

COMMISSIONER OF INCOME TAX-IV, DELHI

v.

M/S HCL COMNET SYSTEMS & SERVICES LTD.

(Civil Appeal No. 5800 of 2008)

SEPTEMBER 23, 2008

[S.H. KAPADIA AND B. SUDERSHAN REDDY, JJ]

Income TAX ACT, 1961:

s. 115JA(2), Second proviso, Explanation, Clause (c) – “Book profit” – Amount set aside as provisions for bad and doubtful debt – Added by A.O. back to “net profit” – HELD: Provision for bad and doubtful debt was made to cover up the debt receivable by the assessee – Such a provision cannot be said to be a provision for liability – Therefore Clause (c) of the Explanation is not attracted to facts of the case – A.O. was not justified in adding back the provision for doubtful debt under Clause (c) of the Explanation.

Words and Phrases:

‘Book profit’, ‘debt’ – Connotation of in the context of s.115JA of Income Tax Act, 1961.

The respondent-assessee, with regard to the assessment year 1997-98, debited an amount of Rs.95,15,187/- on account of bad debts to the ‘profit and loss account’. The A.O. added the said amount back to book profits holding that it was a provision for bad and doubtful debts as per Clause (c) of the Explanation to the second proviso to sub-section (2) of s.115JA of the Income Tax Act, 1961. But, the Commissioner of Income Tax (Appeals), the Income Tax Appellate Tribunal as also the High Court held in favour of the assessee.

In the instant appeal filed by the Revenue, the question for consideration before the Court was as to whether

A the A.O. was justified in adding back the provision for doubtful debts of Rs.95,15,187/- to the net profit under Clause (c) of the Explanation to the second proviso to sub-section (2) of s.115JA of the Income Tax Act, 1961.

Dismissing the appeal, the Court

B

HELD: 1.1 Section 115JA of the Income Tax Act, 1961 which refers to 'deemed income relating to certain companies', has an overriding effect upon other provisions of the Income Tax Act and is applicable only in the case of a company. [para 7] [842-B]

C

1.2 The AO has to accept the authenticity of the accounts maintained in accordance with the provisions of Part II and Part III of Schedule VI to the Companies Act, which are certified by the Auditors and passed by the company in the general meeting. The AO has only the power of examining whether the books of accounts are duly certified by the authorities under the Companies Act and whether such books have been properly maintained in accordance with the Companies Act. He does not have the jurisdiction to go beyond the net profit shown in the profit and loss account except to the extent provided in the Explanation, and has to make adjustment permissible under the Explanation given in Section 115JA of the 1961 Act. [para 9] [843 F-G]

D

1.3 The Explanation has provided six items, i.e. Item Nos.(a) to (f) which if debited to the profit and loss account can be added back to the net profit for computing the book profit. In the instant case, the AO resorted to Item No.(c) which refers to the provision for bad and doubtful debt. The assessee's case would fall within the ambit of Item (c) only if all its ingredients are satisfied, namely, if the amount is set aside as provision; the provision is made for meeting a liability; and the provision should be for an unascertained liability. [para 10] [844 C-D]

E

F

G

H

1.4 A debt payable by the assessee is different from the debt receivable by the assessee. In the instant case "debt" under consideration is "debt receivable" by the assessee, and not any liability payable by the assessee. The provision for bad and doubtful debt, therefore, is made to cover up the probable diminution in the value of asset, i.e. which is an amount receivable by the assessee. Such a provision cannot be said to be a provision for liability, because even if a debt is not recoverable no liability could be fastened upon the assessee. Therefore, Clause (c) of the Explanation is not attracted to the facts of the case. In the circumstances, the A.O. was not justified in adding back the provision for doubtful debts of Rs.92,15,187/- under Clause (c) of the Explanation to the second proviso to sub-section (2) of s.115JA of the 1961 Act. [para 10] [844 F-G 845-A-B]

Apollo Tyres Ltd. v. Commissioner of Income-tax [2002] 255 ITR 273 (SC) - referred to.

Case Law Reference

[2002] 255 ITR 273 (SC) referred to para 8

CIVILAPPELLATE JURISDICTION : Civil Appeal No. 5800 of 2008

From the final Judgment and Order dated 18/5/2007 of the High Court of Delhi at New Delhi in I.T.A. No. 56 of 2007

Naresh Kaushik and B.V. Balaram Das for the Appellant.

M.S. Syali, Peeyoosh Kalra, Aseem Mowar, Mallika Paswal, Mahua C. Kalra and Jagjit Singh Chhabra for the Respondent.

The Judgment of the Court was delivered by

S. H. KAPADIA, J. Leave granted.

2. The short question which arises for determination in this civil appeal filed by the Department is : whether AO was justifi-

A filed in adding back the provision for doubtful debts of Rs.92,15,187/- to the net profit under clause (c) of the Explanation to Section 115JA of the Income-tax Act, 1961.

B 3. In this civil appeal we are concerned with the Assessment Year 1997-98.

C 4. Assessee-company was engaged in trading in data communication equipment and satellite communication services. During the course of assessment proceedings, the AO found that the assessee had debited an amount of Rs.92,15,187/- on account of bad debts to the 'profit and loss account'. However, on the ground that it was a provision for bad and doubtful debts, the AO added the aforesaid amount to the book profits as per Explanation (c) to Section 115JA of the Income-tax Act, 1961 ("1961 Act", for short).

D 5. On appeal, the CIT(A) allowed the assessee's appeal. That decision of CIT(A) stood affirmed by the Tribunal and also by the High Court vide its impugned judgment dated 18.5.07 in ITA No.56 of 2007.

E 6. At the outset, we quote hereinbelow Section 115JA read with clause (c) of the Explanation which defines the expression "book profit" as under:

"Chapter XII-B

F Special provisions relating to certain companies

Deemed income relating to certain companies

G 115JA. (1) Notwithstanding anything contained in any other provisions of this Act, where in the case of an assessee, being a company, the total income, as computed under this Act in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 1997 (hereafter in this section referred to as the relevant previous year) is less than thirty per cent of its book profit, the total income of such assessee chargeable

H

to tax for the relevant previous year shall be deemed to be an amount equal to thirty per cent of such book profit. A

(2) Every assessee, being a company, shall, for the purposes of this section prepare its profit and loss account for the relevant previous year in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956 (1 of 1956) : B

Provided that while preparing profit and loss account, the depreciation shall be calculated on the same method and rates which have been adopted for calculating the depreciation for the purpose of preparing the profit and loss account laid before the company at its annual general meeting in accordance with the provisions of section 210 of the Companies Act, 1956 (1 of 1956): C

Provided further that where a company has adopted or adopts the financial year under the Companies Act, 1956 (1 of 1956), which is different from the previous year under the Act, the method and rates for calculation of depreciation shall correspond to the method and rates which have been adopted for calculating the depreciation for such financial year or part of such financial year falling within the relevant previous year. D E

Explanation.-For the purposes of this section, "book profit" means the net profit as shown in the profit and loss account for the relevant previous year prepared under sub-section (2), as increased by- F

(a) & (b) xxx xxx xxx

(c) the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities; or G

(d), (e) & (f) xxx xxx xxx;

if any amount referred to in clauses (a) to (f) is debited to the profit and loss account, and as reduced by, - H

A	(i) to (viii)	xxx	xxx	xxx
	(3) and (4)	xxx	xxx	xxx"

7. From the above, it is evident that Section 115JA of the 1961 Act which refers to "deemed income relating to certain companies" has an overriding effect upon other provisions of the Income-tax Act. It is applicable only in the case of a company. As per Section 115JA, the AO has to first compute the total income of the assessee as per the provisions of the Income-tax Act. Thereafter, he has to compute 30% of the book profit. Then he has to compare the total income as computed as per the provisions of the Income-tax Act with 30% of book profit computed as per Section 115JA. If 30% of the book profit is more than the total income, then 30% of the book profit shall be deemed to be the "total income" of the assessee for such previous year. As per sub-section (2), the assessee has to prepare the 'profit and loss account' for the relevant previous year in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act. The Explanation defines the words "book profit" which means "net profit" as shown in the profit and loss account for the relevant previous year. Such book profit has to be increased by Item Nos.(a) to (f) of the said Explanation if they are debited to the profit and loss account and from such profit Item Nos.(i) to (ix) of the Explanation are to be reduced. The figure arrived at after the above exercise is the book profit of the assessee for the relevant previous years.

8. This Court has examined the powers of the AO while computing the book profits for the purposes of Section 115J in the case of *Apollo Tyres Ltd. v. Commissioner of Income-tax* – [2002] 255 ITR 273 (SC) which reads as under:

"The Assessing Officer, while computing the book profits of a company under Section 115-J of the Income-tax Act, 1961, has only the power of examining whether the books of account are certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act. The Assessing

Officer, thereafter, has the limited power of making increases and reductions as provided for in the Explanation to section 115J. The Assessing Officer does not have the jurisdiction to go behind the net profits shown in the profit and loss account except to the extent provided in the Explanation. The use of the words "in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act" in section 115J was made for the limited purpose of empowering the Assessing Officer to rely upon the authentic statement of accounts of the company. While so looking into the accounts of the company, the Assessing Officer has to accept the authenticity of the accounts with reference to the provisions of the Companies Act, which obligate the company to maintain its accounts in a manner provided by that Act and the same to be scrutinized and certified by statutory auditors and approved by the company in general meeting and thereafter to be filed before the Registrar of Companies who has a statutory obligation also to examine and be satisfied that the accounts of the company are maintained in accordance with the requirements of the Companies Act. Sub-section (1A) of Section 115J does not empower the Assessing Officer to embark upon a fresh enquiry in regard to the entries made in the books of account of the company."

9. From the above, it is evident that the AO has to accept the authenticity of the accounts maintained in accordance with the provisions of Part II and Part III of Schedule VI to the Companies Act, which are certified by the Auditors and pressed by the company in the general meeting. The AO has only the power of examining whether the books of accounts are duly certified by the authorities under the Companies Act and whether such books have been properly maintained in accordance with the Companies Act. The AO does not have the jurisdiction to go beyond the net profit shown in the profit and loss account except to the extent provided in the Explanation. Thereafter, the AO has to make adjustment permissible under the Explanation

A given in Section 115JA of the 1961 Act. It may be noted, that the adjustments required to be made to the net profit disclosed in the profit and loss account for the purposes of Section 349 of the Companies Act are quite different from the adjustment required to be made under the Explanation to Section 115JA of the 1961 Act. For the purposes of Section 115JA, the AO can increase the net profit determined as per the profit and loss account prepared as per Parts II and III of Schedule VI to the Companies Act only to the extent permissible under the Explanation thereto.

C 10. As stated above, the said Explanation has provided six items, i.e., Item Nos.(a) to (f) which if debited to the profit and loss account can be added back to the net profit for computing the book profit. In this case, we are concerned with Item No.(c) which refers to the provision for bad and doubtful debt.

D The provision for bad and doubtful debt can be added back to the net profit only if Item (c) stands attracted. Item (c) deals with amount(s) set aside as provision made for meeting liabilities, other than ascertained liabilities. The assessee's case would, therefore, fall within the ambit of Item (c) only if the amount is set aside as provision; the provision is made for meeting a liability; and the provision should be for other than ascertained liability, i.e., it should be for an unascertained liability. In other words, all the ingredients should be satisfied to attract Item (c) of the Explanation to Section 115JA. In our view, Item (c) is not attracted.

F There are two types of "debt". A debt payable by the assessee is different from a debt receivable by the assessee. A debt is payable by the assessee where the assessee has to pay the amount to others whereas the debt receivable by the assessee is an amount which the assessee has to receive from others. In the present case "debt" under consideration is "debt receivable" by the assessee. The provision for bad and doubtful debt, therefore, is made to cover up the probable diminution in the value of asset, i.e., debt which is an amount receivable by the assessee. Therefore, such a provision cannot be said to be a provision for liability, because even if a debt is not recoverable no

H

liability could be fastened upon the assessee. In the present A
case, the debt is the amount receivable by the assessee and
not any liability payable by the assessee and, therefore, any
provision made towards irrecoverability of the debt cannot be
said to be a provision for liability. Therefore, in our view Item (c)
of the Explanation is not attracted to the facts of the present B
case. In the circumstances, the AO was not justified in adding
back the provision for doubtful debts of Rs.92,15,187/- under
clause (c) of the Explanation to Section 115JA of the 1961 Act.

11. For the aforesaid reasons, there is no merit in this C
civil appeal and accordingly the same is dismissed with no or-
der as to costs.

R.P.

Appeal dismissed.