme as a device to avoid tax and consequently recorded a perverse finding?*

4. By the order dated 21.06.2010, ITA No.735 of 2009 was admitted to consider the following substantial question of law:

- i) *Whether the Appellate Authorities were correct in holding that during the assessment year 2003-04 the Appellate Commissioner had allowed the claim of Rs.6,03,08,000/- as a bad debt and therefore the carried forward and set off of loss as claimed by the assessee for the current assessment year 2004-05 has to be allowed?*

5. Learned counsels submitted that the substantial question of law as framed in ITA No.735 of 2009 being for the Assessment Year 2004-2005 would be consequential on the answering of the substantial questions of law raised in ITA No.734 of 2009. Hence, learned counsels have addressed arguments insofar as ITA No.734 of 2009 is concerned.

6. The plea of the assessee is that it is a private limited company consisting of two Directors. That even though there was a partition effected between the brothers of one of the Directors, the other brothers were demanding a

share in the properties. One of such properties, standing in the name of the Director, was located at No.78, Nandidurga Road, Bangalore, which was purchased by the assessee-Company consisting of the Director shareholders. The entire property was divided into three blocks. The first two blocks were reserved for sale to outsiders, whereas the third block was sold to the members of the Hindu Undivided Family (HUF) consisting of five members. Five flats were sought to be sold to the shareholders for a total sale consideration of Rs.6,13,08,000/-. A family arrangement was arrived at between the family members of the HUF. Subsequently, a family settlement arrangement was arrived at on 18.03.2003 between the members of the HUF/their relatives and the Company. It was decided therein that the company had agreed to waive the right to recover the dues of such consideration. The said decision was taken in order to avoid future deadlock in the management of the Company on account of any disputes arising between the family members who are also

its shareholders. It was agreed that the demand to collect the balance amounts will be waived. Thereafter, an order was passed under Section 171 of the Income Tax Act, 1961 ('Act' for short). A copy of the family arrangement dated 05.08.2002 and partition deed dated 18.03.2003 were also filed along with the return of income. The Assessing Officer came to the conclusion that it cannot be said that the balance of sale consideration is not recoverable. That the only ground that there could be future disputes/quarrels/ differences between the members of HUF cannot constitute a ground to hold that the same are bad debts. That the future disputes are only apprehended and it is not a definite event. That even before the debt became due, it came to be written off for the very same year in which the debt arose. Therefore, he came to be conclusion that all these are created documents and hence, disbelieved the case of the assessee.

The CIT (Appeals) considered the documents produced by the assessee. In terms of the partition effected, it held that the assessee came to know that the debts could not be recovered. That the family arrangement has been made only to avoid future disputes between the family members since some of them were Directors of the assessee-Company. It was of the view that a debt may become bad and irrecoverable either by an order of the court of law or by the act of contracting parties. That in the normal circumstance, a creditor tries to get back the loan amount, but when he fails to get, he writes it off. However, in exceptional circumstances, the creditor may himself write off the bad debt. That there is no provision under the Act which postulates any situation where such an act cannot be performed by the assessee. Therefore, the appeal was allowed and the order of the Assessing Officer being reversed, relief was granted to the assessee.

7. Learned counsel for the appellant-Revenue contends that the family arrangement is a created document. That such a created document cannot be accepted. That there was no effort by the assessee to recover the debt. That it is a ruse created by the members of the HUF in conjunction with the Company to wrongly write off the debt. That the debt cannot be written off for the very same year it has become due.

8. The same is disputed by the learned Senior counsel Sri A. Shankar appearing for the counsel for the respondent-assessee. It is contended that the finding of the Assessing Officer that the entire scheme is a device to avoid tax cannot be accepted. That the finding of the Assessing Officer is, therefore, not justified. He placed reliance on Section 36(1)(vii) of the Income Tax Act, to contend that as long as the bad debts are shown in the books of accounts, no other question would arise for consideration. The bad debts having been reflected in the

books of accounts, the same requires to be allowed. That there is no law prohibiting writing off the bad debts even in the very same year it became due. His further submission is that the Central Board of Direct Taxes (CBDT) have issued Circular No.12 of 2016 with regard to "admissibility of claim of deduction of Bad Debt under Section 36 (1)(vii) read with Section 36(2) of the Income Tax Act, 1961". While referring to the judgment of the Hon'ble Supreme Court in the case TRF LTD. vs. COMMISSIONER OF INCOME TAX reported in (2010) 323 ITR 397 (SC), wherein it was held that the bad debt could be written off as irrecoverable, as long as it finds a place in the books of account of the assessee. In those circumstances, the Circular enunciated that the claim for any debt or part thereof in any previous year, shall be admissible under Section 36(1)(vii) of the Act, if it is written off as irrecoverable in the books of accounts of the assessee for that previous year and it fulfills the conditions stipulated in sub section (2) of section 36 of the Act.

Consequently, it was directed that no appeals shall be filed on the said ground and all the pending appeals are required to be withdrawn. Hence, he pleads, on this ground also, that the appeal be dismissed.

9. Insofar as the Circular is concerned, learned counsel for the Revenue disputes the same and pleads that the Circular is not applicable to the facts of this case. That he proposes to contest the appeal on merits. The reason for contending that the Circular is not applicable to the facts of the present case is that there is a colorable device adopted by the assessee, which is not covered by the said Circular.

10. Heard learned counsels.

11. The provisions of Section 36(1)(i) and (vii) read as under:

"Other deductions

36. (1) *The deductions provided for in the following clauses shall be allowed in respect of*

the matters dealt with therein, in computing the income referred to in section 28-

(i) the amount of any premium paid in respect of issuance against risk of damage or destruction of stocks or stores used for the purposes of the business or profession;

xxx xxx

(vii) Subject to the provisions of sub-section (2), the amount of [any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year]; "

12. Therefore, the provisions of law being clear and unambiguous, we are of the view that the CIT (Appeals) as well as the Tribunal have rightly applied the law and have granted relief to the assessee. The contention that the documents produced cannot be accepted was negated by both the authorities. The CIT (Appeals) came to the conclusion that no such ambiguity came to be indicated by the Assessing Officer. That it is a partition effected between the members of the HUF. That subsequently

there is an order in terms of Section 171 of the Act. In these circumstances, for the Revenue to contest the claim of the assessee even after passing of the order under Section 171 of the Act cannot be accepted. The requirement of law would postulate that the said bad debts should be written off in the books of accounts of the assessee. Admittedly, the same has been done. Therefore, on compliance of the provision of law the deduction has been granted by the CIT (Appeals).

13. Therefore, in the facts and circumstances of the case, it can be clearly seen that the reason for entering into a family arrangement was with the hope to avoid all future disputes and litigations inter se between the members of the HUF. It is for this reason, the family arrangement was entered into. Therefore, it cannot be said that it is a colorable device and, therefore, the allowance should not be granted to the assessee. With regard to colorable device adopted by the assessee, we

find strength from the judgment of the Supreme Court in the case of COMMISSIONER OF INCOME TAX, GUJARAT VS. A.RAMAN AND CO., reported in (1968) 67 ITR 11 wherein, it was held as follows:

"... But the law does not oblige a trader to make the maximum profit that he can out of his trading transactions. Income which accrues to a trader is taxable in his hands: income which he could have, but has not earned, is not made taxable as income accrued to him. By adopting a device, if it is made to appear that income which belonged to the assessee had been earned by some other person, that income may be brought to tax in the hands of the assessee, and if the income has escaped tax in a previous assessment a case for commencing a proceeding for reassessment under section 147(b) may be made out. Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him.

Effectiveness of the device depends not upon considerations or morality, but on the operation of the Income-tax Act. Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it may lawfully be circumvented."

14. In the circumstances, we do not find any ground to interfere with the orders of the CIT (Appeals) as well as the Tribunal. Therefore, the first substantial question of law in ITA No 734 of 2009 is answered by holding that both the authorities were right in holding that the amount claimed as bad debts to an extent of Rs.6,03,08,000 should be treated as bad debts.

15. Insofar as the Circular is concerned, we are of the view that the contentions of the Revenue cannot be accepted. The Circular clearly suggests that all pending appeals should be withdrawn. Merely relying on the first sentence of the Circular, that it pertains only with regard to filing of appeals on the issue of allowability of bad debts

that are written off as irrecoverable cannot be accepted. The matter pertains to grant of disallowance with regard to bad debts. Hence, even insofar as the Circular is concerned, the appeal would have to be dismissed.

16. Both the substantial questions of law raised in ITA No.734 of 2009 are, therefore, answered against the Revenue and in favour of the assessee.

17. In view of answering both the substantial questions of law in favour of the assessee, ITA No.734 of 2009 is dismissed.

Accordingly, the substantial question of law raised in ITA No.735 of 2009 is answered in terms of the aforesaid judgment.

SD/-
JUDGE

SD/-
JUDGE

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