

**IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCHES "A" : HYDERABAD**

**BEFORE SHRI S.S.GODARA, JUDICIAL MEMBER
AND
SHRI LAXMI PRASAD SAHU, ACCOUNTANT MEMBER**

I.T.A. No. 128/HYD/2021

Assessment Year: 2017-18

Joint Commissioner of
Income Tax (OSD),
Circle-5(1),
HYDERABAD

Vs

Magnaquest
Technologies Limited,
HYDERABAD
[PAN: AACCM3117F]

(Appellant)

(Respondent)

For Revenue : Shri Rajendra Kumar, CIT-DR
For Assessee : Shri K.C.Devdas, AR

Date of Hearing : 07-03-2022

Date of Pronouncement : 10-03-2022

ORDER

PER S.S.GODARA, J.M. :

This Revenue's appeal for AY.2017-18 arises from the CIT(A)-4, Hyderabad's order dated 17-07-2020 passed in case No.10588 / 19-20 / DCIT,Cir-16(2) / CIT(A)-4 / 20-21, involving proceedings u/s.143(3) of the Income Tax Act, 1961 [in short, 'the Act'].

Heard both the parties. Case file perused.

2. It transpires at the outset that this Revenue's instant appeal suffers from 122 days' delay. Hon'ble apex court's recent directions "IN RE: COGNIZANCE FOR EXTENSION OF LIMITATION", Miscellaneous Application No. 21 of 2022 in Suo

Motu Writ Petition(C) No.3 of 2020 has directed exclusion of Covid-19 pandemic outbreak time period from 15-03-2020 to 28-02-2022 from all limitations. The impugned delay stands condoned accordingly.

3. The Revenue's sole substantive ground raised before us in the instant appeal challenges correctness of the CIT(A)'s action deleting Section 36(1)(vii) r.w.s.36(2) bad debts disallowance of Rs.7,51,91,659/- thereby admitting additional evidence in violation of rule 46A of the Income Tax Rules during the course of lower appellate proceedings. Both the learned representatives invited our attention to the impugned lower appellate discussion as follows:

The comments of the appellant's AR on the remand report filed by the AO are summarised as under.

a. The AO has failed to note anything adverse in the additional evidence filed by the AR on the claim of bad debts written off and has merely reiterated that the appellant failed to submit evidence in support of the claim of bad debts written off during the assessment proceedings despite numerous opportunities provided to it. The AR has stated that in the initial notices the AO did not ask any specific question regarding the bad debt written off. In the notice u/s 142(1) issued on 23.10.2019 the AO had asked the appellant to give details of the administrative expenses which included bad debts written off and when in response to the same the appellant submitted the details of bad debts written-off the AO issued show-

cause notice dated 28.11.2019 to submit reply by 29.11.2019. The AO never gave an opportunity to the appellant to file a proper reply to his show-cause.

- b. The appellant has not violated any accounting standard. The Accounting Standard on the subject of provisions is AS-4 which stipulates that provision for bad debts must be made if at the time of finalisation of balance-sheet it is certain that the account receivables will be impaired and a reasonable estimate for the provision can be made. The appellant claims that this was not so in the case of the appellant since these conditions were not satisfied in the previous years prior to FY 2016-17. It is claimed that it was only in the FY 2016-17 that the appellant ascertained the bad debts to be written-off. Further, the AS-4 does not mention that the bad debts written off can be claimed only when the assessee maintains provisions for bad debts.
- c. The appellant further states that as per the provisions of section 36(1)(vii) and 36(2) of the Income Tax Act, whether the bad debts written-off by an assessee can be allowed or not as a business expenditure is not conditional on the fact that the assessee maintained a provision for bad debts.

6. The AO has made an addition of Rs 7,51,91,659/- by under section 36(2) by disallowing the bad debts claimed by the appellant Company. The reason given for disallowance is that,

“...the assessee-Company has neither categorized the bad debts written off amount of Rs 7,51,91,659/- as irrecoverable nor could it provide proper explanation and reasonability for written off the bad debts in the books of accounts nor its submission. In short, the assessee-Company could not render proper reason to establish that the debt in fact has become irrecoverable in the books of accounts.

.....The assessee-Company failed to produce any evidence to the effect that how it had managed and treated the accounts in the income statement in earlier years...”

6.1 Before, initiating any discussion on this issue, it is necessary to understand the extant provisions on this issue as contained in section 36(1)(vii) and 36(2) of the Act. The provision of section 36(1)(vii) is as under.

(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:

The sub-section (2) of section 36 of the Act is reproduced as under.

(2) In making any deduction for a bad debt or part thereof, the following provisions shall apply—

- (i) no such deduction shall be allowed unless such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year, or represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee;
- (ii) if the amount ultimately recovered on any such debt or part of debt is less than the difference between the debt or part and the amount so deducted, the deficiency shall be deductible in the previous year in which the ultimate recovery is made;
- (iii) any such debt or part of debt may be deducted if it has already been written off as irrecoverable in the accounts of an earlier previous year (being a previous year relevant to the assessment year commencing on the 1st day of April, 1988, or any earlier assessment year), but the Assessing Officer had not allowed it to be deducted on the ground that it had not been established to have become a bad debt in that year;
- (iv) where any such debt or part of debt is written off as irrecoverable in the accounts of the previous year (being a previous year relevant to the assessment year commencing on the 1st day of April, 1988, or any earlier assessment year) and the Assessing Officer is satisfied that such debt or part became a bad debt in any earlier previous year not falling beyond a period of four previous years immediately preceding the previous year in which such debt or part is written off, the provisions of sub-section (6) of section 155 shall apply;
- (v) where such debt or part of debt relates to advances made by an assessee to which clause (viiia) of sub-section (1) applies, no such deduction shall be allowed unless the assessee has debited the amount of such debt or part of debt in that previous year to the provision for bad and doubtful debts account made under that clause.

A combined reading of the above-mentioned provisions leads one to understand that as per the provisions of section 36 an assessee is entitled to avail the deduction with respect to bad debts written off in the books if the following conditions are fulfilled,

1. The debt in question must be written off as irrecoverable in the books of accounts for the relevant previous year; and
2. The amount of the debt must be taken into account while computing the income either during the previous year or during the earlier years.

Thus, if the assessee has decided to consider certain debts as irrecoverable he can claim it as deduction provided that the same have been included while computing income either in the previous year or during any earlier year. As regards the question whether a particular debt has become irrecoverable or not, the prerogative is fully in

the hands of the assessee after the amendment in the provisions of section 36(1)(vii) brought about by the Direct Tax Laws (Amendment) Act, 1987 w.e.f. 01.04.1989. Prior to 01-04-1989 the said provision read as under:

"(vii) Subject to the provisions of sub-section (2), the amount of any debt, or part thereof, which is established to have become a bad debt in the previous year"

In the new provision of 36(1)(vii) the words, 'established to have become a bad debt' have been removed and the amended provision reads as under.

"(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"

The rationale behind the amendment is explained in the CBDT Circular no. 551 dated 23.01.1990 which provides the explanatory notes to the Direct Tax Laws (Amendment) Act, 1987. The same is as under.

"DIRECT TAX LAWS (AMENDMENT) ACT, 1987-IV

Amendments to sections 36(1)(vii) and 36(2) to rationalise provisions regarding allowability of bad debts

6.6 The old provisions of clause (vii) of sub-section (1) read with sub-section (2) of the section laid down conditions necessary for allowability of bad debts. It was provided that the debt must be established to have become bad in the previous year. This led to enormous litigation on the question of allowability of bad debt in a particular year, because the bad debt was not necessarily allowed by the assessing officer in the year in which the same had been written off on the ground that the debt was not established to have become bad in that year. In order to eliminate the disputes in the matter of determining the year in which a bad debt can be allowed and also to rationalise the provisions, the Amending Act, 1987 has amended clause (vii) of sub-section (1) and clause (i) of sub-section (2) of the section to provide that the claim for bad debt will be allowed in the year in which such a bad debt has been written off as irrecoverable in the accounts of the assessee."

Thus, after the above-discussed amendment, the assessee is not required to establish that the debts have become irrecoverable. The Hon'ble Supreme Court in the case of **TRF Ltd vs. CIT (2010) 323 ITR 397 (SC)** has held that post 01-04-1989, it is not necessary for the assessee to establish that his debt has become bad. If the debt has been written off in the books then it would be sufficient to allow the deduction. The Hon'ble Apex Court *inter alia* held,

AY 2017-18

"This position in law is well-settled. After 1-4-1989, it is not necessary for the assessee to establish that the debt, in fact, has become irrecoverable. It is enough if the bad debt is written off as irrecoverable in the accounts of the assessee. However, in the present case, the Assessing Officer has not examined whether the debt has, in fact, been written off in accounts of the assessee. When bad debt occurs, the bad debt account is debited and the customer's account is credited, thus, closing the account of the customer. In the case of companies, the provision is deducted from sundry debtors"

The CBDT vide its Circular no. 12 of 2016 dated 30.05.2016 has laid to rest any doubts on this issue by reiterating unequivocally the abovementioned decision of the Hon'ble Supreme Court. The said Circular states inter alia that,

"3. The legislative intention behind the amendment was to eliminate litigation on the issue of the allowability of the bad debt by doing away with the requirement for the assessee to establish that the debt, has in fact, become irrecoverable. However, despite the amendment, disputes on the issue of allowability continue, mostly for the reason that the debt has not been established to be irrecoverable. The Hon'ble Supreme Court in the case of TRF Ltd. In CA Nos. 5292 to 5294 of 2003 vide judgment dated 9.2.2010, has stated that the position of law is well settled. "After 1.4.1989, for allowing deduction for the amount of any bad debt or part thereof under section 36(1)(vii) of the Act, it is not necessary for assessee to establish that the debt, in fact has become irrecoverable; it is enough if bad debt is written off as irrecoverable in the books of accounts of assessee."

4. In view of the above, 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 sub-section 36(2) of the Act."

In light of above discussion it can be inferred that claim for any debt or part thereof as bad 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 is not necessary for assessee to establish that the debt has become irrecoverable.

6.2 Now, let us see how the AO has interpreted and applied the above-discussed provisions in the instant case. The AO has held that the appellant Company has failed to categorize the bad debts as 'irrecoverable' and has failed to provide 'proper explanation' and 'reasonability' for writing off the bad debts in its books, and that the appellant has failed to 'render proper reason to establish that the debt in fact has

become irrecoverable'. The usage of such terms by the AO is sadly reflective of the fact that the AO is still in the mental era prior to 01.04.1989 and has singularly failed to understand the essence of the amendment brought out in the said provisions in 1987.

6.3 The additional evidence filed by the appellant has clearly shown that the outstanding debt payable by 27 parties was declared irrecoverable during the relevant financial year 2016-17 and was entered accordingly in the ledgers of these parties. The copies of the invoices and the party ledgers also show that these were entered as receipts in the Profit and Loss accounts of the concerned financial years. The AO has not been able to find anything adverse in the additional evidence filed by the appellant and has also failed to give any cogent reason why the bad debts written-off by the appellant may be disallowed. Therefore, it is held that the bad debts written-off by the appellant may be allowed to the appellant and the addition made by the AO on this account is thus deleted.

4. It is sufficiently clear from a perusal of the case file that the CIT(A) had very well sought remand report from the Assessing Officer's end regarding the assessee's additional evidence in issue. The Revenue's instant sole substantive ground fails on this count therefore as the CIT(A) has not violated principles of natural justice in this regard.

Coupled with this, it has come on record that the assessee had very well written-off the impugned sums involving 27 parties having outstanding business receivables which had been duly recognised as income in earlier years. We thus hold that the CIT(A) has rightly followed hon'ble apex court's landmark decision in TRF (supra) that the impugned bad debts disallowance had been wrongly made during the course of assessment herein framed on 04-12-2019. The Revenue's substantive ground(s) fail accordingly.

5. This Revenue's appeal is dismissed in above terms.

Order pronounced in the open court on 10th March, 2022

Sd/-
(LAXMI PRASAD SAHU)
ACCOUNTANT MEMBER

Sd/-
(S.S.GODARA)
JUDICIAL MEMBER

Hyderabad, Dated: 10-03-2022

TNMM

Copy to :

1. Joint Commissioner of Income Tax(OSD), Circle-5(1), Hyderabad.

2. Magnaquest Technologies Limited, H.No.8-2-283/B/3, Plot No.254, Avenue-7, Road No.3, Banjara Hills, Hyderabad.

3. CIT(Appeals)-4, Hyderabad.

4. Pr.CIT-4, Hyderabad.

5. D.R. ITAT, Hyderabad.

6. Guard File.