IN THE INCOME TAX APPELLATE TRIBUNAL,
MUMBAI BENCH "A",MUMBAI
BEFORE SHRI N.V. VASUDEVAN (JM) & SHR N.K. BILLAIYA (AM)

I.T.A. No.3558Mum/2011
(A.Y. 2006-07)

M/s. Arrow Coated Products Ltd., Arrow House, 5-D, Laxmi Indl. Estate, New Link Road, Andheri (W), Mumbai-400 053. PAN: AAACA 9525 H	Vs.	Asst. Commr. of Income-tax-8(1), Aaykar Bhavan, M.K. Road, Churchgate, Mumbai-400 020.
Appellant		Respondent

Appellant by		Shri Vipul J. Shah.
Respondent by		Shri C.G.K. Nair.

Date of hearing	01-03-2012
Date of pronouncement	14-03-2012

O R D E R

PER N.K. BILLAIYA , AM :

This is an appeal by the assessee against the order dated 4-2-2011 of CIT(A)-16, Mumbai, relating to assessment year 2006-07. The only issue in this appeal is as to whether the Revenue authorities were justified in denying the claim of the assessee for deduction on account of bad debt a sum of Rs.20,36,000/- while computing the taxable income.

2. The assessee, is a company. It is engaged in the business of importing and trading of computerized digital printing machines, inks, spares, etc. In AY 04-05, the assessee identified some of the dues from its customers as potentially bad. The assessee accordingly made a provision for doubtful debts in the books of account of Rs.70,00,000/-. The provision for doubtful debts was debited to the Profit & Loss account in AY 2004-05. Correspondingly, in the balance-sheet from the gross total

sundry debtors, the provision for doubtful debts was reduced. In the computation of income filed along with the return of income for assessment year 2004-05, the assessee added to the profit as per P & L account the provision for doubtful debts of Rs.70,00,000/-. Thus, the assessee did not claim any deduction on account of bad debts in assessment year 2004-05 though a provision was made in the books of account. It is also to be noticed that the provision for doubtful debts was reduced from the sundry debtors in the final balance sheet. The individual ledger account of the sundry debtors the amount due by them continued to be shown as due and payable and had not been written off.

3. In the assessment years 2005-06 and 2006-07, the assessee wrote off in the accounts of the concerned sundry debtors the provision for doubtful debts already credited in AY 04-05. In assessment year 2005-06, a sum of Rs.49,64,221/- was written off by crediting the sundry debtors account and similarly a sum of Rs.20,36,000/- was written off for assessment year 2006-07 by crediting the sundry debtors account.

4. The AO examined the claim of the assessment year 2006-07 and held that the amount was not transferred to the P & L account and therefore the claim cannot be allowed. In this regard the AO relied on the decision of the Hon'ble Madras High Court in the case of CIT Vs. Hotel Ambassador 121 Taxman 437 wherein it was held that writing off bad debts without charging the profit and loss account is not a write off at all. In this regard, it has to be mentioned that in assessment year 2006-07 the assessee did not debit the amount written off as bad debts in the P & L account because this is part of the sum of Rs.70,00,000/- which was already debited in the P & L account in assessment year 2004-05. As already mentioned though in AY 04-05 the sum of Rs.70,00,000/- was debited to the P & L account in assessment year 2004-05, the same was added to the profit as per profit and loss account in the computation of income. Thus in AY 04-05 deduction of Rs.70,00,000 had not been claimed by the Assessee.

5. On appeal by the assessee, the CIT(A) upheld the order of the AO giving rise to the present appeal by the assessee before the Tribunal. Before us, the learned counsel for the assessee brought to our notice the accounting entries passed in assessment years 2004-05, 2005-06 and 2006-07 and submitted that the fact that the amount claimed as

deduction on account of bad debts was not debited in the P & L account in AY 06-07 cannot be a ground for rejecting the claim of the assessee. In this regard, it was pointed out that writing off debts as bad debts is done by crediting the debtors account and such accounting entry had been passed by the assessee only in the previous year relevant to assessment year 2006-07 in so far as a sum of Rs.20,36,000/- is concerned. He pointed out that the conclusion of the Revenue authorities that the amount should be debited to the P & L account is not correct because a sum of Rs.20,36,000/- claimed as deduction on account of bad debts is part of the sum of Rs.70,00,000/- which was already debited to the P & L account in assessment year 2004-05. In this regard, the assessee also submitted that the AO has not disputed the fact that the sum of Rs.70,00,000/- debited in the P & L account in assessment year 2004-05 was already credited as income in the previous years prior to AY 04-05 and therefore the condition laid down in sec. 36(2) was satisfied. The ld. D.R. relied on the order of the AO/CIT(A).

6. We have considered the rival submissions. On perusal of the accounting entries passed, it is clear that the sum of Rs.20,36,000/- claimed as deduction in AY 06-07 was part of Rs.70,00,000/- claimed as provision for bad debt in AY 04-05 by debiting to the P & L account for AY 04-05 as provision for doubtful debts in assessment year. Correspondingly, in the balance-sheet from the gross total sundry debtors, the provision for doubtful debts was reduced. In the computation of income filed along with the return of income for assessment year 2004-05, the assessee added to the profit as per P & L account the provision for doubtful debts of Rs.70,00,000/-. Thus, the assessee had not claimed as a deduction in the past the sum of Rs.20,36,000/-. In assessment year 2004-05, though a sum of Rs.70,00,000/- was reduced in the balance-sheet from the sundry debtors, the sundry debtors account was not credited and closed. It was only in the previous year relevant to assessment year 2006-07 that the debtors accounts were squared off by crediting the same to the extent of Rs.20,36,000/-. Section 36(1)(vii) of the Act prescribes the conditions for allowing deduction on account of bad debt and it lays down that in computing the income under the head “profits and gains of business”, deduction of any bad debt or part thereof, which is written off as irrecoverable in the accounts of the assessee for the previous year, shall be allowed. Thus, the section contemplates write off of bad debt in the accounts of the assessee for the previous year.

7. In the case of M/S.Vijaya Bank Vs. CIT 323 ITR 166(SC), the Hon'ble Supreme Court held that to claim deduction under section 36(1)(vii) of the Act, it is not necessary to close the individual account of each debtor. The facts of the case were that the Assessee made a provision for bad and doubtful debt by debiting the amount of bad debt to the Profit and Loss Account so as to reduce the profits of the year. The provision account so created was debited and correspondingly the amount of debtors as appearing in the balance sheet was reduced. Thus, the provision account stood obliterated and the sundry debtors in the balance sheet, as at the end of the year, were shown as net of 'provision for doubtful debt'. The Assessing Officer disallowed the said amount on the ground that the bad debt had not been written off in an appropriate manner as required under the accounting principles. According to the AO, the bad debt, supposedly written off by the taxpayer, was a mere provision and the same could not be equated with the actual write off of the bad debt, as required by section 36(1)(vii) of the Act. On the above facts, the Hon'ble Supreme Court considered two questions for determination. The first question was with regard to the manner in which actual write off takes place under the Accounting principles. The second question was whether it was imperative for the assessee-Bank to close the individual account of each debtor in it's Books or a mere reduction in the Loans and Advances Account or Debtors to the extent of the provision for bad and doubtful debt is sufficient? On the first the first question the Hon'ble Suupreme Court referred to it's own ruling in the case of Southern Technologies Ltd. Vs. JCIT 320 ITR 577 (SC) wherein the Hon'ble Supreme Court held as follow:

> "Prior to April 1, 1989, the law, as it then stood, took the view that even in cases in which the assessee(s) makes only a provision in its accounts for bad debts and interest thereon and even though the amount is not actually written off by debiting the profit and loss account of the assessee and crediting the amount to the account of the debtor, the assessee was still entitled to deduction under section 36(1)(vii). [See CIT v. Jwala Prasad Tiwari (1953) 24 ITR 537 (Bom) and Vithaldas H. Dhanjibhai Bardanwala vs. CIT (1981) 130 ITR 95 (Guj)] Such state of law prevailed up to and including the assessment year 1988-89. However, by insertion (with effect from April 1, 1989) of a new Explanation in section 36(1)(vii), it has been clarified that any bad debt written off as irrecoverable in the account of the assessee will not include any provision for bad and doubtful debt made in the accounts of the assessee. The said amendment indicates that before April 1, 1989, even a provision could be treated as a write-off. However, after April 1, 1989, a distinct dichotomy is brought in by way of the said Explanation to section 36(1)(vii). Consequently, after April 1, 1989, a mere provision for bad debt would not be entitled to deduction under Section 36(1)(vii). To understand the above dichotomy, one must understand `how to

> write off'. If an assessee debits an amount of doubtful debt to the profit and loss account and credits the asset account like sundry debtor's account, it would constitute a write off of an actual debt. However, if an assessee debits `provision for doubtful debt' to the profit and loss account and makes a corresponding credit to the `current liabilities and provisions' on the liabilities side of the balance-sheet, then it would constitute a provision for doubtful debt. In the latter case, the assessee would not be entitled to deduction after April 1, 1989."

In light of the above decision, the Hon'ble Supreme Court, held that after the insertion of the Explanation to section 36(1)(vii), the taxpayer is now required not only to debit the Profit and Loss Account but simultaneously also reduce loans and advances/debtors account to the extent of the corresponding amount so that, at the end of the year, the amount of loans and advances/debtors account is shown as net of provisions for bad debt. Since the taxpayer had actually written off the bad debts, in the manner explained above, it was entitled to deduction under section 36(1)(vii) of the Act.

8. On the second question whether it is imperative to close the individual account of each debtor or a mere reduction in the loans and advances/debtors account to the extent of the provision for bad and doubtful debt is sufficient, the Hon'ble Supreme Court held that Section 36(1)(vii) of 1961 Act applies both to Banking and Non-Banking businesses and that it is not necessary to claim deduction on account of bad debts that the individual debtors account should be closed by crediting the said account.

9. In the light of the Hon'ble Supreme Court decision the Assessee could have claimed the deduction of Rs.20,36,000 in AY 04-05 even though the debtors account had not been squared off during the previous year relevant to AY 04-05. It is not necessary that the claim for deduction should be routed through only the P & L account of the previous year in which the deduction is claimed, as has been the stand of the Revenue.

10. The Assessee did not claim deduction in AY 04-05. The question is whether the deduction can be claimed in AY 06-07 on the basis of squaring off the debtors account in the books of accounts of the previous year relevant to AY 06-07. We cannot read the decision of the Hon'ble Supreme Court in the case of Vijaya Bank (supra) and Southern Technologies Ltd. (supra) as laying down a prohibition to claim deduction on account of bad debts in the year in which the account of the debtor is squared off. In fact the stand of the Revenue in the case of Vijaya Bank (supra) was that the individual debtors account should be closed by writing it off as bad debts, for claiming deduction on account of bad

debts. On the above stand of the Revenue, the Hon'ble Supreme Court observed as follows:

> "It is important to note that the assessee-Bank has not only been debiting the Profit and Loss Account to the extent of the impugned bad debt, it is simultaneously reducing the amount of loans and advances or the debtors at the year-end, as stated hereinabove. In other words, the amount of loans and advances or the debtors at the year-end in the balance-sheet is shown as net of the provisions for impugned debt. **<u>However, what is being insisted upon by the Assessing Officer is that mere reduction of the amount of loans and advances or the debtors at the year-end would not suffice and, in the interest of transparency, it would be desirable for the assessee-Bank to close each and every individual account of loans and advances or debtors as a pre-condition for claiming deduction under Section 36(1)(vii) of 1961 Act. This view has been taken by the Assessing Officer because the Assessing Officer apprehended that the assessee-Bank might be taking the benefit of deduction under Section 36(1)(vii) of 1961 Act, twice over.</u>** [See Order of CIT (A) at Pages 66, 67 and 72 of the Paper Book, which refers to the apprehensions of the Assessing Officer]. In this context, it may be noted that there is no finding of the Assessing Officer that the assessee had unauthorisedly claimed the benefit of deduction under Section 36(1)(vii), twice over. The Order of the Assessing Officer is based on an apprehension that, if the assessee fails to close each and every individual account of it's debtor, it may result in assessee claiming deduction twice over. In this case, we are concerned with the interpretation of Section 36(1)(vii) of 1961 Act. We cannot decide the matter on the basis of apprehensions/desirability. It is always open to the Assessing Officer to call for details of individual debtor's account if the Assessing Officer has reasonable grounds to believe that assessee has claimed deduction, twice over. In fact, that exercise has been undertaken in subsequent years. There is also a flip- side to the argument of the Department. Assessee has instituted recovery suits in Courts against it's debtors. If individual accounts are to be closed, then the Debtor/Defendant in each of those suits would rely upon the Bank statement and contend that no amount is due and payable in which event the suit would be dismissed." (underlining by us for emphasis)

11. In the light of the above observations of the Hon'ble Supreme Court, it is reasonable to hold that there is no prohibition to claim deduction on account of bad debts in the year in which the debtors account is squared off by crediting bad debts. The only condition when a claim for deduction is made in the year in which the debtors account is squred off would be to see that the deduction should not have been claimed in the year in which the provision for bad debts was written off in the profit and loss account and corresponding reduction of the debtors is shown in the balance sheet. So long as there is no double deduction, there cannot be any objection for allowing the claim of the Assessee for deduction on account of bad debts.

12. The facts of the present case clearly show that the Assessee had not claimed deduction on account of bad debts in AY 04-05. Thus there is no double deduction claimed by the Assessee or any apprehension that the Assessee might claim double deduction. In such circumstances, we are of the view that the claim of the Assessee deserves to be accepted. We are also of the view that if the claim of the assessee is not allowed, then it would amount to double taxation of the same income because the sum of Rs.70,00,000/-, of which Rs.20,36,000/- is a part, had already been debited to the P & L account in assessment year 2004-05 but added in the computation of total income for that year. In the light of the discussion as above, we are of the view that the claim of the assessee for deduction on account of bad debts of RS.20,36,000/- has to be allowed and the deduction claimed is directed to be allowed.

13. In the result, the appeal by the assessee is allowed.

Order pronounced on the 14th day of March, 2012.

Sd/-
(N.V. VASUDEVAN)
JUDICIAL MEMBER

Sd/-
(N.K. BILLAIYA)
ACCOUNTANT MEMBER

Mumbai: 14th March , 2012.

NG:

Copy to :

1. Assessee.
2. Department.
3 CIT(A)-16,Mumbai.
4 CIT-8,Mumbai.
5.DR,"A" Bench,Mumbai.
6.Master file.
(TRUE COPY)

BY ORDER,

Asst. Registrar, ITAT, Mumbai.