(2014) 10 MAD CK 0254

Madras High Court

Case No: Tax Case (Appeal) No. 512 of 2014

The Commissioner of Income Tax	APPELLANT
Vs	
Tyco Sanmar Limited	RESPONDENT

Date of Decision: Oct. 27, 2014

Acts Referred:

- Income Tax Act, 1961 - Section 143(3), 148, 36(2)

Citation: (2015) 370 ITR 173

Hon'ble Judges: R. Sudhakar, J; R. Karuppiah, J

Bench: Division Bench

Judgement

R. Sudhakar, J.

This Tax Case (Appeal) is filed by the Revenue as against the order of the Income Tax Appellate Tribunal for the assessment year 2005-06.

2. The respondent/assessee is engaged in the manufacturing and selling of safety relief valves. The assessee filed return of income on 26.10.2005 declaring a sum of Rs. 12,64,00,710/-. During the financial year ending 31.03.2005, they sold goods to M/s. Tyco Valves and Controls, L.P. USA. In the invoice, the respondent/assessee/exporter erroneously applied surcharge for Ferry Moly in respect of certain exports, though the component did not contain Ferry Moly. In respect of other goods, higher rate of surcharge was applied erroneously. The discrepancy, on account of the erroneous levy of surcharge, amounted to Rs. 1.68 crores, which was noticed by the assessee at the time of finalisation of audit for the financial year 2004-05. On noticing the discrepancy, the assessee rectified the mistake by issue of credit notes, which resulted in reinstatement of the sales and also the debtors. The error was noticed by the assessee somewhere in May, 2005 during the time of audit for the purpose of filing the returns and the correction was made in the return filed on 26.10.2005. In order to justify the rectification of the invoices on the excess of surcharge and also to comply with the requirements of

Reserve Bank of India Master Circular No.C-15, the assessee obtained permission from the authorised dealer, namely, Corporation Bank for regularising the transaction, as it relates to export sales. This letter of the authorised dealer was issued on 16.11.2005.

3. The assessment in this case was completed under Section 143(3) of the Income Tax Act on 10.12.2008 and subsequently notice under Section 148 was issued on 26.3.2010 for disallowance of Rs. 1.68 crores, which is relatable to the issue of excess billing made to the customer from the total sales. In response to the said notice, the assessee filed their reply. After considering the reply filed by the assessee, the Assessing Officer disallowed the claim of the assessee on the ground that under the mercantile system of accounting followed by the assessee, as and when the bills are raised, the same should be offered to tax and that any amount that could not be realised can be written off as bad debts subject to the conditions stipulated under Section 36(2) of the Income Tax Act. Further, in this case, the sale proceeds are to be realised in foreign currency and the permission to write off the above debts have been given by the Corporation Bank (authorised dealer), as per RBI Master Circular C-15, on 16.11.2005, i.e., during the financial year 2005-06, whereas the debt has been claimed by the assessee in the financial year 2004-05 by netting the bad debts from the sale proceeds, which according to the Assessing Officer is not in order.

4. Aggrieved by the order of the Assessing Officer, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals), who on considering the above fact and the plea of the assessee that the higher rate charged in the invoice on account of surcharge applied erroneously, which resulted in higher claim of Rs. 1.68 crores, which was not lawfully due to the assessee and having realised the same at the time of accounting for the purpose of filing the return, they have rectified the mistake by issue of credit notes in respect of the sale invoice. According to the assessee, it is the re-instating of the credit sale value, the proper revenue due to the assessee has been set out in the return and consequently, the profit of the company for the financial year 2004-05 has been properly stated. The question of bad debt will arise, when there is sale of goods and the consideration of which both the parties accept and the buyer later on fails to honour the sale commitment either in part or in total. There is no dispute either by the assessee or by the overseas buyer that the error is in respect of surcharge and not otherwise. It is, therefore, not a case of bad debt relatable to goods sold and delivered. It is also not a case of the Department that the amount in issue is in relation to the actual value of goods sold and delivered. In other words, the Department accepts excess amount in invoice on account of erroneous claim on surcharge. Therefore, the assessee pleaded that when there is no case of debt on sale, the question of writing off the bad debt will not arise.

5. The Commissioner of Income Tax (Appeals) agreed with the plea of the assessee and allowed the appeal holding as follows:

"8. The contentions of the AR have been considered carefully. For making disallowance of Rs. 1.68 crore the AO relied only on the fact that Corporation Bank being the authorized dealer issued permission to issue credit notes for US dollar 515929 towards the amounts excess charged on M/s. Tyco Valves and Controls, Stafford, USA and to write off at the appellant''s end as per RBI circular. AO has not disputed the contention of the appellant that accounting of sales of Rs. 1.68 crores to M/s. Tyco Valves & Controls, USA is on account of error. It is well settled that what is to be taxed is the real income unless the purpose of the transaction is to defeat the fundamental principal of the Act State Bank of Travancore Vs. Commissioner of Income Tax, Kerala, , which in my opinion is not the case given the facts of the case of the appellant. It does not result at all, there cannot be tax, even though in book-keeping an entry is made about a ''hypothetical income'' which does not materialize Commissioner of Income Tax, Bombay City I Vs. Shoorji Vallabhdas and Co., In the case of the appellant, the book-keeping entry is due to error of commission and hence the judgement is more relevant. Therefore, I am of the considered view that the AO is directed to allow the claim."

6. As against the order of the Commissioner of Income Tax (Appeals), the Revenue went on appeal before the Income Tax Appellate Tribunal. The Tribunal opined in favour of the assessee and held that when the assessee recognised the mistake, it had reversed the entries; the error was rectifiable only at the end of the financial year and if there was no real income for the purpose of tax, no tax could be imposed on hypothetical income. Accordingly, the Tribunal dismissed the appeal filed by the Revenue. The Tribunal held as follows:

"6. We have perused the orders and heard the rival submissions. There is no dispute that assessee had excess billed its customers for a sum of Rs. 1.68 Crores on account of wrong application of surcharge on Ferro Moly and Nickel which were used in manufacture in the products supplied by it to its customers. No doubt, assessee became aware of error only at the time of audit which was after the end of the year. In our opinion, correction of an error in billing and effecting a write-off of bad debt are entirely different. Any businessman with good reputation will not bill his customers in excess of what is legitimately due as per contracts. When assessee found that it had billed something incorrectly, it passed credit notes and reduced the bill amount and correspondingly reduced the debts also. This cannot, in our opinion, be equated with a bad debt write -off. The customers were not legally and lawfully bound to pay such excess amount to the assessee and when there is no legal right vested on the assessee to recover the amount from the customers, there cannot be any debtors at all. When the assessee itself had recognized the mistake, it passed reversal entries. Just because assessee had come to know of the error only after the end of year will not mean that it should be taxed on amounts which were never its income. As noted by the ld. CIT(Appeals), endeavour of the Revenue should be to tax real income and not hypothetical income. We are of the opinion that ld. CIT(Appeals) was well justified in deleting the addition. No interference is called for."

7. Aggrieved by the order of the Tribunal, the present Tax Case (Appeal) has been filed. The Revenue canvassed the issue on the following substantial question of law:

"Whether in the facts and circumstances of the case, the Tribunal was right in not treating the reversal of incorrect bill entries as write off of bad debts?"

8. Learned Standing counsel appearing for the Revenue supporting the findings of the Assessing Officer contended that when the assessee sought permission through the authorised dealer - Corporation Bank seeking to write off the above bad debt, which was granted on 16.11.2005, in the financial year 2005-06, the assessee could not claim benefit for the financial year 2004-05. Therefore, Section 36(2) of the Income Tax Act gets attracted. In any event, by correcting the sale price in the invoice and filing a return on such income on the basis of the corrected invoice, the assessee cannot claim benefit of bad debt for the same financial year, viz., 2004-05 (assessment year 2005-06). Even as per the letter dated 16.11.2005 issued by the Corporation Bank, they can claim such a benefit for the financial year 2005-06, viz., assessment year 2006-07 and not 2005-06. Hence, the order of the Tribunal has to be set aside.

9. Though this argument appears to be appealing at the first blush, on going through the facts, as has been discussed by the Commissioner of Income Tax (Appeals) and the Income Tax Appellate Tribunal, it is clear that the sum of Rs. 1.68 crores, on the excess billing by the assessee on account of the wrong application of surcharge of Ferry Moly and Nickel, which were used in the manufacture of products supplied to the customer, cannot partake the character of the bad debt. When admittedly the liability to surcharge did not accrue with the sale of the goods during the financial year ending 31.3.2005 and the error in the bill came to be noticed by the assessee at the time of audit at the end of the financial year, which occasioned the correction of the error in the billing, it cannot be equated to that of writing off bad debt, which calls for totally a different nature of transaction. If goods have been actually sold and the sale proceeds are not realised, then the question of bad debt would arise. In this case, no goods to the value to support the value of Rs. 1.68 crores were sold and delivered, to become due or bad debt. The assessee found that it had billed the purchaser incorrectly and therefore issued credit notes and reduced the bill amount and correspondingly revised the debts as well. Hence, the Tribunal was correct in holding that it is not a case of writing off a bad debt. The buyer was not legally or lawfully bound to pay the surcharge amount to the assessee and the assessee was not legally entitled to recover the same from the buyer. Therefore, it cannot be said that there is an of element of bad debt, which has to be written off.

10. The next question that would arise is whether the letter of the authorised dealer dated 16.11.2005 would clothe this transaction in the manner in which the Revenue wants to do. We are afraid that such a position may not arise in the present case, as the assessee in this case had complied with the requirement of the RBI Master circular C-15 for regularising the transaction, which is an export sale. The excess

amount on account of surcharge which is not lawfully recoverable has to be set right, for which, permission of the Reserve Bank of India is required in a procedure prescribed. That by itself will not make the amount of Rs. 1.68 crores a bad debt. If the assessee does not follow the procedure, it would entail consequent legal action under the relevant provisions of the Foreign Exchange laws. In this case, the assessee had noticed the error and rectified the same in the balance sheet before the return was filed. It offered to tax the actual income and deleted the income, which is relatable to the erroneous claim under surcharge. Hence, the Tribunal was justified in holding that there is no question of tax on a hypothetical income. We find no error in the order of Tribunal.

11. Accordingly, we find no question of law much less any substantial question of law arises for consideration in this appeal. The order of the Income Tax Appellate Tribunal stands confirmed and this Tax Case (Appeal) stands dismissed. No costs.