

**IN THE HIGH COURT OF KARNATAKA
AT BANGALORE**

Dated this the 13th day of June, 2012

PRESENT

THE HON'BLE MR JUSTICE D V SHYLENDRA KUMAR

AND

THE HON'BLE MR JUSTICE B MANOHAR

Income Tax Appeal No. 23 of 2006

BETWEEN:

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

[By Sri M Thirumalesh, Adv.]

AND:

M/S EPSILON ADVISERS PVT. LTD.
NO.E-13/1, VIJAYA KIRAN APARTMENTS
NO.32, VICTORIA ROAD
BANGALORE.

... RESPONDENT

[By Sri Malhara Rao, Adv. for
Sri S Partha Sarathi, Adv.]

THIS APPEAL IS FILED UNDER SECTION 260A OF THE
INCOME TAX ACT, 1961 ARISING OUT OF ORDER DATED
26.08.2005 PASSED IN ITA NO. 3613/BANG/2004, FOR THE
ASSESSMENT YEAR 2001-02, PRAYING TO SET ASIDE THE SAID
ORDER OF THE TRIBUNAL AND ETC.,

THIS APPEAL COMING ON FOR HEARING, THIS DAY,
SHYLENDRA KUMAR J., DELIVERED THE FOLLOWING:

J U D G M E N T

Appeal by the revenue under Section 260A of the
Income Tax Act, 1961 [for short, the Act].

2. Revenue has raised the following two questions:

1. *Whether the Tribunal was correct in holding that the sum of Rs.5,34,00,000/- can be written off as bad debt which had been advanced by the assessee in favour of one of its group companies M/s BWTL on the ground that the assessee was carrying on money lending business without basing that finding on any material and consequently recorded a perverse finding.*
2. *Whether the assessee carrying on the profession of consultancy service having advanced a sum of Rs.5,34,00,000/- in favor of one of its group companies M/s BWTL to tide over its financial situation can be treated as bad debt and written off as expenses even when the assessee does not carrying on money lending business or having lent this amount in the course of business activity of the assessee.*

as arising out of the order dated 26-8-2005, passed by the Income Tax Appellate Tribunal, Bangalore Bench 'A', in ITA No 3613/Bang/2004, whereby the tribunal had allowed the appeal of the assessee and had reversed the orders of the assessing officer and the appellate commissioner relating to the question as to whether a sum of Rs 5.34 crore can be allowed as a deduction by way of bad debts written off by the assessee during the accounting period corresponding to the assessment year 2001-01, being an amount that had been advanced to another company in which the assessee company being a substantial shareholder and that the other company virtually fading out of business, the assessee had advanced the amount to the other company for its revival, but revival not taking place and the company who had received this amount closing its business activities, had claimed this amount as an irrecoverable debt or bad debt and being the amount advanced during the course of business activity of the assessee company and can be

claimed as deductible expenditure in the accounting year in which, had been written off in the books of accounts of the assessee-company.

3. The assessing officer and the appellate authority had opined that it cannot be so claimed, as the amount was neither being an advance in the course of business activity of the assessee nor the amount can be treated as part of the business of money lending and therefore cannot be described as a loss incurred or a debt which had become irrecoverable in the activity of money lending and accordingly does not qualify for deduction under Section 36(1)(vii) of the Act.

4. The assessee is a private limited company and as its name suggests, its business was one of providing consultancy services in electronic and telecommunications. In the return filed for the assessment year 2001-02, the assessee had claimed a total amount of Rs 6.09 crore as advances paid by the assessee company,

but which had become not recoverable and therefore written off in the books of accounts of the assessee-company during the accounting period corresponding to this assessment year.

5. Out of this amount, a sum of Rs 75.00 lakh was claimed to be an inter-corporate deposit, deposited with M/s BPL Wireless Telecommunication Services Ltd (BWTL) and the balance Rs 5.34 crore was advanced as interest free advance to the very company, if we are to go by the grounds raised in the memorandum of appeal before the tribunal, to which our attention has been drawn by Sri M Thirunalesh, learned standing counsel for the appellant-revenue, and both amounts were claimed as advance not recoverable and written off, for the reason that M/s BWTL, which was later known as India Paging Services Ltd., had closed down its business activities, as the company's business of providing paging services to its customers had become outdated due to advancement in technology and therefore that company had closed down its business. As

M/s BWTL has closed down its business, the assessee-company had claimed the inter-corporate deposit of Rs 75 lakh with that company, which had earned some interest to the assessee company for some time, as also the advance it had made to the other company for its revival and rehabilitation of the said company in the wake of its dwindling business, as bad debts and written off in its books of accounts.

6. Assessing officer while noticed that in so far as the inter-corporate deposit of Rs 75.00 lakh, the assessee had received interest on this deposit from the other company for some time and had also offered it to tax, but when the other company had gone into red, no interest was charged for one year, but nevertheless the assessing officer found justification to allow this amount as an amount irrecoverable and therefore was of the opinion that writing off of it is justified, but did not agree for allowing the balance of Rs 5.34 crore also as bad debt and can be written off in the accounts of the assessee-company, for

the reason that amount cannot be considered as part of an advance made in the course of money lending activity of the assessee; that there was no semblance of a lending activity by the assessee company, in so far as this advance is concerned; that the assessee had from the beginning treated it as interest-free loan and lending was not evidenced by way of any supporting documents; that no security or surety had been obtained for the repayment of this amount and the amount was not advanced as part of business activity, but more out of concern for the sinking sister company in which the assessee-company held substantial interest by way of investment in shares and therefore opined that it cannot be treated as bad debt and on par with the other amount of Rs 75.00 lakh which had been allowed so and disallowed the claim to this extent.

7. The assessing officer also opined that the claim of the assessee that it had written off the said amount as bad debt and as part of business transaction was not justified for the reason that lending of a sum of Rs 5.34 core was

not part of any business activity, for the reason that even the shares held by the assessee-company in M/s BWTL were not treated as part of stock-in-trade, but as long term investment in that company and therefore lending of a sum of Rs 5.34 crore by the assessee company cannot be considered as part of any business activity of the assessee or as incidental to the business of money lending purporting to be carried on by the assessee.

8. One another reason assigned by the assessing officer for not allowing the amount of Rs 5.34 crore as a business loss incurred in the course of the business of the assessee was that even when the amount is recovered, it would not have in any way augmented the income of the assessee and non-receipt or non-recovery of this amount also did not in any way affect the profit or loss of the assessee; that it could never be treated either as a trading receipt or business expenditure and therefore also the amount was not a debt in the course of business and cannot be claimed as an irrecoverable debt etc. The advance made

being interest-free also weighed with the assessing officer in arriving at the said conclusion.

9. The assessee appealed against this order to the appellate commissioner. The appellate commissioner examined the matter in some detail and noticed that total amount of Rs 6.09 crore which the assessee had claimed as bad debt and written off, was an amount that had been advanced from 1998 and 2000 for the main reason that M/s BWTL needed funds for its expansion for providing paging services; that the advance was to enable the sister concern to tide over the competition from other entrants in the field including providers of cellular services, but unfortunately to the assessee, its sister concern could not live up to the expectation of the assessee-company, and noticing this aspect, concurred with the view taken by the assessing officer in so far as rejection of the claim of the assessee for allowing bad debt of Rs 5.34 crore by holding that even as per Article No 23 of the objects clause of Memorandum and Articles of the Company, while money

lending activity was mentioned as an object incidental or ancillary to the attainment of main object, the fact that advance of Rs 5.34 crore did not carry any interest, belied the claim of the assessee that it was part of money lending activity of the assessee; that advancing a huge sum of Rs 5.34 crore for a period of two years and without any expectation of return was not any business activity, much less as part of money lending business activity, though the assessee claimed as such, but more an advance due to other considerations such as relationship between the assessee company and the other company in which the assessee had interest and may be even to save its investment in the other company.

10. Appellate authority also noticed that the assessee company not taking precautionary steps for safeguarding the advance or securing advance was another circumstance to support the view that it was not part of any money lending activity of the assessee, but the

appellate authority found that it was not even part of normal business activity of the assessee.

11. Referring to the provisions of Section 36(1)(vii) of the Act, appellate authority held that for an amount to qualify under this provision it should not only be a debt incurred in normal course of the business but it should also become irrecoverable and further scope for a claim under this provision being circumscribed by conditions mentioned in Section 36(2) of the Act and finding that the assessee's claim did not fit into such a situation, took the view that it was not part of its business activities of money lending in the course of its business; that the views expressed by the assessing officer on this aspect are all fully justified and therefore the claim of the assessee that it is a bad debt fails and accordingly rejected the appeal on this aspect.

12. Assessee appealed further to the tribunal and has met with success. The tribunal by referring to the order of

the assessing officer found that if the assessing officer could allow a sum of Rs 75 lakh which was inter-corporate deposit by the assessee with the other company viz., M/s BWTL, could be allowed as part of bad debt incurred in the course of money lending activity of the assessee and as indicated in the memorandum of association, wherein money lending activity is shown as one of the activities of the assessee company, then there was no reason to make a distinction between this claim and the claim towards Rs 5.34 crore, advanced by the assessee to the other company, wherein it had its deposits and therefore opined that the view taken by the assessing officer and affirmed by the appellate authority that the amount was not one qualifying for deduction under the provisions of Section 36(1)(vii) read with Section 36(2) of the Act and opining that the activity of the business of the assessee is undoubtedly money lending activity and a loss incurred, whether by way of investor or lender, cannot make any difference for claiming a bad debt written off in terms of

Section 36(1)(vii) r/w Section 36(2) of the Act and purporting to follow and apply the view taken by the Supreme Court in the case of **CIT vs NAINITAL BANK [55 ITR 707]** etc., allowed the appeal of the assessee on this aspect, opining that the claim for deduction of Rs 5.34 crore as bad debt is admissible.

13. It is in this background, the revenue is in appeal before us.

14. As noticed earlier, the appeal had been admitted on the questions of law as raised and the assessee is represented by M/s S Parthasarathy and Malhararao, advocates and the revenue is represented by Sri M Thirumalesh, learned standing counsel. We have heard the learned counsel for the parties.

15. Sri Thirumalesh has vehemently urged that the tribunal has virtually recorded a perverse finding in opining that the assessee carries on the business of money lending and that the amount claimed as bad debt

is part of its business activity of lending money to its customers and others; that the tribunal has not recorded a finding relating to the nature of the transaction viz., advance of Rs 5.34 crore being interest-free advance and therefore did not qualify as part of a transaction in the course of money lending activity of the assessee; that a clear finding that this advance was interest free and as even admitted by the assessee has been virtually given a go-by and a wrong analogy is drawn by equating the inter-corporate deposit being allowed as bad debt due to closure of the company with which the deposit had been made to the advance made to the company; that the advances were not part of business activity of the assessee; that it was more out of sympathy and as a measure to protect its own interest in the other company and therefore submits that the view taken by the tribunal is clearly not sustainable in law.

16. Sri Thirumalesh has drawn our attention to the provisions of Section 36(1)(vii) of the Act and has

submitted that it is only such debt which the assessee has incurred in the course of its business activity which has become irrecoverable which alone qualifies for deduction under this provision; that any and every advance does not qualify for deduction; that any and every advance does not qualify as a debt for the purpose of Section 36(1)(vii) of the Act; that the word 'debt' had been judicially examined by several decisions of the Supreme Court, who had, in turn, followed the view expressed on this aspect by the Privy Council while interpreting the corresponding provision in the Income Tax Act, 1922 viz., Section 10(2)(xi) and (xv); that on a proper examination of the nature of the advances in the present situation, the assessing officer as also the appellate authority had correctly opined that it was not at all a debt incurred in the course of money lending activity of the assessee or business activity of the assessee and therefore the finding recorded by the tribunal not based on the facts and circumstances prevailing in the case and not adverting to the material

available in the record, but drawing analogy from different decisions cannot be sustained in law and therefore submits that the order of the tribunal warrants interference.

17. Sri Thirumalesh has drawn our attention to the judgment of a Division Bench of this court in the case of ***CIT vs UNITED BREWERIES LTD [(2010) ITR 546]*** to submit that in the present case also the assessee had not produced any material to substantiate any of its claims such as it was carrying on money lending activity as part of its business or to substantiate that the particular transaction or advance to an extent of Rs 5.34 crore made in favour of its sister concern was as part of its money lending activity; that reversing the finding of the assessing officer as affirmed by the appellate authority without any material nor examining the same, the finding of the tribunal becomes a perverse finding; that the claim of the assessee has never qualified in terms of Section 36(1)(vii) of the Act and therefore submits that the view of the ratio

of this judgment on the question of what can constitute a bad debt, the decision of the tribunal is not sustainable.

18. Reference to the judgment and ratio laid down by the Supreme Court in the case of **CIT vs BIRLA BROS PVT LTD [(1970 77 ITR 751)]** as also in the case of **A V THOMAS & CO LTD vs COMMISSIONER OF INCOME TAX [(1963) 48 ITR 67]** and the discussion relating to what constitutes a 'debt' in these judgments are all relied upon to submit that advance of Rs 5.34 crore in favour of the sister concern never qualified as debt incurred by the assessee in the course of its business activity and therefore submits that on the ratio of the judgments in these decisions, the view taken by the tribunal is not sustainable in law also and seeks to reverse the view taken by the tribunal.

19. Attention is also drawn to parts of the orders of the assessing officer and the appellate authority, wherein it is clearly mentioned that advance was interest free and that

was the very case of the assessee even in terms of the reply given before the assessing officer as per its letter dated 5-5-2003 as is evident from the following paragraphs:

The advances having become irrecoverable and bad has been written off in the books of the company during the year and deduction has been claimed as bad debt in the light of the fact that the company's business activities include money lending also. This is also evidenced by clause No 23 of the objects clause of Memorandum and Articles of Association of the Company.

the assessee's case was that the amount having become irrecoverable or not possible to be realized by the assessee company from the other company, as it had gone into red by closing down its business, the advance was sought to be fitted into as part of money lending activity as in terms of Article 23 of the Memorandum of Association of the Company, money lending also could be one of the activities of the assessee-company and therefore the advance of this amount can be considered as part of such incidental business activity of the assessee.

20. Attention was also drawn to the grounds raised in the memorandum of appeal before the tribunal as under:

The learned Commissioner (Appeals) ought to have appreciated that the amount of Rs.5,34,00,000/- had been given by the appellant to M/s BPL Wireless Tele Communication Services Limited (BWTC) as interest-free loan as the appellant was the substantial share holder for the business and promotional activities of M/s. BWTL.

to submit that this is virtually conceding that the advance was an interest-free advance and it is submitted that when it was not even the case of the assessee that the assessee was either carrying on regular money lending activity or that it had advanced a sum of Rs 5.34 crore to the sister concern as part of its business activity, the finding recorded by the tribunal reversing the view expressed by the assessing officer and the appellate authority on this aspect is an unsustainable finding and therefore the tribunal was in error in concluding that the assessee was entitled to claim the deduction in terms of Section 36(1)(vii) of the Act.

21. Countering such submissions, Sri S Parthasarathy and Sri Malhararao, learned counsel for the assessee, have very vehemently urged that the view taken by the assessing officer and the appellate authority for disallowing the deduction in respect of Rs 5.34 crore claimed by way of bad debt and written off in the books of accounts of the assessee, is clearly not sustainable on the very reasoning and logic as was expressed by these authorities with reference to allowing inter-corporate deposit of Rs 75 lakh having become irrecoverable; that when once the assessing officer had accepted that inter-corporate deposit of Rs 75 lakh was as part of money lending activity of the assessee, the assessing officer as well as the appellate authority could not have made a distinction of this logic in so far as it relates to the advance of Rs 5.34 crore infavour of M/s BWTL; that both advances were on par and therefore was fully justified in admitting the claim of the assessee as a claim towards bad debt and written off in the books of accounts of the

assessee for the same accounting period in respect of a sum of Rs 5.34 crore as admissible under Section 36(1)(vii) of the Act and therefore no interference is warranted in this appeal.

22. Sri Parthasarathy has also submitted that the tribunal has examined the possibility of admitting this claim vis-à-vis permitted activities of the assessee in terms of its memorandum of association; that money lending activity was being one of the permitted activities of the assessee and the assessing officer as well as the appellate authority having affirmed for the purpose of inability of the sister concern to refund or repay the deposit of Rs 75 lakh, as an amount so permissible and an advance made in the course of money lending activity of the assessee, that cannot be varied in so far as other advances made to the very company and therefore also has urged that there is no need for disturbing the view taken by the tribunal on this aspect and the appeal of the revenue deserves to be dismissed.

23. Sri Parthasarathy has also submitted that the assessee had placed before the tribunal facts to the effect that advance of Rs 5.34 crore was not an interest-free advance, but it did carry interest and it had been so indicated in the books of accounts and a detailed paper book which had been placed before the tribunal running into 104 pages and wherefore the finding of the tribunal on this aspect should not be disturbed, but it can be disturbed and if so warranted only on examining the records but not otherwise etc.

24. Sri Parthasarathy has also placed reliance on the decision of the Supreme Court in the case of **COMMISSIONER OF INCOME TAX vs PANDIT LAKSHMI KANT KHA & OTHERS [(1972) 84 ITR 481]** to submit that a debt incurred in the course of business activity of the assessee, if it is written off in any accounting period, it can be claimed as bad debt in the corresponding assessment year and the assessee having written off the debt of Rs 5.34 crore as bad debt in the accounting period

corresponding to the assessment year in question, the assessee was entitled to claim this deduction and therefore the tribunal was fully justified in allowing the same, reversing the view taken by the lower authorities.

25. Reliance is also placed on a decision of the Bombay High Court in the case of **COMMISSIONER OF INCOME TAX vs INVESTA INDUSTRIAL CORPORATION [(1979) 119 ITR 380]** to submit that advance made to a business associate by an assessee, if becomes irrecoverable, it can be claimed as loss in trade and qualifies for deduction in terms of Section 36(1)(vii) of the Act and therefore submits that mere fact that the assessee had made an advance to its sister concern cannot in any way detract from eligibility for claiming deduction under this provision so long as the amount was a debt and it had become irrecoverable and in fact had been written off in the books of accounts as such.

26. We have bestowed out attention to the submissions made at the Bar, perused the orders of the assessing

officer, appellate authority and the tribunal and also examined the submissions in the light of the decisions relied upon by the parties.

27. As indicated earlier, the question to be answered in this appeal is as to whether the tribunal has committed an error in law in reversing the finding of the assessing officer and affirming order of the appellate authority and in taking the view that the assessee qualifies for claiming deduction in respect of the sum of Rs 5.34 crore and if not as to whether the finding recorded by the tribunal is not sustainable as being one perverse and warrants interference?

28. Submission of Sri Thirumalesh, learned standing counsel for the appellant-revenue that the amount which qualifies for deduction in terms of Section 36(1)(vii) of the Act that it should be basically a debt and a debt which has become bad and therefore so written off as irrecoverable in the accounts of the assessee for the

previous year corresponding to the assessment year, is an unexceptional legal postulate and has been so noticed judicially also.

29. Expression 'debt' as noticed and discussed by this court in the case of **UNITED BREWERIES** [supra] is the view evolved over a period of time and in the context of examination of the expression 'debt' even as it occurs in the corresponding provisions of the Income Tax Act, 1922 i.e. Sections 10(2)(xi) and 10(2)(xv) of that Act and the provisions of Section 36(1)(vii) of the Act.

30. In the case of **A V THOMAS & CO LTD** [supra], the Supreme Court had occasion to examine this aspect in some detail and on such examination and applying the interpretation placed on these provisions by the Privy Council by **Rowlatt J**, in the case of **CURLIS vs J & G OLDFIELD LTD [(1925) 9 TAX CAS 319, 330]**, noticed that the expression 'debt' as it occurs in Section 10(2)(xi) has a special meaning and connotation; that it should be

viewed in the background of the nature of the activity that is carried by an assessee as its business activity and the amount being allowable as deduction in computing the profits and loss of the business; that it should be an activity incidental to the business and an amount which was not by way of a debt for any capital investment etc.; that it should be part of its trading activity and therefore an amount which could make a difference to the profit and loss statement of the assessee depending upon the receipt or non-receipt of the amount and such being the test, mere fact that a particular activity is a permitted activity in the memorandum of association of the company by itself cannot be the determinative factor for deciding as to whether an amount either spent or allowed as a credit in favour of a customer or lent to any other business associate or even as a deposit etc., becomes or is a part of business expenditure, and can be described as a 'debt'.

31. Ultimately, the purpose for which the amount was given, the nature of the lending, nature of the activity

carried on by the assessee, which constitutes business activity of the assessee, are all factors which are to be considered in determining as to whether an amount given by the assessee is one which qualifies as a 'debt'.

32. A debt may be because of any service provided by the assessee to its customers for which an amount or fees is payable but not so paid or a price payable for any of the goods supplied but not paid by the customer or an amount actually lent out by the assessee as part of the business activity of the assessee and to qualify for deduction under Section 36(1)(vii), it is such debt which has become irrecoverable for various reasons.

33. It is in this background, the business activity, whether it is money lending or otherwise, assumes importance, as in the instant case, it is an amount which had been advanced by the assessee to its sister concern.

34. On an examination of these circumstances, in the exercise undertaken by the assessing officer and the

appellate authority it was revealed that the business activity of the assessee was not as a part of advancing of moneys or money lending activity, though Sri Parthasarathy, learned counsel for the assessee has very vehemently urged that the assessing officer and the appellate authority themselves had confirmed this view that a sum of Rs 75 lakh allowed as deduction, which was an inter-corporate deposit, was part of money lending activity of the assessee and that the assessee had considerable amount of interest income from the deposit made or amount advanced to other customers or associates, that in itself is not the criterion for deciding as to whether the activity was a money lending activity of the assessee or its business was money lending, as it pointed out by Sri Thirumalesh, learned standing counsel for the appellant-assessee that the assessee did not hold any permission or licence or was recognized as a money lender nor was it recognized as a financial institution, banking or

non-banking, which has the business of receiving deposits and lending money, both for interest.

35. It is never the case of the assessee that it had been receiving deposits on payment of interest and it was lending money. Either on facts or from the activity carried on by the assessee or from the circumstance, the tribunal could have never used the reasoning of the assessing officer or the appellate authority to conclude that the assessee should be taken to be carrying on the activity of money lending as a business activity and therefore on the same reasoning the amount of Rs 5.34 crore advanced to its sister concern also should be allowed. This view is not supportable for more than one reason that it is not based on any material on record; that there was nothing on record to indicate that the assessee had been recognized as money lender in terms of any legal provisions or business practice and the mere fact that the assessing officer and the appellate authority have opined correctly or otherwise that inter-corporate deposit of Rs 75 lakh

qualifies for deduction under Section 36(1)(vii) of the Act being a deposit made in the money lending business activity of the assessee automatically entails the assessee to a like deduction in respect of the advance to the extent of Rs 5.34 crore also as a deduction under the very provision of law without more. The assessee's main business activity was only in providing services in telecommunication technology and not in money lending activity.

36. While it may be true that in terms of No 23 of the objects clause of Memorandum and Articles of Association of the Company, the assessee could have carried on this activity incidental to its main business, it was not made known as to whether the assessee was carrying this business also in a systematic manner. Mere fact that the assessee had made some inter-corporate deposits and the assessee earned income by way of interest in itself is not a circumstance to conclude that it was carrying on money lending activity as part of its business activity.

37. Recording of a finding to the effect that the amount of Rs 5.34 crore advanced to its sister concern was an interest-free while is borne out from the records and supported by the very stand of the assessee, submission of Sri Parthasarathy to the effect that contrary was made good in terms of certain material that had been placed by the assessee before the tribunal in a paperbook filed by it cannot be accepted for the reason that mere filing a paperbook is not evidence nor the assessee can be permitted to lead evidence contrary to its own admitted case. It is, therefore, we reject this submission for calling for records and reexamine the same and for remanding the matter to the tribunal.

38. In the result, we conclude that the tribunal has committed an error in answering the two questions posed for our examination and we answer the questions in the negative and in favour of the revenue. The appeal is allowed, impugned order of the tribunal is set aside and

the order of the assessing officer as affirmed by the
appellate authority is restored. No order as to costs.

**Sd/-
JUDGE**

**Sd/-
JUDGE**

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