

Privy Council Appeal No. 71 of 1930.

The Commissioner of Income Tax, Central Provinces and Berar - *Appellant*

v.

Sir S. M. Chitnavis, since deceased (now represented by Krishna Rao, minor, through his guardian Parwati Bai Lady Chitnavis) *Respondent*

FROM

THE COURT OF THE JUDICIAL COMMISSIONER OF THE CENTRAL PROVINCES.

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL DELIVERED THE 26TH APRIL, 1932.

Present at the Hearing :

LORD BLANESBURGH.

LORD RUSSELL OF KILLOWEN.

SIR DINSHAH MULLA.

[*Delivered by* LORD RUSSELL OF KILLOWEN.]

This is an appeal from a judgment of the Court of the Judicial Commissioner, Central Provinces, upon a reference of questions of law, made at the instance of an assessee, under Section 66 (2) of the Indian Income Tax Act, 1922, which will hereafter be referred to as the Act.

The questions involved were considered by the said Court to be of such importance that the case was (after argument before two Commissioners) re-argued before a full Bench.

Two separate and distinct matters were raised for decision before the said Court, and its adjudication upon each was adverse to the present appellant. In respect of one of such matters he made no attempt to appeal, and the dispute in regard thereto is at an end. In regard to the other matter, however, he applied to the said Court for leave to appeal to His Majesty in Council, and in response to that application the Court certified that the requirements of Section 109 (c) of the Code of Civil Procedure, 1908,

were fulfilled, " inasmuch as a question of great public importance is involved in the case."

Their Lordships draw attention to this aspect of the case at the outset in view of the contentions which were advanced before them on behalf of the respondent.

The facts of the case may now be stated.

Sir Shanker Rao Chitnavis (who will be referred to as the assessee) for the purpose of assessment to income tax for the year 1926-1927 had, under Section 22 of the Act, to make a return of his total income during the year 1925-1926. He returned that income at Rs. 74,668. The Income Tax officer, proceeding under Section 23 of the Act, by his order dated the 17th January, 1927, assessed the total income at a figure of Rs. 1,16,480. In arriving at this figure the officer had (*inter alia*) disallowed certain deductions which had been made by the assessee. The assessee appealed, under Section 30 of the Act, against the assessment to the Assistant Commissioner, who, by his order dated the 25th April, 1927, reduced the amount of the assessment to Rs. 1,13,012. The Assistant Commissioner allowed some, but disallowed others, of the said deductions.

Among the deductions which the assessee had made from the gross income of his business was a sum of Rs. 17,983-11-6 for bad debts. The officer had disallowed Rs. 7,481-13-9 of this deduction, thereby increasing the figure of assessment by that amount. The Assistant Commissioner affirmed this disallowance. It is round this sum of Rs. 7,481-13-9, and the right of the assessee to deduct it, that this appeal revolves.

The officer, in his order, dealt with the matter thus :—

" Bad debts claimed amount to Rs. 17,983-11-6. Lists were called for and scrutinized and found that as much as Rs. 7,481-13-9 are very old and time-barred."

He accordingly would not allow the Rs. 7,481-13-9 to be deducted.

The Assistant Commissioner, in his order, used the following language :—

" It is urged that the whole of the bad debt amounting to Rs. 17,982 should have been allowed. Lists were called for showing details of dates when the amounts were due in order to ascertain when the debts were really ascertained to be bad and on examination it was found that Rs. 7,481 were on account of old bad debts which could not be allowed in the account year. The rest were allowed. Mr. Zinzarde argues that it should be left to the assessee to declare when the debts were bad and the Income-tax Officer should not go on the presumption that the amount had become time-barred in previous years. It appears to me that the criterion to know when the debt is bad is that all the legal remedies to recover fail. The assessee could not be said to be able to recover an old debt although he may entertain a hope to recover. Mere hope will not convert an irrecoverable loan into a recoverable item. It is, I think, not right to allow sums which had become time-barred long before the account year."

The assessee then required the Commissioner to refer to the High Court, under Section 66 (2) of the Act, certain questions of law alleged to arise out of the order of the Assistant Commissioner,

that which related to the said sum of Rs. 7,481-13-9 being described in the assessee's petition in these terms :—

“ Has not the assessee got the option of declaring debts bad when he finds after sufficient waiting that from the circumstances of the debtors he is unable to recover them ? Can the Income-tax authority deprive the assessee of this option ? Should not the Income-tax Officer and the Assistant Commissioner have allowed Rs. 7,481-13-9 to the assessee on the same considerations on which the remaining amount out of Rs. 17,982 claimed by him was allowed ? ”

An oral affirmation was made by the general agent of the assessee, which contained the following statement in regard to the bad debts :—

“ The bad debts, amounting to Rs. 7,481, had already gone bad, owing to their being time-barred much before the account year. That is they had gone time-barred in previous account years. But we did not write them off in the hope that they would be collected later on. But as they did not come to be so collected, they were written off during the account year.”

The Commissioner, in accordance with section 66 (2) of the Act, drew up a statement of the case and referred it, with his own opinion thereon, to the Court of the Judicial Commissioner. The statement contains two passages which require to be set out. The first is this :—

“ Rs. 7,481-13-9.—In all, the assessee had claimed a deduction of Rs. 17,982 on account of bad debts. Of these, debts amounting to Rs. 10,105 were such as had fallen bad during the account year and were written off in that year and were allowed. Debts amounting to Rs. 7,481-13-9 were very old and had become bad on account of being time-barred or otherwise much before the account year. They should have been written off in those years and were therefore not allowed.”

The other passage runs thus :—

“ I beg to say that the assessment is to be made on the income of the previous year. This is arrived at after making certain deductions or allowances specified in the Act. These deductions or allowances must also relate to the previous year. Expenditure, actual or notional, that does not relate to the previous year cannot be allowed. The Act does not allow losses to be carried forward from one year to another. Bad debts are a form of notional expenditure and such expenditure must be deemed to be incurred when the debts become bad, that is when they are found to be irrecoverable. When they become bad is a question of fact to be determined by the Income-tax Officer. It is clear, I submit, that an assessee cannot be allowed to accumulate bad debts and write them off in a year when he will escape the largest possible amount of income-tax by doing so. This answers the first two parts of the first question. The contention that the bad debts amounting to Rs. 7,481 should have been allowed on the same ground as the balance of the total claim of Rs. 17,982 was allowed does not hold good, in as much as the remaining debts became bad during the account year and were written off during that period and as such were correctly allowed. I submit therefore that this part of the question should be answered in the negative.”

The opinion of the Full Bench was unanimous on the points involved in the reference, and in accordance therewith the Court

of the Judicial Commissioner by order of the 13th December, 1928, answered the question in relation to bad debts as follows :—

“ The assessee has the option of declaring debts bad when he finds, after sufficient waiting, that from the circumstances of the debtors he is unable to recover them. As the law at present stands the income-tax authority cannot deprive the assessee of this option. The present non-applicant was, therefore, entitled to the deduction of Rs. 7,481-13-9 on the same consideration on which the balance of the amount of Rs. 17,892 was allowed.”

The grounds for this decision are contained in the opinion delivered by Mr. Kinkhede, additional Judicial Commissioner, with which the two other members of the Court merely expressed their agreement. He took the view as their Lordships read his opinion, (1) that an assessee is entitled in ascertaining his profits for a year to deduct such debts as he adjudges to be in that year bad debts ; (2) that in assessing the taxable profits for any account year the assessee is entitled to have deducted the whole amount which the assessee has in fact written off as irrecoverable in his accounts of that year ; and (3) that in this regard the assessee is the sole arbiter, and that his decision is final. That this correctly represents the view of the Judicial Commissioner may be seen from the following passages in his opinion. After stating that the argument of the assessee's Counsel (based upon some official Manual) was correct, he said : “ It entitles the assessee to urge that in deducing the taxable income in the shape of book profits of the account year, the whole of the amount of bad debts written off by him in his account as irrecoverable in the account year must be deducted.” And later on he uses the following language : “ The assessee must for obvious reasons be the sole arbiter of his own rights and privileges as regards the business he conducts in his own interest. What is to his interest, and what is prejudicial to him, must depend upon his own decision. It therefore follows that on the question whether to treat any particular debt as bad or irrecoverable, his word or decision must be final ; for he alone is or can be the judge of the risks, chances and circumstances which may affect the recovery or non-recovery of that debt from his debtor.” In other words the Judicial Commissioner thinks that the assessee is the sole person to decide whether a debt is bad and when it became bad.

The Judicial Commissioner in coming to this view seems to have been to some extent influenced by the mistaken belief that if a creditor writes a debt off in his books as bad, that act in some way puts an end to any right ever to recover the debt. This would appear from the following extract from his opinion :

“ An entry in the creditor's account books writing off a debt as a bad debt in any particular year is under such circumstances likely to be interpreted by the debtor as *prima facie* good evidence of conduct on the part of the creditor wherefrom an abandonment of his right to demand it might reasonably be inferred so as to serve as a good answer to any future demand, on the occasion of any adjustment or fresh loan. Such an entry is, in my opinion, a conscious act on the creditor's part whereby he determines his

election, once and for ever, to treat the debt referred to therein as bad or irrecoverable. It, therefore, stands to reason that the creditor must have full discretion in the matter, because, it is he, and not the Income-tax Officer, who knows, or must be deemed to know, the circumstances and risks as well as chances of recovery from his debtor. The Income-tax Officer cannot, therefore, legally insist that the assessee must subordinate his own will or discretion and even his decision in the matter to his decision."

Their Lordships are of opinion that the views of the Judicial Commissioner enumerated above are erroneous, and that the assessee has no such decisive voice as suggested.

Although the Act nowhere in terms authorises the deduction of bad debts of a business, such a deduction is necessarily allowable. What are chargeable to income tax in respect of a business are the profits and gains of a year; and in assessing the amount of the profits and gains of a year account must necessarily be taken of all losses incurred, otherwise you would not arrive at the true profits and gains. But the losses must be losses incurred in that year. You may not, when setting out to ascertain the profits and gains of one year, deduct a loss which had in fact been incurred before the commencement of that year. If you did, you would not arrive at the true profits and gains of the year. For the purpose of computing yearly profits and gains, each year is a separate self-contained period time, in regard to which profits earned or losses sustained before its commencement are irrelevant. It thus follows that a debt, which had in fact become a bad debt before the commencement of a particular year, could not properly be deducted in ascertaining the profits of that year, because the loss had not been sustained in that year.

Whether a debt is a bad debt, and, if so, at what point of time it became a bad debt, are questions which in their Lordships' view are questions of fact, to be decided in the event of dispute by the appropriate tribunal, and not by the *ipse dixit* of any one else. The mere fact that a debt was incurred at a date beyond the period of limitation will not of itself make the debt a bad debt; still less will it fix the date at which it became a bad debt. A statute barred debt is not necessarily bad; neither is a debt which is not statute barred necessarily good. The age of the debt is no doubt a relevant matter to take into consideration. In every case it is a question of fact, to be determined after consideration of all relevant circumstances.

If, therefore, the order and decision of the Court of the Judicial Commissioner depend upon the view that this question of fact is one as to which the sole arbiter is the assessee, that order and decision cannot stand.

It was, however, argued by Mr. Latter on behalf of the respondent that the appeal must be dismissed. He conceded that an assessee was not entitled, in computing his business profits and gains of one year, to deduct a loss in fact incurred in an earlier year. Further he said that he was not concerned to argue that an assessee was the sole arbiter to decide whether a debt was bad, and when it had become bad, because this particular assessee was

entitled to succeed upon the evidence as it stood in this particular case. He claimed that in this particular case, the deduction of the Rs. 7,481-13-9 had been disallowed by the officer and the Assistant Commissioner solely upon the insufficient ground that the debts represented by that sum had become statute-barred before the year in question; and that accordingly the debts being admittedly bad there was no evidence to justify the disallowance of the deduction in the particular year.

Their Lordships are not prepared to accept the view that the disallowance rested solely on the fact that the limitation period had expired. The debts are stated to be not only time-barred, but are also described as "very old," and as "old bad debts which could not be allowed in the account year."

However this may be, it is clear that the members of the Court of the Judicial Commissioner intended to decide and thought that they were deciding, not a question affecting only a particular assessee and depending upon the state of the evidence in a particular case, but a question of great public importance affecting assessees generally, and depending upon general principles.

The questions for reference under Section 66 of the Act (which were framed by the assessee) are, perhaps, not very happily worded; but the use of the word "option" and the question whether the income-tax authority can deprive the assessee of the alleged option help to throw light upon what was the real issue between the parties. Their Lordships feel no doubt as to what that issue was, and how it arose. The officer (under Section 23 of the Act), after considering the evidence and account books produced, disallowed the deduction; and the Assistant Commissioner confirmed the disallowance. The argument on behalf of the assessee is apparent in the order of the Assistant Commissioner. He states therein that the pleader for the assessee "argues that it should be left to the assessee to declare when the debts were bad, and the Income-tax officer should not go on the presumption that the amount had become time-barred in previous years." From this their Lordships are satisfied that the attitude adopted by the assessee, when challenged, was to decline to establish by evidence that these old debts had not already become bad before the commencement of the year of account, and to claim the right to be sole arbiter of the question in dispute. That was the real issue between the parties which the Court of the Judicial Commissioner (wrongly, as their Lordships conceive) decided in favour of the assessee.

In their Lordships' opinion the question which was referred to the Court in relation to bad debts should have been answered as follows:—

"The assessee has no 'option' of declaring debts bad. Whether a debt is bad, and when it became bad, are questions of fact to be determined in case of dispute not by the assessee or by the exercise of any 'option' on his part, but by the appro-

appropriate tribunal upon a consideration of all relevant and admissible evidence. In the circumstances of the present case it is not possible to say that the Income-tax Officer and the Assistant Commissioner should have allowed Rs. 7,481-13-9 to the assessee on the same consideration on which the remaining amount of Rs. 17,982 claimed by him was allowed."

Their Lordships will, accordingly, humbly advise His Majesty that this appeal should be allowed and the order of the Assistant Commissioner dated, the 25th April, 1927, restored so far as relates to the Rs. 7,481-13-9.

There will be no costs of this appeal.

In the Privy Council.

THE COMMISSIONER OF INCOME TAX, CENTRAL
PROVINCES AND BERAR.

v.

SIR S. M. CHITNAVIS, SINCE DECEASED (NOW
REPRESENTED BY KRISHNA RAO, MINOR,
THROUGH HIS GUARDIAN PARWATI BAI
LADY CHITNAVIS).

DELIVERED BY LORD RUSSELL OF KILLOWEN.

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