

(2006) 11 GAU CK 0052

Gauhati High Court

Case No: None

Amines and Plasticizers Ltd.

APPELLANT

Vs

Deputy Commissioner of Income
Tax (Assessment) and Others

RESPONDENT

Date of Decision: Nov. 21, 2006

Acts Referred:

- Income Tax Act, 1961 - Section 115J, 260A

Citation: (2007) 1 GLR 513 : (2007) 1 GLT 421 : (2008) 296 ITR 727

Hon'ble Judges: U.B. Saha, J; D. Biswas, J

Bench: Division Bench

Final Decision: Allowed

Judgement

D. Biswas, J.

This appeal u/s 260A of the Income Tax Act, 1961 directed against the Judgment and Order dated 8.10.2002 passed by the Income Tax Appellate Tribunal, Guwahati Bench, Guwahati in ITA No. 229 (Gau.) of 1998 was admitted for hearing on the following questions of law:

1. Whether on the facts and circumstances of the case and in view of the provisions of Section 115J(1A) of the Act, the learned Income Tax Appellate Tribunal was justified in holding that the provision for the doubtful debts has to be added back to the profits for the purpose of determination of the book profit u/s 115J of the Act ?
2. Whether Section 115J is overriding in nature and other provisions of the Act have no bearing in computing the taxable book profit under the said section ?
3. Whether on the facts and circumstances of the case the provision for doubtful debts will not amount to diminishing in the value of the assets, i.e., the Sundry Debtors and whether the same has to be added back to the profit for determination of the book profit u/s 115J of the Act ?

2. The dispute pertains to the Assessment Year 1990-91. The appellant is a company incorporated under the provisions of the Companies Act, 1956. In the return, the total income of the assessee was shown as nil and taxable book profit u/s 115J of the Act was determined at Rs. 3,36,950. The Assessing Officer accepted the return in the original assessment order dated 24.2.1993. The said order was set aside by the Commissioner of Income Tax on the ground that an amount of Rs. 11,52,221 pertaining to the provision of doubtful debt though debited to the profit and loss account was not added back to determine the book profit u/s 115J of the Act. A fresh assessment was made by the Assessing Officer by the order dated 11.3.1997. The Assessing Officer held that the provision of doubtful debt was not an ascertained liability and accordingly, the same was added back to the total income of the appellant-company. The assessee preferred an appeal (Appeal No. Gawa/ 381/95-97) before the CIT (Appeals) against the fresh assessment order dated 11.3.1997. The CIT (Appeals) held that the provisions of Section 115J have overriding effect on other provisions of the Act and deleted the addition of Rs. 11,52,221. The Revenue preferred an appeal ITA No. 229(Gau.)/1998. The assessee also preferred a cross-appeal. The learned Tribunal disposed of the appeal and the cross-appeal by the order dated 8.10.2002 setting aside the order of the CIT (Appeals) affirming the order of assessment dated 11.3.1997. Rectification application filed by the assessee was also rejected. Hence, this appeal.

3. The assessee made a provision for doubtful debt of Rs. 11,52,221 by debiting from the profit and loss account during the relevant assessment year in addition to Rs. 13,93,825 provided in earlier years as considered adequate by the management in view of the continued efforts for recovery. The assessee being a company is required to prepare its profit and loss account in accordance with the provisions of Parts II and III of Schedule IV of the Companies Act, 1956. Explanation to Sub-section (1)(a) of Section 115J defines "book profit" for the purpose of Section 115J as the "net profit" shown in the profit and loss account increased by the amount for amounts setting aside the provision made for meeting liabilities, other than ascertained liabilities. The learned Tribunal was of the view that the provision of Rs. 11,52,221 was not written off as a bad debt and it is merely a provision made against doubtful debt. Hence, it cannot be treated as a provision for ascertained liability. The Tribunal relied upon a decision of the Madras High Court in CIT v. Beardsell Ltd. reported in 224 ITR 256 in coming to the above conclusion.

4. In Breadsell Ltd. (supra), the Madras High Court was of the view that if a debt had become irrecoverable, the same could be written off and deducted from the profit of the business. A debt, recovery of which was doubtful could not be termed as an ascertained liability within the meaning of Clause (c) of the Explanation to Sub-section (1A) of Section 115J of the Income Tax Act and such a debt could not be excluded from the book profits. Dr. Saraf, learned senior counsel for the appellant argued that the decision in Breadsell Ltd. (supra) no longer holds the field. According to Dr. Saraf, provision for ascertained liability is permissible only when

the recovery of a debt becomes doubtful. Therefore, writing off such a doubtful debt cannot be a pre-condition for computation of the profit and loss account by a company as provided in Section 115J of the Act. Dr. Saraf also relied upon the decisions of the hon'ble Supreme Court in State Bank of Patiala, Patiala Vs. Commissioner of Income Tax, Patiala, and National Rayon Corporation Ltd. etc. Vs. Commissioner of Income Tax, wherein the distinction between "provision" and "reserve" has been discussed, in order to show that in the case at hand the amount earmarked as liability by the Board of directors against unrecovered debts is nothing short of provision in respect of ascertained liability within the meaning of Section 115J. Dr. Saraf also relied upon a decision of the Bombay High Court in The Commissioner of Income Tax, Mumbai City - VI Vs. M/s. Echjay Forgings Pvt. Ltd., in support of his contention.

5. In the State Bank of Patiala (supra), the hon'ble Supreme Court was seized with an issue under the Companies (Profits) Surtax Act, 1964. Referring to a number of earlier decisions, the Supreme Court held that if the transfer of an amount is made adhoc where there is no information or anticipated liability, such fund can only be treated as reserve and that where a fund has been credited to meet a liability which has actually arisen and is known on the date of preparation of the balance sheet, it would obviously be a provision. It may be mentioned here that a distinction between a provision and a reserve in commercial parlour is well-known. Provision made against anticipated loss and contingencies are charges against profits and to be taken into account in course of receipt and profits and loss account in the balance sheet while reserves are appropriation of profits, the asset by which they are represented being retained by forming part of the capital employed in the business. An amount set aside out of profits and not designed to meet a liability is reserve, but an amount set aside out of profits to provide for any known liability of which the amount cannot be determined with substantial accuracy is a provision. The hon'ble Supreme Court also approved the contention that where the liability has actually arisen or is anticipated legitimately by the assessee though the quantum of the liability has not been determined, a fund to meet such a liability cannot be treated as reserve. In National Rayon Corporation Ltd. (supra), the Supreme Court observed that if an amount is retained by way of providing for a known liability, that amount shall not be treated as reserve. This observation has been rendered in the context of provisions of Clause 7(2)(b) of the Act of 1964. In Echajay Forgings (P.) Ltd. (supra), the Bombay High Court was seized with a number of questions including the question about the legality and validity of addition of Rs. 1,64,411 being the provision for doubtful debts. The Bombay High Court also held that a provision made for ascertained liability is not to be added into the books of accounts for the purpose of taxation u/s 115J.

6. In the instant case, there is no dispute that the assessee has made a provision for doubtful debt to the tune of Rs. 11,52,221 for the relevant assessment year. The amount has been determined by the Board of directors who are the only authority

competent to determine the extent of doubtful debts. There is also no dispute that the appellant's profit has been computed as per provisions of Parts II and III of Schedule VI of the Companies Act, 1956. The provisions made for doubtful debt for diminution in the value of the assets, i.e., sundry debt is fully supported by the opinion of the directors. The learned Tribunal allowed the appeal by the Revenue directing addition of Rs. 11,52,221 on the ground that it was not written-off as the actual bad debt, relying upon the decision in Breadsell Ltd. (supra). The learned Tribunal was oblivious of the fact that a provision made against doubtful debt would be of no purpose if such debts are written off. The decisions of the hon'ble Supreme Court, as discussed above, leave no scope for doubt that any amount retained as profit for any known liability is a provision and the amount retained in excess of the known liability is reserve. In the instant case, the Board of directors is the best authority to ascertain the extent of liability and once they so decide, the amount retained on that count providing for known liability cannot be added with the profit and loss account. The assessing officer is not authorized to scrutinize the accounts duly submitted with audit report and to question the decision of the Board of directors. (See [National Rayon Corporation Ltd. etc. Vs. Commissioner of Income Tax, and Apollo Tyres Ltd. Vs. Commissioner of Income Tax, Kochi, \).](#)

7. Mr. Bhuyan, learned Counsel for the Revenue relied upon the decisions of the hon'ble Supreme Court in [Murarilal Mahabir Prasad and Others Vs. Shri B.R. Vad and Others, and Apollo Tyres Ltd. Vs. Commissioner of Income Tax, Kochi, .](#) In M/s. Murarilal Mahabir Prasad (supra), in para-12, the principles of interpretation of the language of taxing statute has been explained. The decision in Apollo Tyres Ltd. (supra) on the other hand shows that the assessing officer cannot scrutinize the profit and loss accounts of the assessee-company certified by the statutory auditors. The questions raised and answered in that case in our considered view is of no help in the given context of the case at hand. The directors have formed an opinion as to what is reasonably necessary for meeting the known liability against debts due. The profits and loss account have been prepared as per relevant provision of the Companies Act, 1956 and the same is not in dispute. Regular accounting procedures have been followed. Directors opinion shows that as against doubtful debts of Rs. 51,79,064 and doubtful advance of Rs. 2,40,132, a sum of Rs. 11,52,221 has been provided for during the assessment year, as considered adequate by the management in view of the continued efforts for recovery. Therefore, the claim of the assessee could not be rejected simply on the ground that the doubtful debts have not been written off as actual bad debts.

8. For discussions above, we set aside the order dated 8.10.2002 of the learned Tribunal and answer the questions formulated in favour of the assessee and against the Revenue.

9. The appeal is allowed in terms of the above observations.