

Failure to recover sum advanced to share broker for investment was business loss and not bad debt: Delhi HC

Summary – The High Court of Delhi in a recent case of Escotracs Finance & Investments Ltd., (the Assessee) held that Mere failure to recover sum from share broker which was given as advance for investment in *badla* transactions could, at best, be a business loss but would not be a bad debt

Facts

- The assessee was engaged in the business of finance and investment. The assessee along with another group company EHL advanced a sum to the broker, KKC for investment in *badla* transactions. Unfortunately shares were not purchased by the broker. The broker was unable to repay the money advanced. Later, Memorandum of Agreement was entered into with the broker a part of amount was agreed to be paid by the broker by cheques and a small part by way of shares to be transferred by the broker. The balance sum was written off as bad debt in the books of the assessee as well as EHL. The assessee's share of these bad debts worked out to Rs.71.82 lakhs. Thus, the assessee reduced its profits by writing off a sum of Rs.71.82 lakhs in the profit and loss account claiming it to be a bad debt.
- However, the Assessing Officer was of the view that the amount could not be treated as a bad debt since; (i) there was no specific waiver of any liability (ii) No debt as such had arisen at all or been recognised as such (iii) 'Broker had undertaken to pay sums due to assessee and for the balance' he had undertaken to furnish assessee with shares' (iv) 'At the best the shortfall between sums given by the assessee and payments agreed to be made to the assessee could be considered as the cost of shares to the assessee' and (v) 'Any loss arising, if at all, out of above transaction could only be speculative in nature.'
- On appeal, the Commissioner (Appeals) confirmed the order of the Assessing Officer.
- On further appeal, the Tribunal was of the view that the assessee was engaged in a speculative transaction. It held that the investment made with the broker was in speculative business and the loss suffered on account thereof was a speculative loss which could only be set off against the speculative income. Since in the assessment year in question the assessee had earned certain speculative income against which the set off of speculative loss should be allowed to the assessee, the matter should be restored to the file of the Assessing Officer to re-compute the speculative loss after allowing the set off of speculative income and to carry forward the loss, if any, as per law.
- On appeal to the Tribunal:

Held

- In the considered view of the Court, the Tribunal appears to have misconstrued the nature of the transaction involving the assessee and the broker KKC. It also overlooked the basic fact that the assessee was a finance and investment company. This is evident from its observation in the

impugned order that 'since the assessee himself was not engaged in dealing of shares, it cannot be said to have been engaged in trading of shares.' This was plainly contrary to the factual position. Thirdly, it was not the assessee's case to begin with before the Assessing Officer, that the amount written off by it was a 'speculative loss'.

- The Assessing Officer's analysis of what really the transaction was, was based on the correct understanding of the legal position emanating from section 36(1)(vii). This corresponds to section 2(10)(xi) Income Tax Act, 1922, which was interpreted by the Supreme Court in *A.V. Thomas & Company Ltd. v. CIT* [1963] 48 ITR 67. There, the Court explained that '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.'
- The revenue was right in the contention that what was not shown to be part of the income of the assessee for an earlier previous year could not possibly be written off as a debt in the year in question. The failure by the broker to return the aforementioned sum was at the highest a business loss and nothing more. It was not even the assessee's case that it was a speculative loss. The observations of the Assessing Officer have been taken out of context. It was observed by the Assessing Officer, in the process of negating the claim of the assessee that it was a bad debt, that 'it may be cost of shares purchased, speculation loss of the assessee or may assume any other form.' This could not be construed as the Assessing Officer holding it to be a speculative loss.
- Consequently, the question framed is to be answered in the affirmative, *i.e.*, in favour of the revenue and against the assessee.