Inter-corporate deposits non-recoverable due to merger of entities allowable as bad debts

Summary – The Mumbai ITAT in a recent case of Godrej & Boyce Mfg. Co. Ltd., (the Assessee) held that while computing depreciation under section 32, value of block of assets in case of resulting company should be written down value of assets of demerged company immediately before demerger

Where inter-corporate deposits became irrecoverable and same were written off by assessee, it was allowable as bad debt

Facts - I

- The assessee claimed depreciation. In the tax audit report the assessee made the following disclosure that the assets transferred from the demerged company pursuant to the scheme of arrangement under sections 291 and 394 of the Companies Act, 1956, have been taken over at the written down value of the block of assets as appearing in the books of account of the demerged company immediately before the demerger. The written down value of the block of assets as appearing in the books of account of the demerged company has been reduced to incorporate the effect of interest capitalized by the assessee in the books of account and claimed as revenue expenses under the income-tax in the earlier previous year's.
- The Assessing Officer observed that the relevant asset transferred to the assessee company should be considered at the income tax written down value for the purpose of computing the depreciation under section 32.
- The Assessing Officer held that in the scheme of demerger, the demerged company was to reduce the written down value of the assets transferred to the resulting company. Hence, the resulting company should add to its block of assets written down value of the assets taken over by it. The assessee could not take a tax advantage by entering into a scheme of demerger because the intention of the Legislature was to make such a scheme tax neutral. Since depreciation was to be computed as per the provisions of section 32, the written down value of the assets as per Income-tax Act should be considered.
- On appeal, the Commissioner (Appeals) decided against the assessee.
- On second appeal:

Held - I

- The view taken by the Assessing Officer after referring to the memorandum explaining the provisions of Finance Bill, 1999 that provisions relating to the demerger of companies were introduced based on certain principles one of which was that the demergers should be tax neutral and should not attract any additional tax liability. The value of the assets of the demerged company should be the same when transferred to the resulting company. The amendment made by the

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Finance Act, 2003 with effect from 1-4-2004, is curative and clarificatory in nature. The omission of the words 'as appearing in the books of account' have neither taken away nor affected any rights of the assessee which were accrued to him before the said amendment. The amendment made *vide* Finance Act, 2003 has just removed the ambiguity. It has neither taken away any right of any assessee nor has given any new right to the revenue.

- The view taken by the Tribunal in the case of *Godrej Industries Ltd.* v. Asstt. CIT [2008] 26 SOT 445 (Mum.) was that the emphasis of the Legislature in Explanation 2B after the amendment made *vide* Finance Act, 2000 was that the value of the block of assets in the case of resulting company shall be the written down value of the assets of the demerged company immediately before the demerger. Hence, it is not found any infirmity in the findings of the lower authorities that only the written down value of the transferred assets of the demerged company as per the accounts maintained under the Income-tax Act shall accordingly constitute the written down value of the block of assets of the resulting company.

Facts – II

- The assessee had written off inter corporate deposits placed with GH. The assessee explained to the Assessing Officer that the demerged company GC was in the business of carrying out financial operations and had advanced an amount to GH. Since the GC had merged into the assessee company as result thereof inter corporate deposits placed by the erstwhile GC being irrecoverable, had been written off by the assessee company.
- The Assessing Officer, however, did not agree with the contention of the assessee and held that the bad debts could be allowed only if such debt had passed through trading/profit and loss account of the company. He therefore held that the deduction could not be allowed since the debt had been taken into account in computing the income of the assessee and accordingly disallowed the above claim of the assessee.
- On appeal, the Commissioner (Appeals) however allowed the claim of the assessee observing that the demerged company GC was in business of lending the money. The money was lent in the course of business. The interest income from the loans was always assessed as business income of the GC. The said GC had merged with the assessee company and the assessee had written off the deposit as the amount had become irrecoverable. He therefore held that the claim was allowable as bad debt under section 36(1)(vii) read with section 36(2). He observed that under the provisions of section 36(1) read with section 36(2), such a claim of bad debts was allowable, even if the debts were not passed through the profit and loss account but the debts were representing money lent in the ordinary course of business of lending carried on by the assessee.
- On second appeal:

Held - I

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- The assessee contended that the finance business of the demerged company was further carried over by the assessee company, though, it was not the exclusive business but one of the business activities of the resulting company. The condition of passing the entry through profit and loss account is not mandatory in case of money lent in the business of money lending even as per the provisions of section 36(2)(i). It is not found any infirmity in the order of the Commissioner (Appeals) on this issue and the same is accordingly upheld.

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