REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO._____OF 2022
(@ SPECIAL LEAVE PETITION (CIVIL) NO. 672 OF 2020)

PR. COMMISSIONER OF INCOME TAX 6 ...APPELLANT(S)

VERSUS

KHYATI REALTORS PVT. LTD. ...RESPONDENT(S)

J U D G M E N T

S. RAVINDRA BHAT, J.

1. Special leave granted. With consent of the counsels for the parties, the appeal was heard finally. The Revenue has appealed a decision of the Bombay High Court[1] which affirmed an order[2] of the Income Tax Appellate Tribunal (hereinafter, "ITAT") which had upheld a claim by the respondent (hereinafter, "assessee") for writing off ₹ 10 crores as a bad debt.

2. The assessee carries on real estate development business, trading in transferable development rights (TDR) and finance. In respect of its return for the assessment year 2009-2010, the Assessment Officer (hereinafter, "AO") issued a

[1] In ITA No. 291 of 2017, decided on 30.04.2019.
[2] In ITA No.129/Mum/2014, decided on 04.03.2016.

notice under Section 143(2) of the Income Tax Act 1961 (hereinafter "Act" or "IT Act") on 18.08.2010, and also under Section 142(1) of the Act, calling for various details. The assessee filed its response thereto. The scrutiny assessment was completed by the AO under Section 143(3) on 30.12.2011, determining the total income of the assessee at ₹ 87,880/-. The assessee contended that an amount of ₹ 10 crores was deposited with one M/s C. Bhansali Developers Pvt. Ltd. towards acquisition of commercial premises two years prior to the assessment year in question (i.e., in 2007). It was contended that the project did not appear to make any progress, and consequently, the assessee sought return of the amounts from the builder. However, the latter did not respond. As a result, the assessee's Board of Directors resolved to write off the amount as a bad debt in 2009. It was also contended that the amount could also be construed as a loan, since the assessee had 'financing' as one of its objects. In a letter dated 26.12.2011 to the AO, the assessee *inter alia* contended as follows:

> *"We submit that as per provisions of Section 36(2), in respect of monies advanced in the ordinary course of business, the same allowable as bad debts even if the amount has not been taken into account in computing the total income. This is well accepted position in respect of write off of advances given in the lending business. The present case fully falls within the provisions of sec. 36(2) hence the write off of advances is allowable u/s. 36(1)(vii)."*

3. The AO disallowed the sum of ₹ 10 crores claimed as a bad debt in determining its income under "Profits and Gains of Business or Profession". Aggrieved, the assessee appealed. Before the appellate Commissioner (hereinafter, "CIT (A)") the assessee reiterated the contents of a letter dated 05.12.2011 written to the AO as follows:

> *"As part of our regular business activity, the company in order to purchase certain commercial premises had made reservation by way of bookings in the upcoming project at Old Mumbai Pune Highway, Khapoli, which was to be developed by M/s C. Bhansali Developers Pvt Ltd. In order to confirm the reservation/booking of said*

> *commercial premises, builder insisted for advance of Rs 10 crores. Accordingly, the company had advanced Rs 10 crores on 06.03.2007 towards reserving/booking of the commercial premises in the said project ... Since the said advance was for purchase of commercial property, there was no question of charging interest thereon...However, further development about the said project of the builder is that the builder after taking advances from us did not proceed in this matter and possibly siphoned the money for other purposes. On coming to know about their non-proceeding in the development of the said project, we had a number of meetings with the directors of M/s C. Bhansali Developers Pvt Ltd. They did not listen to our request for returning the money…"*

4. The CIT(A) confirmed the disallowance on account of bad debts and interest. A further appeal was preferred to the ITAT, which allowed the assessee's plea. The Revenue sought an appeal to the Bombay High Court under Section 260A of the IT Act. The Bombay High Court ruled that no question of law requiring a decision arose in the appeal and consequently declined to entertain the Revenue's plea.

5. The Revenue contended that Section 36(1)(vii) of the Act gives benefit to the assessee to claim a deduction on any bad debt or part thereof, which is written off as irrecoverable in the accounts of the assessee for the previous year. This benefit is subject to Section 36(2) of the Act. It is obligatory upon the assessee to prove to the AO that the case satisfies the ingredients of both Section 36(1)(vii) and Section 36(2) of the Act. It was urged that the ITAT and the High Court erred in accepting the assessee's contentions, which were not supported by any material or document. It was submitted that the assessee's claim of giving ₹ 10 crores to M/s C. Bhansali Developers Pvt. Ltd. for the alleged project was not substantiated by any material. Additionally, the assessee had also pleaded that the amount was given as a 'loan' to the developer, which was a different plea altogether. This plea was bereft of any material as to the terms of the loan, or the conditions of repayment, including interest. It was submitted that by virtue of Section 36(2) of the Act, the AO has to be satisfied that the action of writing off is on sound and reasonable basis, and not a device. Reliance was placed on *Catholic Syrian Bank Ltd. v. Commissioner of*

Income Tax, Thrissur[3] to urge that the assessee is obligated to prove to the AO that the claim satisfies the ingredients of both Section 36(1)(vii) on the one hand and Section 36(2) of the Act as well.

6. The Revenue further argued that the assessee's submission that the amount could alternatively be deducted as an expenditure exclusively laid out for commercial purposes under Section 37 of the Act was belated, and raised for the first time only after the order of the CIT(A).

7. Ms. Kavita Jha, learned counsel for the assessee urged this court not to interfere with the findings of the ITAT and the High Court. She highlighted that the following facts and circumstances were not in dispute:

i) The assessee was engaged in the business of real estate and financing.

ii) The objects clause of the Memorandum of Association of the assessee company reflected the business of contractors, erectors, constructors of buildings, etc., as well as receiving or lending money as its objects.

iii) ₹ 10 crores was advanced on 06.03.2007 to M/s C. Bhansali Developers Pvt. Ltd. to acquire certain commercial premises and for reservation by way of bookings in their upcoming project on the Old Mumbai-Pune Highway in Khopoli.

iv) The said ₹10 crores was written off during assessment year 2009-10.

v) The ₹ 10 crores advanced to M/s C. Bhansali on 06.03.2007 was in the ordinary course of its business.

8. It was contended that since the builder/borrower defaulted in repaying the amount, the respondent assessee decided to write off the same as a bad debt under

[3] (2012) 3 SCC 784.

Section 36(1)(vii) read with Section 36(2) of the Act. It was contended that after the amendment of Section 36 of the Act in 1989, there was virtually no scope for the AO to scrutinize in detail a decision to write off the debt. Counsel relied on the decision of this court in *T.R.F. Limited v. Commissioner of Income Tax, Ranchi*[4].

9. Ms. Jha further contended that there was nothing in the Act which barred an assessee from claiming the benefit of Section 37 of the Act in a case where the expenditure was laid out or incurred exclusively for business or commercial purposes, where it might not be successful to establish its claim for deduction under any other head.

10. The learned counsel also relied on the judgment of this court in *Commissioner of Income Tax v. Mysore Sugar Co. Ltd.*[5] As well as other judgments of High Courts, such as *Mohan Meakin Ltd. v. Commissioner of Income Tax*[6]*; Harshad J. Choksi v. Commissioner of Income Tax*[7] and *IBM World Trade Corporation v. Commissioner of Income Tax*[8] to buttress her submissions.

Analysis and Conclusions

11. Section 36 of the Act occurs under the heading 'other deductions', and its relevant extract, for the purpose of this case, is as follows:

> *"36. (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28—*
> ***

[4] (2010) 13 SCC 532.
[5] 1963 (2) SCR 976.
[6] 2012 (348) ITR 109 (Del).
[7] 349 ITR 250 (Bom).
[8] 1990 (186) ITR 412 (Bom).

(vii) subject to the provisions of sub-section (2), the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year:
Provided that in the case of an assessee to which clause (viia) applies, the amount of the deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under that clause:
Provided further that where the amount of such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof becomes irrecoverable or of an earlier previous year on the basis of income computation and disclosure standards notified under sub-section (2) of Section 145 without recording the same in the accounts, then, such debt or part thereof shall be allowed in the previous year in which such debt or part thereof becomes irrecoverable and it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the purposes of this clause.
Explanation 1.—For the purposes of this clause, any bad debt or part thereof written off as irrecoverable in the accounts of the assessee shall not include any provision for bad and doubtful debts made in the accounts of the assessee.
Explanation 2.—For the removal of doubts, it is hereby clarified that for the purposes of the proviso to clause (vii) of this sub-section and clause (v) of sub-section (2), the account referred to therein shall be only one account in respect of provision for bad and doubtful debts under clause (viia) and such account shall relate to all types of advances, including advances made by rural branches;….
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(2) In making any deduction for a bad debt or part thereof, the following provisions shall apply—
(i) no such deduction shall be allowed unless such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year, or represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee;
(ii) if the amount ultimately recovered on any such debt or part of debt is less than the difference between the debt or part and the amount so deducted, the deficiency shall be deductible in the previous year in which the ultimate recovery is made;
(iii) any such debt or part of debt may be deducted if it has already been written off as irrecoverable in the accounts of an earlier previous year (being a previous year relevant to the assessment year commencing on the 1st day of April, 1988, or any earlier assessment year), but the Assessing Officer had not allowed it to be deducted on the ground that it had not been established to have become a bad debt in that year;
(iv) where any such debt or part of debt is written off as irrecoverable in the accounts of the previous year (being a previous year relevant to the assessment year commencing on the 1st day of April, 1988, or any earlier assessment year) and the Assessing Officer is satisfied that such debt or part became a bad debt in any earlier previous year not falling beyond a period of four previous years

immediately preceding the previous year in which such debt or part is written off, the provisions of sub-section (6) of Section 155 shall apply;
(v) where such debt or part of debt relates to advances made by an assessee to which clause (viia) of sub-section (1) applies, no such deduction shall be allowed unless the assessee has debited the amount of such debt or part of debt in that previous year to the provision for bad and doubtful debts account made under that clause."

Section 37 reads as follows:

"37. (1) Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".
Explanation 1.—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure."

12. The income of every assessee has to be assessed according to the statutory framework laid out Chapter IV, Part D of the Act. That chapter deals with heads of income. Section 28 of the Act deals with the chargeability of income to tax under the head 'Profits and Gains of Business or Profession'. The other deductions that an assessee can claim are elaborated under Section 36 of the Act, which opens with the phrase *"the deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in Section 28".* For the purposes of computing income chargeable to tax, therefore, besides specific deductions, 'other deductions' enumerated in different clauses of Section 36 can be allowed by the AO. Each of the deductions must relate to the business carried out by the assessee. If the assessee carries on a business and writes off a debt relating to the business as irrecoverable, it would without doubt be entitled to a corresponding deduction under clause (*vii*) of sub-section (1) of Section 36 subject to the fulfilment of the conditions set forth in sub-section (2) of Section 36 of the IT Act.

13. Before the amendment in 1989, the law was that even in cases where the assessee had made only a provision in its accounts for bad debts and interest thereon, without the amount actually being debited from the assessee's Profit and Loss account, the assessee could still claim deduction under Section 36(1)(vii) of the Act. With effect from 1 April 1989, with the insertion of the new Explanation under Section 36(1)(vii), any bad debt written-off as irrecoverable in the account of the assessee would not include any 'provision' for bad and doubtful debt made in the accounts of the assessee. In other words, before this date, even a provision could be treated as a write off. However, after this date, the Explanation to Section 36(1)(vii) brought about a change. As a result, a mere provision for bad debt *per se* was not entitled to deduction under Section 36(1)(vii). This position in law was recognized by this court in *Southern Technologies Ltd. v. Joint Commissioner of Income Tax, Coimbatore*[9]:

> *"25. [B]y insertion (w.e.f. 1.4.1989) of a new Explanation in Section 36(1)(vii), it has been clarified that any bad debt written off as irrecoverable in the account of the assessee will not include any provision for bad and doubtful debt made in the accounts of the assessee. The said amendment indicates that before 1.4.1989, even a provision could be treated as a write off. However, after 1.4.1989, a distinct dichotomy is brought in by way of the said Explanation to Section 36(1)(vii). Consequently, after 1.4.1989, a mere provision for bad debt would not be entitled to deduction under Section 36(1)(vii). To understand the above dichotomy, one must understand "how to write off". If an assessee debits an amount of doubtful debt to the P&L Account and credits the asset account like sundry debtor's Account, it would constitute a write off of an actual debt. However, if an assessee debits "provision for doubtful debt" to the P&L Account and makes a corresponding credit to the "current liabilities and provisions" on the Liabilities side of the balance sheet, then it would constitute a provision for doubtful debt. In the latter case, assessee would not be entitled to deduction after 1.4.1989.*
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> *38. The point to be noted is that the IT Act is a tax on "real income", i.e., the profits arrived at on commercial principles subject to the provisions of the IT Act. Therefore, if by Explanation to Section 36(1)(vii) a provision for doubtful debt is kept out of the ambit of the bad debt which is written off then, one has to take into*

[9] (2010) 2 SCR 380.

> *account the said Explanation in computation of total income under the IT Act failing which one cannot ascertain the real profits. This is where the concept of "add back" comes in. In our view, a provision for NPA debited to P&L Account under the 1998 Directions is only a notional expense and, therefore, there would be add back to that extent in the computation of total income under the IT Act.*
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> *39. One of the contentions raised on behalf of NBFC before us was that in this case there is no scope for "add back" of the Provision against NPA to the taxable income of the assessee. We find no merit in this contention. Under the IT Act, the charge is on Profits and Gains, not on gross receipts (which, however, has Profits embedded in it). Therefore, subject to the requirements of the IT Act, profits to be assessed under the IT Act have got to be Real Profits which have to be computed on ordinary principles of commercial accounting. In other words, profits have got to be computed after deducting Losses/ Expenses incurred for business, even though such losses/ expenses may not be admissible under Sections 30 to 43D of the IT Act, unless such Losses/ Expenses are expressly or by necessary implication disallowed by the Act. Therefore, even applying the theory of Real Income, a debit which is expressly disallowed by Explanation to Section 36(1)(vii), if claimed, has got to be added back to the total income of the assessee because the said Act seeks to tax the "real income" which is income computed according to ordinary commercial principles but subject to the provisions of the IT Act. Under Section 36(1)(vii) read with the Explanation, a "write off" is a condition for allowance."*

14. It is thus evident that merely stating a bad and doubtful debt as an irrecoverable write off without the appropriate treatment in the accounts, as well as non-compliance with the conditions in Section 36(1)(vii), 36(2), and Explanation to Section 36(1)(vii) would not entitle the assessee to claim a deduction. This position was reiterated again in *Catholic Syrian Bank (supra):*

> *"5. The language of Section 36(1)(vii) of the Act is unambiguous and does not admit of two interpretations. It applies to all banks, commercial or rural, scheduled or unscheduled. It gives a benefit to the Assessee to claim a deduction on any bad debt or part thereof, which is written off as irrecoverable in the accounts of the Assessee for the previous year. This benefit is subject only to Section 36(2) of the Act. It is obligatory upon the Assessee to prove to the assessing officer that the case satisfies the ingredients of Section 36(1)(vii) on the one hand and that it satisfies the requirements stated in Section 36(2) of the Act on the other. The proviso to Section 36(1)(vii) does not, in absolute terms, control the application of this provision as it comes into operation only when the case of the Assessee is one which falls squarely under Section 36(1)(viia) of the Act. We may also notice that the explanation to Section 36(1)(vii), introduced by the Finance Act, 2001, has to be examined in conjunction with the principal section. The explanation specifically excluded any provision for bad and doubtful debts made in the account of the Assessee from the*

> *ambit and scope of 'any bad debt, or part thereof, written off as irrecoverable in the accounts of the Assessee'. Thus, the concept of making a provision for bad and doubtful debts will fall outside the scope of Section 36(1)(vii) simplicitor. The proviso, as already noticed, will have to be read with the provisions of Section 36(1)(viia) of the Act."*

15. The assessee had relied on the ruling in *T.R.F. Limited* (supra). In that judgment, this court had *inter alia*, observed that:

> *"4. This position in law is well-settled. After 1st April, 1989, it is not necessary for the assessee to establish that the debt, in fact, has become irrecoverable. It is enough if the bad debt is written off as irrecoverable in the accounts of the assessee. However, in the present case, the Assessing Officer has not examined whether the debt has, in fact, been written off in accounts of the assessee. When bad debt occurs, the bad debt account is debited and the customer's account is credited, thus, closing the account of the customer. In the case of Companies, the provision is deducted from Sundry Debtors. As stated above, the Assessing Officer has not examined whether, in fact, the bad debt or part thereof is written off in the accounts of the assessee. This exercise has not been undertaken by the Assessing Officer. Hence, the matter is remitted to the Assessing Officer for de novo consideration of the above-mentioned aspect only and that too only to the extent of the write off."*

16. This court did not examine the impact of Section 36(2) and the condition of write off, in the accounts of the assessee during the previous year, in *T.R.F Ltd.* (supra). However, the judgments in *Southern Technologies* (supra), and *Catholic Syrian Bank* (supra) spelt out the conditions subject to which an assessee could write off a bad and doubtful debt. Interestingly, Kapadia, C.J was a party to *T.R.F* and *Catholic Syrian Bank;* he in fact authored the judgment in *Southern Technologies.* Furthermore, *Catholic Syrian Bank* (supra) is by a bench of three judges, whereas the other decisions are by benches of two Judges. In the circumstances, this Court has to accord primacy to *Southern Technologies* (supra).

17. It is evident from the above rulings of this court, that:

(i) The amount of any bad debt or part thereof has to be written-off as irrecoverable in the accounts of the assessee for the previous year;

(ii) Such bad debt or part of it written-off as irrecoverable in the accounts of the assessee cannot include any *provision* for bad and doubtful debts made in the accounts of the assessee;

(iii) No deduction is allowable unless the debt or part of it *"has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year"*, or represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee;

(iv) The assessee is obliged to prove to the AO that the case satisfies the ingredients of Section 36(1)(vii) as well as Section 36(2) of the Act.

18. In the present case, the record shows that the accounts of the assessee nowhere showed that the advance was made by it to M/s C. Bhansali Developers Pvt. Ltd. in the ordinary course of business. Its primary argument was that the amount of ₹ 10 crores was given *for the purpose of purchasing constructed premises.* However, the amount was written-off on 28.03.2009. As noted by the CIT(A), there was no material to substantiate this submission, in respect of payment of the amount, the time by which the constructed unit was to be given to it, the area agreed to be purchased, etc. Equally, in support of its other argument that the amount was given as a loan, the assessee nowhere established the duration of the advance, the terms and conditions applicable to it, interest payable, etc. The assessee conceded that it had received interest income for the relevant assessment year. However, it could not establish that any interest was paid (or shown to be payable in its accounts) for the sum of ₹ 10 crores. Furthermore, there is nothing on record to suggest that the requirement of the law that the bad debt was written-off as irrecoverable in the assessee's accounts for the previous year had been satisfied. Another reason why the

amount could not have been written-off, is that the assessee's claim was that it was given to M/s Bhansali Developers Pvt. Ltd. for acquiring immovable property – it therefore, was in the nature of a capital expenditure. It could not have been treated as a business expenditure. In *A.V. Thomas and Co. Ltd., Alleppey v. The Commissioner of Income Tax, (Bangalore) Kerala*[10] this court held as follows:

> *"16. Now, a question under s. 10(2)(xi) can only arise if there is a bad or doubtful debt. Before a debt can become bad or doubtful it must first be a debt. What is meant by debt in this connection was laid down by Rowlatt J., in Curtis v. J. & G. Oldfield Ltd., (1925) 9 TC 319 as follows :-*
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> *"When the Rule speaks of a bad debt it means a debt which is a debt that would have come into the balance sheet as a trading debt in the trade that is in question and that it is bad. It does not really mean any bad debt which, when it was a good debt, would not have come in to swell the profits."*
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> *17. A debt in such cases is an outstanding which if recovered would have swelled the profits. It is not money handed over to someone for purchasing a thing which that person has failed to return even though no purchase was made. In the section a debt means something more than a mere advance. It means something which is related to business or results from it. To be claimable as a bad or doubtful debt it must first be shown as a proper debt…"*

19. In view of the above discussion, it is held that the assessee's claim for deduction of ₹ 10 crore as a bad and doubtful debt could not have been allowed. The findings of the ITAT and the High Court, to the contrary, are therefore, insubstantial and have to be set aside.

20. The second issue relates to the admissibility of an expenditure as a deduction, which does not fall within the provisions of Sections 28 to 43, and is not capital in nature, but is laid out or spent exclusively for the purpose of business, under Section 37 of the Act. A similar provision existed under the old Income Tax Act, 1922 as in the case of provision for bad debts, by Section 10(2)[11]. This aspect was considered

[10] [1963] Supp (1) SCR 776.

[11] *Section 10(2):* [S]*uch profits or gains shall be computed after making the following allowances, namely :-*

by this court in *The Commissioner of Income Tax v. The Mysore Sugar Co., Ltd.*[12] The assessee there was engaged in production of sugar. It used to advance monies to cane growers in consideration of supply of sugarcane. Due to drought, the cane growers could not repay amounts advanced. The assessee claimed the outstanding to be bad debts, and sought to write them off. This was not allowed; the Income Tax Officer held the expenditure to be capital in nature. The High Court however, set aside that determination. This court confirmed the view of the High Court. However, the court also examined the argument whether in such eventualities, the expenditure could be claimed to be exclusively laid out for the purpose of business (under the provision corresponding to Section 37(1) of the Act). This court held as follows:

> *"7. The tax under the head "Business" is payable under s. 10 of the Income-tax Act. That section provides by sub-s. (1) that the tax shall be payable by an assessee under the head "profits and gains of business, etc." in respect of the profits or gains of any business, etc. carried on by him. Under sub-s. (2), these profits or gains are computed after making certain allowances. Clause (xi) allows deduction of bad and doubtful business debts. It provides that when the assessee's accounts in respect of any part of his business are not kept on the cash basis, such sum, in respect of bad and doubtful debts, due to the assessee in respect of that part of the his business is deductible but not exceeding the amount actually written off as irrecoverable in the books of the assessee. Clause (xv) allows any expenditure not included in cls. (i) to (xiv), which is not in the nature of capital expenditure or personal expenses of the assessee, to be deducted, if laid out or expanded wholly and exclusively for the purpose of such business, etc. The clauses expressly provided what can be deducted; but the general scheme of the section is that profits or gains must be calculated after deducting outgoings reasonably attributable as business expenditure but so as not to deduct any portion of an expenditure of a capital nature. If an expenditure comes within any of the enumerated classes of allowances, the case can be considered under the appropriate class; but there may be an*

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(xi) When the assessee's accounts in respect of any part of his business, profession or vocation are not kept on the cash basis, such sum, in respect of bad and doubtful debts, due to the assessee in respect of that part of his business, profession or vocation, and in the case of an assessee carrying on a banking or money lending business such sum in respect of loans made in the ordinary course of such business as the Income-tax Officer may estimate to be irrecoverable but not exceeding the amount actually written off as irrecoverable in the books of the assessee :

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(xv) any expenditure (not being an allowance of the nature described in any of the clauses (i) to (xiv) inclusive, and not being in the nature of capital expenditure or personal expenses) laid out or expended wholly and exclusively for the purpose of such business, profession or vocations".

[12] 1963 (2) SCR 976

> *expenditure which, though not exactly covered by any of the enumerated classes, may have to be considered in finding out the true assessable profits or gains. This was laid down by the Privy Council in Commissioner of Income-tax v. Chitnavis I.L.R. (1932) IndAp 290 and has been accepted by this Court. In other words, s. 10(2) does not deal exhaustively with the deductions, which must be made to arrive at the true profits and gains.*
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> *8. To find out whether an expenditure is on the capital account or on revenue, one must consider the expenditure in relation to the business. Since all payments reduce capital in the ultimate analysis, one is apt to consider a loss as amounting to a loss capital. But this is not true of all losses, because losses in the running of the business cannot be said to be of capital. The questions to consider in this connection are : for that was the money laid out? Was it to acquire an asset of an enduring nature for the benefit of the business, or was it an outgoing in the doing of the business? If money be lost in the first circumstances, it is a loss of capital, but if lost in the second circumstances, it is a revenue loss. In the first, it bears the character of an investment, but in the second, to use a commonly understood phrase, it bears the character of current expenses.*

21. It is apparent that this court was satisfied that the disallowance of the amount, on account of bad and doubtful debt, did not preclude a claim for deduction, on the ground that the expenditure was exclusively laid out for the purpose of business. The court applied the test of whether the expense was incurred for business, or whether it fell into the capital stream. In the facts of the case, the tests were satisfied – the expenditure was for the purpose of business, and did not fall in the capital stream.

22. The assessee had relied on a few High Court judgments which have ruled that even if a claim for deduction under Section 36(1) is not allowed, the possibility of its exclusion under Section 37 cannot be ruled out. This court is of the opinion that as a proposition of law, that enunciation is unexceptional, since the heads of expenditure that can be claimed as deduction are not exhaustive – which is the precise reason for the existence of Section 37. Therefore, in a given case, if the expenditure relates to business, and the claim for its treatment under other provisions are unsuccessful, application of Section 37 is *per se* not excluded.

23. This court is of the opinion however, that in the facts of this case, the judgment in *Southern Technologies* (supra) on this issue (where the claim of bad and doubtful debt was disallowed) is appropriate, and applicable. The relevant extract of the said judgment is as follows:

> *"44. As stated above, Section 36(1)(vii) after 1.4.1989 draws a distinction between write off and provision for doubtful debt. The IT Act deals only with doubtful debt. It is for the assessee to establish that the provision is made as the loan is irrecoverable. However, in view of Explanation which keeps such a provision outside the scope of "written off" bad debt, Section 37 cannot come in. If an item falls under Sections 30 to 36, but is excluded by an Explanation to Section 36 (1) (vii) then Section 37 cannot come in. Section 37 applies only to items which do not fall in Section 30 to 36. If a provision for doubtful debt is expressly excluded from Section 36 (1) (vii) then such a provision cannot claim deduction under Section 37 of the IT Act even on the basis of "real income theory" as explained above."*

24. In view of the foregoing discussion, the Revenue's appeal has to succeed. The impugned judgment of the High Court and the order of ITAT are hereby set aside. The appeal is allowed, in the above terms, without order on costs.

.....J.
[UDAY UMESH LALIT]

.....J.
[S. RAVINDRA BHAT]

.....J.
[SUDHANSHU DHULIA]

New Delhi,
August 25, 2022