

**IN THE HIGH COURT OF KARNATAKA  
DHARWAD BENCH**

DATED THIS THE 16<sup>th</sup> DAY OF AUGUST 2016

PRESENT

**THE HON'BLE MR. JUSTICE H.BILLAPPA**

AND

**THE HON'BLE MR. JUSTICE K.N.PHANEENDRA**

I.T.A. No.100132/2014

Between

1. The Commissioner of Income Tax,  
Dr. B R Ambedkar Road, Belgaum.

2. ACIT, Circle-I, Vijayapura.

...Appellants

(By Sri Y.V.Raviraj, Advocate)

And:

Shri Basaveshwara Sahakari Bank  
Niyamith, Sector No.25,  
Basaveshwara Circle,  
Navanagar, Bagalkot.  
PAN: AAAAS1703P

...Respondent

(By Sri G.Venkatesh, Advocate for Sriyuths A.Shankar,  
M.Lava, Manjunat G. and Shashank Hegde, Advocates)

This ITA is filed under Section 260A of the Income-Tax Act, 1961 against the order passed in ITA NO.534/BANG/2013 dated 27.06.2014 on the file of the Income Tax Appellate Tribunal, 'B' Bench, Bangalore, partly allowing the appeal filed by the assesseees.

This ITA coming on for Orders this day,  
**H.BILLAPPA, J.**, delivered the following:

## **JUDGMENT**

Heard the learned counsel for the parties.

2. The following substantial questions of law arise for consideration in this appeal;

- i) Whether the interest paid to members of a Co-operative Bank above Rs.10,000/- should be added to tax or not?
- ii) Whether interest receivable from non-performing assets, bad and doubtful debts though the actual expression used is interest payable and not reflected in the profit and loss account, could be deducted?

3. The learned counsel for the parties submit that the matter is covered by a decision of this Court in ITA No.200002/2015 and connected appeals.

4. This Court in ITA No.200002/2015 and connected appeals has raised the following substantial questions of law in addition to one more question regarding gratuity;

- i) Whether the interest paid to members of a Co-operative Bank above Rs.10,000/- should be added to tax or not?

- ii) Whether interest receivable from non-performing assets, bad and doubtful debts though the actual expression used is interest payable and not reflected in the profit and loss account, could be deducted?

5. The first question is answered at para 2 as follows:

" 2. .... The point is squarely covered by a Division Bench judgment of this Court in *ITA No.100116/2014* between the *Commissioner of Income Tax and another vs. The Bagalkot District Central Co-operative Bank* dated 16.12.2015 wherein, with reference to a circular of the Government of India bearing No.19/2015 in F.No.142/14/2015 TPL, it has been held as follows:

"42.5 In view of this, the provisions of the section 194(3)(v) of the Income-tax Act have been amended so as to expressly provide that the exemption provided from deduction of tax from payment of interest to members by a co-operative society under Section 194A(3)(v) of the Income-tax Act shall not apply to the payment of interest on time deposits by the co-operative banks to its members. As this amendment is effective from the prospective dated of 1<sup>st</sup> June, 2015, the co-operative bank shall be required to deduct tax from the payment of interest on time deposits of its members, on or after the 1<sup>st</sup> June 2015. Hence, a cooperative bank was not required to deduct tax from the payment of interest on time deposits of its members paid or credited before 1<sup>st</sup> June 2015."

In view of the above circular, the said substantial question of law does not survive for consideration."

6. The second question is answered at para 5 as follows:

“ 5. One other substantial question of law framed is,

“Whether interest receivable from non-performing assets, bad and doubtful debts though the actual expression used is interest payable and not reflected in the profit and loss account, could be deducted?”

In this regard, the learned counsel for the assessee has produced a judgment of this Court in *Commissioner of Income-Tax and another vs. Canfin Homes Ltd. (2012) 347 ITR 382 (Karn)* with reference to non-performing assets. The Division Bench of this Court has held as follows:

“ Therefore, it is clear, if an assessee adopts the mercantile system of accounting and in his accounts he shows a particular income as accruing, whether that amount is really accrued or not is liable to bring the said income to tax. His accounts should reflect true and correct statement of affairs. Merely because the said amount accrued was not realised immediately cannot be a ground to avoid payment of tax. But, if in his account it is clearly stated though a particular income is due to him but it is not possible to recover the same, then it cannot be said to have been accrued and the said amount cannot be brought to tax. In the instant case, we are concerned with a non-performing asset. As the definition of non-performing asset shows an asset becomes non-performing when it ceases to yield income. Non-performing asset is an asset in respect of which interest has remained unpaid and has become past due. Once a particular asset is shown to be a non-performing asset, then the assumption is it is not yielding any revenue. When it is not yielding any revenue,

the question of showing that revenue and paying tax would not arise. As is clear from the policy guidelines issued by the National Housing Bank, the income from non-performing asset should be recognised only when it is actually received. That is what the Tribunal held in the instant case. Therefore, the contention of the Revenue that in respect of non-performing assets even though it does not yield any income as the assessee has adopted a mercantile system of accounting, he has to pay tax on the revenue which has accrued notionally is without any basis. In that view of the matter, the second substantial question framed is answered against, the Revenue and in favour of the assessee."

At this, the learned counsel for the revenue would submit that the decision only refers to non-performing assets and it is not evident that non-performing assets would also cover other classification of loans and advances. In this regard, the learned counsel for the assessee would point out that non-performing assets would include the other categories of substandard assets, doubtful assets, loss assets, etc., all of which would come within the purview of non-performing assets. In this regard, he would draw attention to the prudential norms for income recognition, asset classification and provisioning pertaining to advances.

Volume I of 'Tannan's Banking Law and Practice in India', has extracted these prudential norms in line with the international practices and as per the recommendations of the Narasimham Committee on the financial system, the Reserve Bank of India has introduced, in a phased manner, prudential norms for income recognition, asset classification and provisioning for the advances portfolio of the Banks so as to move

towards greater consistency and transparency in the published accounts.

The definition of non-performing assets is as follows:

"1. Non-performing assets:

An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.

A "non-performing asset" (NPA) is a loan or an advance where:

(i) the interest and / or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan;

(ii) the account remains "out of order" for a period of more than 90 days as indicated below, in respect of an Overdraft / Cash Credit (OD/CC);

(iii) the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted;

(iv) the instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops;

(v) the instalment of principal or interest thereon remains overdue for one crop seasons for long duration crops.

Banks should, classify an account as NPA only if the interest charged during any quarter is not serviced fully within 90 days from the end of the quarter."

Further, asset classification which is separately dealt with reference to categories of non-performing assets, as follows:

"Banks are required to classify non-performing assets further into the following

three categories based on the period for which the asset has remained non-performing and the realisability of the dues:

- (a) Sub-standard Assets
- (b) Doubtful Assets
- (c) Loss Assets"

Therefore, it is evident that the mere nomenclature adopted with reference to the bad loans and advances receivable, would refer to all non-performing assets of any nature, of whatever category it was placed as a non-performing asset and therefore, the decision of this court in *Canfin Homes* would squarely apply. Accordingly, the above question of law also stands answered.

7. The decision in ITA No.200002/2015 and connected appeals is applicable to the substantial questions of law raised in this appeal also. Therefore, the substantial questions of law raised in this appeal are answered in terms of the order passed in ITA No.200002/2015 and connected appeals and the appeal is disposed of, accordingly.

**Sd/-  
JUDGE**

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JUDGE**

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