IN THE INCOME TAX APPELLATE TRIBUNAL
AHMEDABAD BENCH " A "

Before Shri MUKUL KUMAR SHRAWAT, JUDICIAL MEMBER
and Shri A. K. GARODIA, ACCOUNTANT MEMBER

I.T.A. No. 3774/ Ahd/2008
(Assessment year 2005-06)

M/s. Hindusthan MI Swaco Limited, (formerly Hindusthan Magcobar Chemicals Ltd.,) 208/1, GIDC Industrial Area, Panoli (via Ankleshwar) - 394116	Vs.	DCIT, Bharuch Circle, Bharuch

PAN/GIR No. : AAACH5320B

(APPELLANT) .. (RESPONDENT)

Appellant by: Shri R. S. Singhvi, AR
Respondent by: Shri S. K. Meena, Sr. DR

O R D E R

PER SHRI A. K. GARODIA, AM:-

This is assessee's appeal directed against ht order of Ld. CIT(A) V, Baroda dated 21.08.2008 for the assessment year 2005-06.

2. Ground No.1 of the appeal reads as under:

> 1) "The Id. Commissioner of Income Tax (Appeals)-VI, Baroda has erred in law and in facts in confirming the addition of Rs. 65,00,000/- being the amount written off by the appellant as non-recoverable addition made being in complete disregard of the law and in facts deserves to be allowed as claimed."

3. The brief facts of the case are that it is noted by the A.O. in its order that the assessee had claimed bad debts of Rs.65,00,000/-. It is further noted by the A.O. that the assessee company has given Inter Corporate Deposit (ICD) of Rs.65 lacs to VHEL Industries Ltd. It is also noted by the A.O. that the assessee has stated that a suit in the jurisdictional court has been filed under the Negotiable Instruments Act 1981 for the recovery of the principal loan with interest. The A.O. was of the opinion that since the assessee has filed a suit in the jurisdictional court, it cannot be said that the amount is irrecoverable. The A.O. also noted that the matter is pending with the court and there is every possibility of recovery of the amount in question. After hearing the assessee, the A.O. held that in view of this fact that the assessee has filed criminal case against the defaulter company i.e. M/s. VHEL industries Ltd., the assessee still hopes to recover the money and hence, it cannot be said that this money has become irrecoverable. The A.O. held that the debt in the present case has not become irrecoverable. The 2nd allegation of the A.O. is that in the course of assessment proceeding, the assessee was asked as to whether the assessee is in the business of money lending/NBFC and if so, he asked the assessee to furnish necessary supporting documents. In reply, it was submitted by the assessee before the A.O. that the assessee is neither in the money lending business nor NBFC and hence, no document is required to be submitted. Thereafter, the A.O. has observed in para 7.7 of the assessment order that as per the provisions of Section 36(2) of the Income tax Act, 1961, principal amount representing money lent in the ordinary course of business and becoming bad debt, is allowed to be deducted. The A.O. held that since the assessee is not covered under this provision, the assessee cannot claim the principal amount as bad

debt. On these two basis, the A.O. rejected the claim of the assessee regarding deduction on account of bad debt of Rs.65 lacs. Being aggrieved, the assessee carried the matter in appeal before CIT(A) but without success and now, the assessee is in further paella before us.

4. It was submitted by the Ld. A.R. of the assessee that the amount in question was advanced by the assessee as ICD in the assessment year 1996-97. In this regard, our attention w as drawn to page 38 of the paper book which is a request letter dated 06.02.1996 from VHEL Industries Ltd. to the assessee requesting for short term loan. Our attention was also drawn to page 39 of the paper book as per which short term loan of Rs.75 lacs was given by the assessee to that party. It was submitted by the Ld. A.R. that out of this amount of Rs.75 lacs advanced in the month of Feb 1996, the assessee bas received back an amount of Rs.10 lacs and the balance amount of Rs.65 lacs is outstanding from that account only. It was submitted that regarding the first allegation of the A.O. that the debt has not become irrecoverable, the issue is settled now as per the judgment of Hon'ble Apex Court rendered in the case of TRF Ltd. Vs CIT as reported in 323 ITR 397 (S.C.).

5. Regarding the 2nd allegation of the A.O. that since the assessee is not in the money lending business, deduction cannot be allowed on account of principal amount, it is submitted that this issue also is now covered in favour of the assessee by various tribunal decisions as under:

(a) ITW Sugar India Ltd. Vs DCIT 110 TTJ 117 (Hyd.)

(b) Poysha Oxygen (P) Ltd., Vs ACIT 10 SOT 711 (Del.)

(c) CIT Vs Tulip Star Hotels Ltd. 57 DTR 210 (Del.) H.C.

6. It was submitted that in all these cases, the facts are identical. As in the present case, in these cases also, the amount in question was advanced by the assessee by way of ICD and it was held by the tribunal in two cases and

by the Hon'ble Delhi High Court in the case of Tulip Star Hotels (supra) that when the amount in question was given by way of ICD, it is to be treated as debt and such debt having become bad, it qualifies for deduction u/s 36(1)(vii) of the Act. It was also held that provisions of clause (i) of Section 36(2) do not come in the way of the assessee since the money was lent in the ordinary course of money lending carried out by the assessee. Our attention was drawn to this finding of the tribunal in the case of Poysha Oxygen (P) Ltd. (supra) in para 19 of the judgement that if the interest for the money lent was assessed as business income in the earlier year or even in the year in which the bad debt is written off, conditions stipulated in Section 36(2)(i) is satisfied. It is pointed out by the Ld. A.R. that in the present case also, the interest income pertaining to this ICD has been assessed as business income. He drawn our attention to the copy of the assessment order passed by the A.O. u/s143(3) in assessment year 1996-97 i.e. 1st year in which the amount in question was lent by the assessee. It is submitted that the copy of this assessment order is available on pages 31.-37 of the paper book. He drawn our attention to the computation as per this assessment order and shown to us that the entire income in that year was assessed by the A.O. as business income and the A.O. also allowed deduction u/s 80HH to the extent of 20% of gross total income in that year. It has also been submitted by him that the P & L account of the assessee of that year is available on pages 12 of the paper book, which shows profit before taxation is of Rs.66,39,358/- and in the assessment order of that year, the A.O. is starting the computation of income with this figure only. He also drawn our attention to page 19 of the paper book containing details of other income in that year which include Rs.14,97,670/- on account of interest income. It is also submitted that in the present year also, the A.O. made an addition of Rs.13 lacs on account of

interest income of this very ICD and made addition of Rs.13 lacs and this addition was made by him in the head 'income from business' and there is no addition made by the A.O. in the head 'income from other sources'. It is submitted that although this addition on account of interest income made by the A.O. has been deleted by the Ld. CIT(A) but the fact remains that even in the present year, the A.O. has treated the interest income on this ICD as 'income form business'. It is also submitted that as per the decision of CIT(A) in para 2.3, this addition of Rs.13 lacs on account of interest income was deleted with the remark that in case if after outcome of the suit, the assessee receives interest in respect of assessment year 2005-06, the same would be taxable in that year. It is submitted that if the assessee receives this amount of interest at any time then the same will be included in the income of the assessee as business income only of the present year. It is submitted that the facts are identical in the present case as compared to the facts in the case of Poysha Oxygen Pvt. Ltd. (supra).

7. He again drawn our attention to para 12 of the tribunal decision in the case of ITW SIGNODE India Ltd. (supra) and it is submitted that this finding is given by the tribunal in that case that advancing of ICD, is in the usual course of business and if the company is doing so, it need not be in money lending business and advancing of ICD is in the normal course of business, the loss arising therefrom cannot be anything else but such loss is in the usual course of business. It is submitted that as per this judgment also, when the money is lent by the assessee by way of ICD, there is no further requirement that the assessee must be doing money lending business. To bring home this position that the money lent by the assessee company is in the form of ICD and the same was actually written off, he drawn our attention to the audited balance sheet of the assessee company for the year

ended 31.03.2005, copy of which was submitted before us. It is submitted that it can be seen in the P & L account for the present year that an amount of Rs.65 lacs was debited on account of extra ordinary item. He has drawn our attention to page 16 of the balance sheet being Schedule 8 where it is shown that the amount outstanding as on 3.103.2004 as ICD was Rs.65 lacs which has been reduced to Rs. 'nil' as on 31.03.2005. It is submitted that these facts show that the amount in question was advanced by the assessee by way of ICD and the same was actually written off in the present year.

8. As against this, the Ld. D.R. of the revenue supported the orders of authorities below.

9. We have considered the rival submission, perused the material on record and have gone through the orders of authorities below and the judgements cited by the Ld. A.R. of the assessee. We find that the amount in question was advanced by the assessee in the month of Feb 1996 and in the balance sheet for the year ended 31.03.1996, the same is appearing under the head 'current assets' and sub-heading 'Inter Corporate Deposits (ICD)' as per balance sheet available in the paper book of which relevant pages are 10 and 17 and it is not under the heading 'investments'. In the balance sheet for the year ended 2004 also, the amount in question was shown as outstanding against the item ICD under the heading "loans & advances", which is a current asset and it is not under the heading "investments". Hence, this fact is available on record that the amount in question was advanced by the assessee by way of ICD. This is not the objection of the A.O. that the assessee has not written off the amount in question in the books of account. The allegations of the A.O. are two; first objection is this that the debt has not become bad or doubtful. This aspect is now covered in favour of the assessee by the judgment of Hon'ble Apex Court that after the

amendment in the provisions of Section 36(1) (vii) of the Income tax Act, 1961 w.e.f. 01.04.1989 that in order to obtain a deduction in relation to bad debt, it is not necessary for the assessee to establish that the debt in fact has become irrecoverable and it is enough if the bad debt is written of as irrecoverable in the account of the assessee. Since in the present case, this is not disputed by the A.O. that the assessee has written off the amount in question in its account, this allegation of the A.O. that the debt has not become bad, is not valid and hence, rejected by respectfully following the judgment of Hon'ble Apex Court in the case of TRF Ltd. (supra).

10. The 2nd allegation of the A.O. is that the assessee is not in money lending business and hence, the assessee is not eligible for deduction as bad debt for the principal amount of loan given by the assessee. This aspect is now covered in favour of the assessee by the decision of the Tribunal rendered in the case of Poysha Oxygen Pvt. Ltd. (Supra). In that case, the tribunal has decided on this basis that if the interest income for the money lent is being assessed as business income in any earlier year or even in the year in which the bad debt is written off, the requirement of Section 36(2)(i) is satisfied. While holding so, the tribunal has followed the judgement of Hon'ble High Court of Madras rendered in the case of CIT Vs City Motor Service Ltd. 61 ITR 418. The relevant para of this decision is para 19, which is reproduced below:

> "19. The learned AM has stated in paragraph 19 of the order that "Admittedly the amount of bad debt claimed by the assessee has not been taken into account in computing the income of the assessee in any of the previous year". The observations which follow indicate that the learned AM took the above view because in his opinion the amount of Rs. 1 crore advanced to FMLC did not represent money lent in the ordinary course of the business as money-lender. This point has already been discussed by me and I have held that the amount-represented money-lending advance. In the case of money-lending advance, the only way in which the conditions stipulated. in section 36(2)(i) of the Act, namely,-that then debt should have been "taker)

into account" in computing the income of the assessee of the previous year in which, the debts written off, or of an-earlier previous year, can be satisfied is to see if the interest on the advance was assessed as the assessee's business income. I must here refer to the judgment of the Madras High Court in CIT- vs. City Motor Service Lid. (1966) 61 ITR 418 in which judgment this aspect was considered. That case resembles the present case on facts. The company had the power under its memorandum of association to advance monies for interest. In respect of advances given to Sungo Limited, the revenue brought to charge the interest "due as business income of the assessee. In fact, in years where the assessee did not offer any income on the footing that it did not realize the same the revenue insisted that since Sungo Limited was in a sound financial position the assessee ought to have charged interest and thus added interest as its business income. When the assessee could not recover the debt and claimed it as bad debt under section 10(2)(xi) of the 1922 Act (forerunner of section 36(1)(vii) of the 1961 Act) the revenue contended that the assessee was not entitled to the allowance since the debt, if realized, would not have gone lo "swell the profits" of the business. This contention was repelled by Hon'ble Justice Veeraswami, as His Lordship then was. Speaking for the Division Bench, His Lordship observed :

> •Learned counsel appearing for the revenue contends that the requisite that the debt if realized should have gone to swell the profits of the business is not satisfied. We are unable to accept this contention. The fact that in the previous assessment years the revenue brought to charge the interest due from advances made by the assessee to Sungo Limited demonstrates that the debt did go to swell the business profits of the assessee. As we mentioned earlier, the interest so due to the assessee was treated by the revenue itself throughout as business income. It cannot, therefore, be pretended that the debt was not one In which if realized would not have gone to swell the business profits of the assessee. The memorandum of association of the assessee-company empowered it to carry on business as financiers and also lo lend, deposit or advance monies on such terms as might seem expedient, the financing of the monies being confined to the parties doing business similar to that of the assessee. When the assessee made advances to Sungo Limited, which was dealing in shares, it was within the power of the assessee-company and it could well be described as in the course of carrying on its business. When monies are so advanced as incidental to and in the course of its business, often the advances would constitute a debt which, when realized, would go to swell the profits of the business. Actually, in this case the advances did go to swell the business profits of the assessee."

Thus, there is authority for the proposition that where monies are lent in the ordinary course of the business, the condition stipulated in section 36(2)(i) is satisfied if the interest from the monies lent was assessed as business income in the earlier years or even in the year in which the bad debt is written off. What has been laid down in the judgment of the Madras High Court has found- expression in section 36(2)(i). It is not worthy that the present section uses the same language which the judgment uses at pages 421-422 of the report, as can be seen from the sentence (in the judgment): "It is no doubt true

that the amount lent as principal will not by itself swell the -profits and what, is meant is that it is taken into account in the context of c6mputati5n of income" (herein italic). Therefore, if the interest of Rs.17,40,984/- was assessed as business income of the assessee in the assessment order for the assessment year 1996-97 and the interest on the loan was similarly assessed in the assessment order for the assessment year 1997-98, both in orders passed under section 143(3) of the Act. The revenue cannot turn around now and say that the advance to FMLC was not a money-lending advance. I do not, therefore, see with respect, any basis for the observation of the learned AM in paragraph 19 of the order that "Admittedly the amount of bad debt claimed by the assessee has not been taken into account in computing the income of the assessee in any of the previous year". This observation, again with respect, seems to run contrary to the past history of assessments. That apart the learned representative of the assessee did raise a valid point when he submitted that even in the order passed by the Assessing Officer for the year under appeal on 16-8-2004 to give effect to the directions of the CIT (Appeals), he had allowed deduction in respect of the interest of Rs.5,52,329/-, which is the interest for the very year under appeal. This interest was assessed by the Assessing Officer in the assessment order for the year under appeal refusing the assessee's claim for write off of the same along with the principal amount of Rs.1 crore. In the impugned order, the CIT (Appeals) directed the Assessing Officer to verify whether the interest amount of Rs.5,52,329/- was earlier assessed as business income and further directed the Assessing Officer to allow deduction under section 36(l)(vii) in respect of the same if the assessee brings enough material to justify the write off. Pursuant to this direction, the Assessing Officer had verified the assessment record and he has observed in his (Order dated 16-8-2004 that the aforesaid amount of interest has already taxed in the assessment year 19.96.97 and accordingly allowed relief. It is pertinent to mention that against the direction of the CIT (Appeals), no appeal has been preferred by the department before the Tribunal. The relief given by the Assessing Officer in his order dated 16-8-2004 has thus become final, as also the finding that the interest was earlier assessed as business income of the assessee. In the light of these facts, I am unable to agree with the learned AM when he says that the bad debt claimed by the assessee has not been taken into account in computing the assessee's income in any of the earlier previous years or in the impugned year. ”

11. From the above para of this tribunal decision, it is seen that it was held by the tribunal in that case that the conditions stipulated in Section 36(2)(i) is satisfied if interest for money lent was assessed as ‘business income’ in the earlier year or even in the year in which the bad debt is written off. In the present case, the interest income for the money lent was assessed by the A.O. in assessment year 1996-97 under the head ‘income form business’ as per the copy of the assessment order for that year passed by the A.O. u/s143(3). In

the present year also, the interest income on this money lent by the A.O. was added in the income of the assessee under the head 'income form business' although such addition was deleted by the Ld. CIT(A) on this basis that if the money is ultimately realized by the assessee, it will be added in the income of the present year. Hence, as per the department, the interest income on this money lent by the assessee is assessable as business income only even in the present year. This being the position, we find that in the present case, the facts are identical with the facts in the case of Poysha Oxygen Pvt. Ltd. (supra). Hence, by respectfully following this Third Member decision of the tribunal, we hold that the assessee is eligible for deduction as bad debt for the amount of Rs.65 lacs written off by the assessee in the present year which has been advanced by the assessee as ICD in the financial year 1995-96. This ground of the assessee's appeal stands allowed.

12. Grounds No. 2 & 3 are interconnected which red as under:

> "2) The Id. Commissioner of Income Tax (Appeals)-VI, Baroda has erred in law and in facts in holding that in terms of sec. 145A of the Act, the inventory of finished goods was required to be enhanced by the amount of excise duty leviable even though such inventory of finished goods was not removed out of the factory premises. The Id. CIT(A) completely ignored the legal position that the excise duty is leviable on finished goods only at the time of removal of finished goods from the factory premises and not otherwise. The Id. CIT(A) ought to have held that the value of inventory of finished goods was not required to be enhanced by an amount of Rs. 2,24,328/-.
>
> 3) The Id. Commissioner of income Tax (Appeals)-VI, Baroda has further erred in holding that while increasing the value of inventory by the amount of leviable excise duty of Rs. 2,24,3281- would result into creation of liability which, in turn, would be an allowable expenditure u/s. 43B. This finding of the Id. CIT(A) is in complete disregard of the law and therefore deserves to be cancelled."

13. The brief facts of the case are noted by the A.O. in para 9 of the assessment order that on verification of valuation of the closing stock, it is noted that the assessee has valued closing stock of raw material and packing material without considering the excise duty though it has included the excise duty in the value of closing stock of finished goods. The A.O. made addition on this account of Rs.2,24,328/- out of which Rs.1,98,087/- was on account of excise duty of closing stock of raw material and balance amount of Rs.26,241/- was on account of excise duty on closing stock of packing material. Being aggrieved, the assessee carried the matter in appeal before Ld. CIT(A). It is held by the Ld. CIT(A) that as per the amendment in Section 145A w.e.f. 1.8.1999, while valuing the closing stock of inventory, adjustment has to be made with regard to tax, duty, cess & fee actually paid or incurred by the assessee. He held that the amount of actual excise duty paid during the year is allowable expenditure in terms of Section 43B of the Income tax Act, 1961. He confirmed the addition made by the A.O. on this account but directed the A.O. to verify as to whether the assessee has made payment of excise duty before filing the return of income and if so, to allow deduction to that extent u/s 43B. Now, the assessee is in further appeal before us.

14. It is submitted by the Ld. A.R. that excise duty with regard to closing stock of raw material and packing material is not required to be paid afterwards but it is required to be paid at the time of purchase itself. It is submitted that hence, the direction of Ld. CIT(A) should be modified and the A.O. should be directed to verify as to whether any excise duty was paid by the assessee at the time of purchase of raw material and stores and the addition can be made on account of closing stock of raw material and packing material if it is found that the assessee is making payment of excise

duty in respect of purchase of these two items. It is also submitted that the A.O. should also find out as to whether the assessee is debiting the expenses to the P & L account on account of payment of excise duty on purchase of raw material and packing material and in that case only, addition can be made in respect of excise duty on closing stock of raw material and packing material.

15. Ld. D.R. of the revenue supported the orders of authorities below.

16. We have considered the rival submissions, perused the material on record and have gone through the orders of authorities below. We find that two types of accounting systems are generally followed by the assessee in respect of accounting of excise duty paid on purchase of raw material, packing material etc. One method is gross method where the total value of purchase including excise duty is debited to P & L account. In such cases, for the closing stock of raw material and packing material, excise duty component should also be considered for the purpose of valuation of closing stock of those items. 2nd method which is widely followed is this that the excise duty component out of purchase price of raw material/packing material etc, is not debited to the purchase account of the respective items but the same is debited to the excise duty recoverable account for which the assessee is eligible for modvat / cenvat credit in respect of excise duty paid on the purchase of inputs. In such cases, even if the value is added in the value of closing stock of raw material as per the provisions of Section 145A, the assessee is eligible for deduction on account of payment of excise duty at the time of purchase, which is not claimed by the assessee by way of debit in the P & L account and as a result, there will be no actual addition. In the present case, these facts are not available on record as to which system of accounting is being followed by the assessee. We, therefore, feel that the

A.O. should examine this aspect from this angle. The assessee should furnish the relevant details with the evidence before the A.O. regarding the method of accounting system being followed by the assessee. If the assessee is following the 1st method of accounting i.e. gross method then the addition has to be made in the value of closing stock of raw material and packing material in respect of excise duty component as has been done by the A.O. in the present case. But if the assessee is followings the 2nd method of accounting i.e. net basis, then no actual addition is required to be made because if we make addition of excise duty component in the value of closing stock of raw material and packing material, corresponding deduction has to be allowed by including such excise duty component in the value of purchases debited in the P & L account. Accordingly, we modify the direction of the Ld. CIT(A) and the A.O. is directed to decide this issue in the light of above discussion and he should pass necessary order as per law after providing adequate opportunity of being heard to the assessee. In the result, grounds No.2 & 3 of the assessee' appeal, are allowed for statistical purposes.

17. In the result, appeal of the assessee stands allowed in terms indicated above.

18. Order pronounced in the open court on 05th Aug., 2011.

Sd./-	Sd./-
(MUKUL KUMAR SHRAWAT)	(A. K. GARODIA)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Ahmedabad; Dated : 05th Aug., 2011
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Copy of the Order forwarded to:

1. The applicant
2. The Respondent
3. The CIT Concerned
4. The Ld. CIT (Appeals)
5. The DR, Ahmedabad
6. The Guard File

1. Date of dictation……1/8
2. Date on which the typed draft is placed before the Dictating Member……2/8 Other Member ……
3. Date on which the approved draft comes to the Sr. P.S./P.S. 4/8
4. Date on which the fair order is placed before the Dictating Member for pronouncement …5/8
5. Date on which the fair order comes back to the Sr. P.S./P.S. 5/8
6. Date on which the file goes to the Bench Clerk ……05/08/2011
7. Date on which the file goes to the Head Clerk ……..
8. The date on which the file goes to the Assistant Registrar for signature on the order …….
9. Date of Despatch of the order. ……..