

TAX FLASH NEWS

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Bad debt claim on account of sale of investment is allowed as business loss even though the profit from similar transaction was offered under the head capital gains during earlier years

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Anant Raj Ltd.¹ (the taxpayer) dealt with an issue of allowability of bad debts claim arising on account of sale of investment where profit from the same transaction in the earlier year was offered under the head capital gains. The Tribunal held that when the taxpayer has pointed out its bonafide and legal claim before the AO that correct head in which it is assessable is 'business income', then the taxpayer's stand of earlier years cannot be the ground to tax the same or deny any legal claim. Therefore, the claim of loss incurred during the relevant assessment year (AY) was allowed as business loss or bad debt.

Facts of the case

The taxpayer, engaged in the real estate business, had various subsidiaries through which it had acquired land/plots. Subsidiaries hand over such land for the development and give all the development rights to the taxpayer to develop projects, townships, commercial establishments, etc. The taxpayer as a part of its business venture applies for Change Land Use (CLU) and other permission from the government to start the development project. Though the investments were made in the equity share capital of the subsidiary, however, the underlying asset was land and the purpose were to acquire the land and develop the same to earn business income. Since investment was made in equity share capital, as per the disclosure norms under the Companies Act, same were declared as 'Long-Term Investments'.

Since the taxpayer as a part of business venture decided to dispose-off the said investment and negotiated with the investors who were interested in making the investment even though the asset of the company was merely 2.53 acres of agricultural land. However, the aggregate consideration as agreed between the parties was depended upon the condition that if the taxpayer could get CLU and other clearances by the government, then only the price would be paid which was agreed at INR930 million.

As per the agreement with the buyer, INR150 million was initially payable and the balance amount was payable subject to taxpayer getting various permission. Since, the agreement for transfer of shares was entered in the Assessment Year 2010-11, the taxpayer offered the entire amount of INR 930 million on accrual basis under the head 'Long Term Capital Gain'. Subsequently, due to the governmental order², the entire project had failed, and CLU and other legal permission ostensibly could not be obtained. The said piece of plot/land was sold by the taxpayer for INR 56 million as compared to the aggregate consideration of INR 930 million. During the Assessment Year 2013-14, the amount which was claimed as long term capital gain in earlier year was claimed as business loss/written off as bad debt.

The Assessing Officer (AO) observed that amount was capital in nature and hence cannot be allowed as bad debt. The taxpayer did not offer the same as business income in earlier years. The AO observed that the amount which was to be claimed as bad debt was

¹ Anant Raj Ltd. v. ACIT- [ITA No. 5169 & 5677/Del/2017, AY- 2013-14]-Taxsutra.com

² There was certain turn of events that the adjacent land and the part of the land under the taxpayer's project was acquired by the government for widening of the national highways and certain areas were declared as green belt.

the amount which was to be claimed as bad debt was not trade receivable but was sale of shares which was capital in nature and the sale of shares sold were held as investment and not in stock-in-trade. The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Tribunal's decision

The substance of the transaction of sale of shares was the underlying asset i.e. agricultural land and the services of CLU has made the asset more valuable. The sale consideration of the shares in AY 2010-11 was in fact profit /income for the services rendered in connection with obtaining the CLU and other clearance because the value of the agricultural land of 2.53 acre could not have fetched price of INR 930 million, as its value was only dependent upon obtaining the CLUs for commercial use and other governmental permission. If the taxpayer in the AY 2010-11 had offered the income on transaction of shares which was mainly had the value purely due to its business venture and core business activities, and if such an income has accrued in pursuance of an agreement entered between the taxpayer and the buyer, then same was assessable under the head 'business income'.

The Tribunal relied on various decisions³ and observed that the principle enunciated by the Supreme Court clinches the issue that, if the taxpayer in the earlier years had offered the income or loss under the different head of income either under an erroneous presumption of law or by mistake, then it does not act as an estoppel or bar the taxpayer to point out that same was assessable under the different head.

The principles laid down by the Supreme Court in various decisions⁴ were that if either the taxpayer had offered income or the AO in the earlier assessment year has assessed the income under the particular head which was originally assessable in a different head, even though the same was liable to be assessed under the head 'business or profession', then there was no embargo either on the AO or on the taxpayer to show the income or loss under the head 'business or profession' in the subsequent year. The taxpayer can always point out in the subsequent year in which it is claiming any deduction or loss that the income offered in the earlier years was not shown under the correct head and in this year the same is assessable under the correct head.

The claim regarding the allowability of the bad debts or business loss has to be determined by the AO in the year in which the loss has claimed in P&L account and the assessment of the corresponding income as capital

gain in an earlier year will not be binding on the taxpayer. It was always open for the taxpayer to point out that it was to be assessed under the correct head i.e. business income. The fact that declaration and assessment of the corresponding income has been assessed as capital gain and accepted in the earlier year will not have any impact.

The claim of income or loss or any deduction has to be examined afresh in the year in which it is claimed. Thus, the bad debt or loss which was claimed in this year has to be determined in this year only without distributing the earlier assessment which has attained finality.

The Tribunal relied on the decision of the Bombay High Court in the case of Hybrid Financial Services Ltd.⁵ wherein the Court observed that, firstly, the taxpayer need not required to establish/approve that debt has in fact become irrecoverable and it is sufficient that the bad debt was written off irrecoverable in the account of the taxpayer. The Court observed that there is no requirement under the Act that the bad debt has to accrue out of income under the same head 'income from business or profession' to be deducted as income. When the taxpayer itself has pointed out its bonafide and legal claim before the AO that correct head in which it is assessable is 'business income', then acquiescence by the taxpayer in earlier year cannot be the ground to tax the same or deny any legal claim.

Therefore, the claim of loss made in the current AY was allowable as business loss or bad debt and thus allowed to be set-off in the revenue account as claimed by the taxpayer and not as a capital loss.

Our comments

The Mumbai Tribunal in the case of Jal Venkatesh Investments P. Ltd.⁶ held that loss on account of writing off of debentures were allowed as bad debts since the debenture is part of its business and any loss arising from the diminution in the value should be treated as a business loss. The Tribunal disregarded the contention of the tax department that any loss in investment is a capital loss and the same cannot be allowed as bad debts.

In the present case the Tribunal has held that if the taxpayer in the earlier years had offered the income or loss under a different head of income either under an erroneous presumption of law or by mistake, then it does not act as an estoppel or bar for the taxpayer to contend that same was assessable under the different head of income in the subsequent year. Accordingly, the Tribunal held that the claim of business loss or bad debt is allowable on revenue account.

³ New Jehangir Vakil Mills Co. Ltd. v. CIT [1963] 49 ITR 0137 (SC), CIT v. Manmohan Das [1966] 59 ITR 699(SC), CIT vs. Western India Oil Distributing Company Ltd. [2001] 249 ITR 517 (SC)

⁴ CIT v. Western India Oil Distributing Company Ltd. [2001] 249 ITR 0517 (SC)

⁵ PCIT vs. Hybrid Financial Services Ltd. (ITA No.1265 and 1469 of 2017)

⁶ Jal Venkatesh Investments P. Ltd v. DCIT (ITA No.3557/Mum/2010)

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