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**(2002) 02 CAL CK 0028**

**Calcutta High Court**

**Case No:** IT Ref. No. 48 of 1995 20 February 2002 A.Y. 1976-77

Commissioner of Income Tax

APPELLANT

Vs

AVERY INDIA LTD.

RESPONDENT

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**Date of Decision:** Feb. 20, 2002

**Citation:** (2002) 174 CTR 426

**Hon'ble Judges:** Maharaja Sinha, J; Ajoy Nath Ray, J

**Bench:** Full Bench

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### **Judgement**

@JUDGMENTTAG-ORDER

By the Court

Five assessment years are involved in this reference but we deal with the question with reference to only one of those as a representative and prototype assessment year.

That one is the assessment year 1976-77.

The question referred to us is as follows :

"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in not confirming the order of the Commissioner (Appeals) in respect of bad and doubtful debt reserves."

2. The point whether bad and doubtful debts were correctly classed as reserves by the Tribunal becomes relevant in view of the Companies (Profits) Surtax Act, 1964.

Under that Act the capital base of the company has an effect on the incidence of the liability of surtax. The profit remaining the same, the surtax would become lessened as the capital base of the company became broadened.

It was thus in the interest of the assessee-respondent to emphasise that the bad and doubtful debts also form reserves in the true sense of the term. This is because

a reserve true and proper, and not merely so-called by the accountant of the company, is, without doubt a part of the capital base.

Under the Second Schedule of the said Act the computation of the company's capital is to be made. The first clause of the said Schedule provides that the capital of a company shall be taken as on the first day of the previous year relevant to the assessment year.

In the said clause under sub-clause (ii) the reserves of a company are included. The Explanation to the said clause mentions some items, in relation to standard corporate accounts, which are not to be regarded as reserve or capital for the computation of corporate surtax.

3. The facts of this case, set out in a very brief compass are as follows:

The opening balance for the assessment year under review showed an amount of Rs. 18,09,370 as the carried forward reserve for bad and doubtful debts.

During the said year, a fresh amount of Rs. 1,49,398 was added to the said opening balance. The bad and doubtful debts thus aggregated Rs. 19,58,768 taking the entire year into consideration.

It is also an admitted fact a sum of Rs. 15,40,400 was written back or charged to the P&L a/c during the year in question leaving a balance amount of Rs. 4,18,368.

This amount of Rs. 4,18,368 is the amount in question before us. The company would have us answer that this is a part of the company's capital base but the revenue contends otherwise. May be, the requirement that the capital as on the first day of the year is made was not given proper importance at any stage, but we do not want to enter into this extra side issue entirely on our own.

It is also an admitted fact that in regard to the writing back of the said amount of Rs. 15,40,400, the company had followed its usual practice of charging an ad hoc percentage of the bad and doubtful debts to its P&L a/c in every different previous year. It is the clear contention of the assessee that this writing back of the ad hoc percentage of the sum total of bad and doubtful debts did not bear any particular relation to any specified debt owed to the company.

The Commissioner (Appeals) had found in favour of the revenue. From the decision of the Tribunal we find (specifically from page 77 of the paper book) that the bad and doubtful debt reserve of Rs. 18,09,370 as the opening balance on 1-1-1975, was noted by the Tribunal, it further noted that identical contentions as raised by the assessee before the Tribunal were accepted by the Commissioner (Appeals) for the assessment year 1975-76. The Tribunal noted that the order for the assessment year 1975-76 had become final and the department had not contested it. In that order the bad and doubtful debt reserve of Rs. 18,09,370 was mentioned. The Tribunal thereafter opined that in view of this accepted position for the assessment year next

preceding, the opening balance in respect of the bad and doubtful debt reserve was correct. It further went on to hold that the reserve for bad and doubtful debts, as claimed by the assessee, were to be treated as part of the capital for surtax purposes.

4. We need not go into the authorities for two very simple propositions of law, although some authorities will be considered hereafter. The first proposition is that a decision taken in regard to an earlier assessment year does not operate as a res judicata for a subsequent assessment year. Thus the Tribunal's decision has to be judged on its merits as to the correct application of the law for the assessment year 1976-77 itself, whatever might have been the decision of the Commissioner (Appeals) for the assessment year 1975-76.

5. The second simple proposition of law is that even if the company and the company's accountants call the bad and doubtful debt amount as a reserve, yet the true nature of the fund has to be examined and the nomenclature given by the accountant is by no means finally determinative or an end of the matter altogether.

The basic difference of approach to the present issue as between the revenue and the assessee was that the revenue characterized the amount in question as a provision made by the company for bad and doubtful debts and, therefore, this could not form the company's capital base., the assessee, on the other hand, was at pains to argue that this amount formed a reserve by the company not merely as called by the accountants and not merely as accepted even by the Commissioner (Appeals) in the very earlier year, but as a true and correct picture of the actual accounting position, as shown by the company's practice followed from year to year.

6. Mr. Deb appearing in support of the revenue placed before us passages from Pickle's Accountancy and also two Division Bench judgments of our High Court given respectively in the cases of [Commissioner of Income Tax and Super Profits Tax Vs. Eyre Smelting Pvt. Ltd.](#), and [Commissioner of Income Tax Vs. Jugantar P. Ltd.](#) . The difference between reserves and provisions in a company's accounts is very well-examined in these cases and we need not tread the ground which has been already trod there. Both Mr. Deb and Dr. Pal appearing for the assessee relied on two Supreme Court cases also, viz. the case of [Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad](#), and also the case of CIT v. Saran Engineering (1987) 161 ITR 741 , the latter being particularly relied upon by Dr. Pal, as the Tribunal had also relied upon this case.

Dr. Pal showed us passages from Vazir Sultan's case to emphasise that even a bad and doubtful debt account is not necessarily a provision in a company's hands because if the amount mentioned there is no reasonably necessary to cover the bad and doubtful debt account, then and in that event the excess provision becomes a

reserve.

For this proposition, i.e., that an excess provision must be treated as reserve and thus very similar to the free capital base of company, Dr. Pal also gave us the case of [Commissioner of Income Tax Vs. Jyoti Ltd.](#), where, in a passage at p. 399 dicta can be found to the said effect.

7. In the case of Jyoti Ltd. (supra), a sum of Rs. 85,000 was opined by their Lordships of the Supreme Court to be a reserve, although the sum came under the heading of bad and doubtful debt. Their Lordships pointed out that it was a sum which was more than reasonably necessary to cover any known liability and no actual bad debt could be pointed out which could be fitted to this sum. The amount, therefore, got released into the area of reserve.

8. If we take the case of Saran Engineering (supra), almost a similar position would be found; the passage at page 744 is important in this regard. A sum of Rs. 5 lakhs was in issue. Justice Sabyasachi Mukherjee, as his Lordship then was, delivered the judgment there as his Lordship had delivered the judgment in the above Jugantar case (supra) also when taking the Reference Bench in our High Court. His Lordship pointed out that the said sum of Rs. 5 lakhs, although under bad and doubtful debts reserve, appeared to be more than the amount reasonably necessary to be provided in respect of bad and doubtful debts; the assessee's case before the Supreme Court was that a separate provision was made for bad and doubtful debts. His Lordship recorded that it was not the revenue's case that the provision for bad and doubtful debts was less than the amount reasonably necessary. As soon as these findings were reached, the sum of Rs. 5 lakhs escaped from the bonds of the reasonable necessity for provision and it became a reserve even though classed by the accountant as a bad and doubtful debt.

9. There is nothing on record in our case to show that the sum under bad and doubtful debt, which the company's accountants have called a reserve, are actually so. No particular debts have been pinpointed and it has been the company's admitted practice that out of the bad and doubtful debts only an ad hoc percentage is written off and charged to the profit and loss account in every accounting year. The Tribunal has gone very largely by the fact that the entirety of the bad and doubtful debts was treated as a reserve for the assessment year 1975-76 and thus, if it was a reserve, it must have continued to be so also throughout the year in question before us. No doubt, if the Tribunal had found that the bad and doubtful reserve was an unreasonably unnecessary excess which the company did not reasonably need to provide for its bad and doubtful debts reasonably and properly so-called, then and in that event the excess provision could be called reserves and perhaps even reserves for bad and doubtful debts, but there is absolutely no justification to come to this conclusion from the facts found by the Tribunal.

10. Before parting with this case, we would point out that although accountants are free to use their technique in the manner they best think fit, and no doubt they know the techniques and speciality of their subject more than a layman, yet a bad and doubtful debt, although strictly an asset, is supposed to be an asset which has practically gone the way of all flesh, only it remains to be knocked off, from the P&L a/c in a particular accounting year, and to claim the necessary deduction on the reasonable estimate of the asset being lost when no reasonable rays of hope remain for its recovery. But regularly to class a reserve head, as a reserve for bad and doubtful debts, is to create a confusion by joining two items which are ordinarily incompatible.

However, whatever be the accounting nomenclature, the true state of things have to be looked into. This is the standard law and even in the two Supreme Court cases we have mentioned above this would be found repeated with the usual authority.

Thus, the reference is decided in favour of the revenue and the question is answered in the negative.

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