M.R.O. 14—10,000—21-4-22

# MADRAS RECORD OFFICE.

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## Government of Madras.

Revenue **DEPARTMENT.**

G.O. No. 216 Press ~~Mis.~~

429-430

Dated 29-1- 1867.

***Not to be folded or roughly handled***

*Proceedings of the Madras Government, Revenue Department, 29th January* 1861.

No. 429. Read the following letter from C. H. LUSHINGTON, Esq., Secretary to the Government of India, (Financial Department) to J. D. BOURDILLON, Esq., Secretary to the Government of Fort Saint George, dated Fort William, 11th December 1860, No. 12,077:—

SIR,

I am directed to acknowledge the receipt of your letter No. 2,085, dated the 8th ultimo, and its enclosures, forwarding for orders a reference from the Special Commissioner for the Income Tax at Madras, in regard to the exact meaning of the permission given at the close of Rule 4 in Section 98 of Act XXXII of 1860, to deduct bad debts from returns of profits, and requesting instructions in more general and comprehensive terms, than the form in which the queries are submitted by the Special Commissioner, including a definition of the meaning of the phrase "bad debt."

In reply I am desired to forward for information and guidance, a copy of the Advocate General's opinion, in respect to the points referred to, and to state that the Honorable the President in Council concurs in that opinion.

OPINION.

With reference to the specific questions put by the Income Tax Commissioners, I am clearly of opinion,

1st. That a debt, ascertained to be a bad debt in one year, can only be taken into account as a loss, and set off against the profits of the year in which it is so ascertained to be a bad one, and that no portion of such debt, *after* it has once been set off against the profits of one year, can be set off against or taken in reduction of the next or of any succeeding year.

Thus in the instance put by the Commissioner, A. B. cannot after setting off against the loss of 1859 (arising from the discovery in that year that a debt previously treated as good is a bad one) the profits of that year which are thereby wholly absorbed, and after thus obtaining exemption from Assessment for one year, carry forward the uncertain debit balance in the next or in any subsequent year.

The principle of the tax as a tax on income is to assess the duties on the actual profits of each year, without reference to the profits made or losses sustained in any other year. Thus if a man sustain in 1859 losses which swallow up all his profits for the year, he will, in making his return for 1860, based upon the profits of 1859, have no profits whatever to return. But if in 1860, he makes a clear profit, although that profit may not be sufficient to meet the losses of 1859, he will have to return in 1861, the whole net profits of 1860, without making any deduction for the balance of loss remaining over from 1859, a bad debt does not in this respect differ from any other kind of loss. The difficulty may be greater in determining when it is to be treated as a loss; but when once this has been ascertained, it must be determined once for all, and no part of it can be taken in diminution of the profits of a year subsequent to that in which it was originally treated as lost.

2nd. The refusalof a Public Company to declare a dividend can of itself make no difference whatever in regard to the assessment of the profits of such Company, such a Company is entitled to deduct a bad debt from the profits of the year in which the debt is ascertained to be a bad one, but it must do so, as an individual must, once for all, and however prudent and reasonable its conduct may be in not declaring a dividend from the profits of one year, until a loss made or ascertained in a previous year (whether in the shape of a bad debt or not) is made good, the right of the State to the duties upon the net profits of each succeeding year calculated according to the Act, cannot be affected thereby.

It will be seen from the foregoing remarks that I agree generally with the views stated by Mr. Ellis, in his letter of the 27th ultimo.

With respect to the meaning of the term "bad debt" itself, it is almost impossible to give any definition of it which shall apply to all cases, and much must be left to the discretion

of the Commissioners in determining what shall be allowed as a bad debt or not. The only general definition that can be safely given of it is, I think, that it must be a debt which has been during the period for which the return of profits has been made for the first time ascertained to be irrecoverable and has been *bonâ fide* and upon reasonable grounds written off to profit and loss, or otherwise so dealt with in the creditor's books as to leave any amount that may in any subsequent year be recovered on account, to enter into the profits of such subsequent year, and I am inclined to think that where this has occurred with reference to part of a debt, the part so ascertained and so dealt with may be treated as a bad debt, while the rest cannot be so treated. The Income Tax Commissioners in England seem, from the evidence before the Select Committee of the House of Commons in 1851, to have adopted a stricter definition of the term than this, and to have required the person claiming a deduction on account of bad debts to state that the amount has been struck off his books and forgiven to the debtor,* and they made no allowance in respect of debts that were partially bad, so that where the accounts of a firm showed in one year debts none of which had been finally settled, and some of which were due from persons whose Estates were being wound up, and the firm had made an estimate that the dividends they would receive would amount to a certain sum, but nothing was then ascertained for certain as to the amounts, the Commissioners would make no allowance for bad debts at that period, but would wait until the account was wound up and closed and would then treat the sums which had proved absolutely irrecoverable as bad debts, I think that this rule was too stringent and that there is nothing in the language of the Act that absolutely required so narrow a construction to be put on the word "bad debts," at the same time the Commissioners seem to have adopted their rule from a sense of the great opportunities of evasion that would be afforded by sanctioning a more liberal rule. The rule was apparently felt to be too stringent by the Select Committee and the Government, for in 1853, a Clause was inserted in the new Act expressly empowering the Commissioners to estimate the value of all doubtful debts, and in the case of Bankruptcy or Insolvency of the debtors to take the amount of dividends which may be reasonably expected to be realized as the value of the debt, a similar Clause was inserted in the draft of the present Bill, but was omitted in Committee probably from its being supposed that under the words of Rule 4, Section 98, the Commissioners were already competent to make an allowance in respect of all debts which they were satisfied were bad, notwithstanding the legal possibility of their being recoverable wholly or in part and also to distinguish between such part of the debt as might be reasonably expected to be realized and such part as was practically hopeless.

* *See the evidence of Mr. Dickens and Mr. Cave (Special Commissioners) of 3rd July* 1851 *before the House of Commons answer* 1312, 13, 14. *First Report of Select Committee, paragraph* 158, *evidence of Mr. Jeffrey* (*25th May* 1852) *answers* 5704 *to* 5719 (*2nd Report of Select Committee*) *paragraph* 388.

I think that it will be inexpedient to fetter the discretion of the Commissioners in determining what shall be deemed wholly or in part a bad debt, or what allowance they shall make in respect of it, further than by pointing out the general principle upon which they should act. In applying the rule as above suggested by me, no doubt difficulties will occur, but considerable difficulties are inherent I think to the subject, and must occur whatever definition or rule in regard to bad debts be adopted. Care must be taken however not to adopt a part of the definition alone, without looking at the whole, as otherwise evasion of the duties justly claimable will be (easy). Thus I do not think that a firm which has long had in its books a debt known to be bad, but which it has not (in consequence of some rule of the firm or of inadvertance) previously written off to profit and loss, can by merely writing it off in the year for which the profits are estimated, claim an allowance for the debt as a bad debt chargeable against the profits of that year, such a debt will not fulfil the condition of having been for the first time ascertained to be a bad one, during the period for which the profits are estimated, nor can a firm having ascertained in that period that a debt is absolutely bad and irrecoverable to an extent more than sufficient to swallow up the profits of that year, satisfy the condition of the Act by merely writing off to profit and loss in that year, so much as will meet their profits, carrying on the balance of the debt as an asset in the accounts of the next year, and repeat the process the next

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year by then carrying that balance to profit and loss and setting off such apparent loss against the profits of such, next year. It is clear that in such a case, the firm could, but for the object of avoiding the Income Tax, have written off in the first year not merely the part which exactly balanced the profits of that year, but the whole or so much as was ascertained to be irrecoverable The first writing off to profit and loss of a part only would not be such a *bonâ fide* or reasonable dealing with the debt in the books as would satisfy the conditions above stated.

The main principle for the Commissioners to bear in mind in each case will be that the debt must be one, by the discovery of the badness of which in whole or in part, the profits of the particular year may reasonably and *bonâ fide* be deemed to have been deminished. But the mode of applying this principle to each particular case, must necessarily be left greatly to the judgment of the Commissioners.

(Signed) W. RITCHIE,

*24th November* 1860.

True Copy.)

(Signed) R. F. STACK,
*Officiating Solicitor to Government.*

(A true Copy.)

(Signed) C. HUGH LUSHINGTON,
*Secretary to the Government of India.*

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No. 430. ORDER THEREON, 29th January 1861, No. 216.

Ordered to be communicated to the Special Commissioner in reply to his letter of the 7th November, No. 46, and to the Income Tax Commissioners and the Board of Revenue for their information and guidance.

(Signed) J. D. BOURDILLON,
*Secretary to Government.*

R—8th Novr 60 No 142 143

Rec'd 1860 Dec 6
Pro: of Govt for January 61.
No 3070

From
The Secretary to the
Govt of India

Dated 11th
Rec'd 29th } Dec 1860.

Encl

Forward a Copy of the Advocate Genl's opinion in regard to the exact meaning of the permission given in the Income Tax Act to deduct bad debts from Returns of Profits

No 429 & 430.

No 216. 29th January
Withdrawn Order

C 8 Jany 61st

No 216.

Ordered to be communicated to the Special Comm in reply to his letter of the 4th Inst. No 46 and to the Income Tax Commissioners & the Bd of Revs for their information and guidance.

Fort St Geo
29th January 1861.

3 Encls

To The Spl Comm of the Income Tax

1 " President of the Income Tax Com

6 " Bd of Revs