

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD**TAX APPEAL NO. 249 of 2002****With****TAX APPEAL NO. 463 of 2005****TO****TAX APPEAL NO. 467 of 2005****FOR APPROVAL AND SIGNATURE:****HONOURABLE MR.JUSTICE KS JHAVERI****and****HONOURABLE MR.JUSTICE K.J.THAKER**

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- 1 Whether Reporters of Local Papers may be allowed to see the judgment ?
 - 2 To be referred to the Reporter or not ?
 - 3 Whether their Lordships wish to see the fair copy of the judgment ?
 - 4 Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 or any order made thereunder ?
 - 5 Whether it is to be circulated to the civil judge ?
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JOINT COMMI. OF INCOME-TAX....Appellant(s)**Versus****PARSHWANATH HOUSING FINANCING CORPN. LTD.....Opponent(s)****Appearance:****MR NITIN K MEHTA, ADVOCATE for the Appellant(s) No. 1****MR SN SOPARKAR, Sr. Advocate, with MR BS SOPARKAR, MRS SWATI SOPARKAR, ADVOCATE for the Opponent(s) No. 1****CORAM:****HONOURABLE MR.JUSTICE KS JHAVERI****and****HONOURABLE MR.JUSTICE K.J.THAKER****Date : 01/12/2014****COMMON ORAL JUDGMENT**

(PER : HONOURABLE MR.JUSTICE KS JHAVERI)

1. Since, the issue involved in all these appeals is similar, they are heard together and disposed of by this common judgment.

2. All these appeals are filed by the appellant-revenue against the order of the Tribunal passed in I.T.A. No.648/Ahd/2000 for A.Y. 1991-92, Dated : 27.08.2001, and I.T.A. Nos.553 & 2472/Ahd/1999 for A.Y. 1993-94 and 1995-96 and I.T.A. No.641/Ahd/2000 for A.Y. 1994-95 and I.T.A. No.1262/Ahd/2001 for A.Y. 1997-98, Dated : 30.07.2004, whereby, the Tribunal allowed all the appeals, which were filed by the assessee.

3. The factual matrix of the matters run in a very narrow compass, as borne out from the facts narrated in the order of the AO, which read as under;

4. The assessee filed its original return of income for different assessment years. Pursuant thereto, case of the assessee for different years came to be examined by the concerned AOs during the relevant assessment years. Thereafter, certain additions came to be made to the income of the assessee for the relevant assessment years towards interest income due to the assessee. Hence, the assessee approached the CIT(A) by filing separate appeal

for each assessment year, which, came to be dismissed. Being aggrieved thereby, the assessee carried the matter before the Tribunal, which allowed the appeals filed by the assessee. Hence, the appellant-Revenue preferred the present appeals.

5. It appears that the AO examined the case of the assessee for relevant assessment years and held that they were liable to tax for the interest income, which would accrue in future, as they were following the mercantile system.

6. The main bone of the contention raised by Mr. Mehta, learned Advocate for the appellant-revenue, was that the assessee did not charge interest, by picking and choosing, on some of the Cooperative Societies, namely Mallinathorabhy (Odhav) Co. Op. Housing Society, Padmavatinagar (Naroda) Co. Op., Mahavir Smruti (Odhav) Co. Op. Housing Society, Shantinath Babhu (Naroda) Co. Op. Housing Society, Addinathnagar (Odhav) Co. Op. Housing Society, Sumtinath Prabhu (Naroda) Co. Op. Housing Society Ltd., Dipalinagar (Odhav) Co. Op. Housing Society etc.. However, the Tribunal went on recording the observations of the Auditor, which reads as follows;

"5. The note at Sr. No.6 of the Annexure to Auditor's report dealing with the subject reads as under:-

"In respect of loan or advance in nature of loan given by the company, the parties generally repay the principal amount as stipulated or rescheduled and are also generally regular in payment of interest except in the cases of seven Societies amounting to Rs.49,09,502/- and 694 individuals amounting to Rs.29,94,456/- where reasonable steps have been taken by the company for recovery of the principal and interest.

5.1 Further, note at Sr. No.3 of the Schedule-8 to the Auditor's report read as under:-

"Company has taken legal action for recovery of residential housing loans amounting to Rs.49,09,502/- given to seven cooperative housing Societies pending the litigation, the same are considered good and no interest have been charged as per accounting policies""

7. The only aspect on which the assessee was directed by both CIT(A) and AO was that having mercantile system of accounting and that the assessee having not explained the reasons for applying different yard-stick for charging interest for the debtors falling in the same category. The terminology of the word accrued / rather interest accrued was read in by the AO and the CIT(A). However, on appeal, the Tribunal gave its finding on facts and the basis for directing

the interest to be charged was that the assessee-Company could recover interest up to the year ending on March, 1999, and therefore, the interest at the rate of 15 per cent was charged. However, the Tribunal relied on Section 34 of the Code of Civil Procedure, relating to the term 'interest' and considered that aspect by interpreting various decisions of various High Courts in Para-6 relied on by the assessee, which reads as under;

"6. The assessee has relied on the following judgments:-

(1) CIT Vs. U.P. Financial Corporation(All.), 217 ITR 191;

(2) CIT Vs. U.P. Financial Corporation(All.), 194 ITR 282;

(3) CIT Vs. Naskarpara Jute Mills Co. Ltd. (Cal.), 141 ITR 384;

(4) CIT Vs. Orissa State Financial Corporation(Orissa), 201 ITR 595;

(5) CIT Vs. M.P. Finance Corporation(Madhya Pradesh High Court), 227 ITR 888;

(6) CIT Vs. Citibank N.A.(Bombay High Court), 208 ITR 930;

(7) CIT Vs. Rajasthan Financial Corporation(Rajasthan High Court), 89.taxman 376".

8. The tribunal in Paras-8 and 9 of its order, Dated : 27.08.2001, has observed and held as under;

"8. We have considered the rival submission of representatives of both the parties, perused the records and gone through the decision referred. The assessee followed mercantile method of accounting which means all income accrued during the year should be accounted for in the books of account irrespective of the fact that the income is received in this year or it received in future. The "accrual of income" is root of the issue of the appeal. "Accrue" means the right to receive profit and that there must be a debt owed to the assessee by some body. Unless and until there is created in favour of the assessee a debit due by somebody, it cannot be said that he has acquired a right to receive the income or that income has accrued to him. To deal with such a situation, the Institute of Chartered Accountant has also issued guidelines is AS9. It has been suggested that in case of uncertainty the revenue will be recognized only when it is reasonable certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, the revenue is recognized at the time of sale or rendering of services even though payments are made by the installments. It if is read with section 34 of Civil Procedure, it will be found that interest will be payable at such rate as the Court deem reasonable to be paid on the principal sum adjudged, from the date of the suit

to the date of the secres. It means in case a where suits have been filed, interest will be finalized by the Court and without order of the Court, the assessee did not have right to receive, since there was no right to receive interest income. It will not accrue and accordingly assessee need not account for it in books of account and it cannot be treated as income for the year under appeal.

9. After giving a deep and thoughtful consideration to the entire material and facts, we are of the considered opinion that in case of uncertainty of interest income from housing loans given to societies, which is *sub judice*, it can not be treated as income accrued or received to the assessee in the year under appeal. Therefore, the orders of the revenue authorities are quashed."

9. Mr. Mehta, learned Advocate for the appellant-Revenue, took us through the entire record and submitted that the substantial question of law framed are as under;

"[1] whether, when the assessee was following mercantile system of accounting, the Income Tax Appellate Tribunal was justified in law and on facts in holding that the interest income from housing loans given by the assessee to the seven societies could not be treated as income accrued or received to the assessee?

[2] Whether the Tribunal on the facts of the case was justified in placing

reliance on the provisions of section 34 of the Code of Civil Procedure, particularly in view of section 5 of the Income Tax Act, 1961?"

10. As far as first question of law is concerned, Mr. Mehta has relied upon a decision of the Apex Court in "**STATE BANK OF TRAVANCORE VS. CIT**", [1986] 158 ITR 102, and submitted that the same would apply in full force to the facts of the present case. He has, further, relied on a decision of the High Court of Himachal Pradesh "**H.P. MINERAL AND IND. DEVELOPMENT CORPORATION VS. CIT**", [2008] 302 ITR 120 (HP) and has contended that the Tribunal has misread the word 'accrual' and it ought to have upheld the reasoning given by the CIT(A).

11. As against this, Mr. Soparkar, learned Sr. Advocate, placed reliance on the following judgments;

(1) "**CIT VS. U.P. FINANCIAL CORPORATION**", [1992] 194 ITR 282;

(2) "**CIT VS. ORISSA STATE FINANCIAL CORPORATION**", [1993] 201 ITR 595

(3) "**MAHARASHTRA STATE FINANCIAL CORPORATION LTD. VS. CIT**", [2005] 278 ITR 654 (Bom);

(4) **"UCO BANK VS. CIT, WEST BENGAL-III, KOLKATA"**, [2014] 43 taxmann.com 294;

12. Having heard the learned Counsels for the parties and having given our anxious thought, the decision in **"STATE BANK OF TRAVANCORE"** (Supra) cannot be made applicable to the facts of the case and in favour of the Revenue. More particularly, while considering the earlier decisions, regarding the principle of real income, the Apex Court in **"STATE BANK OF TRAVANCORE"** (Supra) has laid down the following presumptions;

"As a result of the aforesaid discussion, the following propositions emerge:

(1) It is the income which has really accrued or arisen to the assessee that is taxable. Whether the income has really accrued or arisen to the concept of real income would apply where there has been a surrender of income which in theory may have accrued but in the reality of the situation, no income had resulted because the income did not really accrue. (3) where a debt has become bad, deduction in compliance with the provisions of the Act should be claimed and allowed. (4) where the Act applies, the concept of real income should not be so read as to defeat the provisions of the Act. (5) If there is any diversion of income at source under

any statute or by overriding title, there is no income to the assessee. (6) The conduct of the parties in treating the income in a particular manner is material evidence of the fact whether income has accrued or not. (7) Mere improbability of recovery, where the conduct of the assessee is unequivocal, cannot be treated as evidence of the fact that income has not resulted or accrued to the assessee. After debiting the debtor's account and not reversing that entry-but taking the interest merely in suspense account cannot be such evidence to show that no real income has accrued to the assessee or been treated as such by the assessee. (8) The concept of real income is certainly applicable in judging whether there has been income or not but, in every case, it must be applied with care and within well-recognized limits. "

13. From the above, it is clear that the case of the assessee would not fall in any of the above. In the said case, the amounts were waived, whereas, in this case, it was never kept in interest so as to avoid unreal inflated profits. In this case, they become bad debts under Section 36(1) of the Act and that has been accepted by the Tribunal. Thus, the decision of 158 ITR and 82 ITR would be applicable. Merely, because the assessee was following mercantile system of accounting, it cannot be said that the Tribunal was not justified in law and in facts in holding that the interest income, commission,

loans to the 7 societies could not be treated as income accrued or received by the assessee.

14. We are basing our view in concurring with the Tribunal, on the basis of the finding of facts arrived at by the Tribunal and even on the basis of the latest decision of the Kolkata High Court in the case of **"UCO BANK Vs. CIT"**(supra), wherein, it has considered the case of **"STATE BANK OF TRAVANCORE VS. CIT, KERALA"**, [1977] 110 ITR 336 and the decision of the Apex Court in **"UCO BANK VS. CIT"**, [1999] 237 ITR 889 and while considering the same, at Paras-4, 13, 14 and 18, it observed and held as under;

"4. In case of assessment of tax under the Income Tax Act, no tax was levied on sticky loans on accrual basis. This was clarified by a circular of the Board dated 6th October, 1952, which was rescinded in view of the judgment of the Kerala High Court in the case of *State Bank of Travancore v. CIT* [1986] 158 ITR 102/24 Taxman 337(SC).

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13. Chargeable interest has been defined in Section 2(5) of the Interest Act 1974, to mean the total amount of interest referred to in Section 5, computed in the manner laid down in Section 6. Thus, chargeable interest of any previous year of a credit institution is the total amount of interest (other than interest on loans

and advances made to other credit institutions, co-operative societies etc., accruing or arising to the credit institution in that previous year.

14. Chargeable interest is interest that accrued or arose in the previous year, irrespective of whether such interest was actually received. Thus, where any loan or advance is given for a certain term, for example, where a loan is given for 5 years and interest is to be computed periodically, but is actually realised in advance, at the time of disbursement of the loan/advance, the interest would become chargeable. Periodically and not at the time when it is actually realised. Similarly, if the interest is to be computed in monthly, quarterly, or yearly rests, chargeable interest would accrue at the end of the months, quarter or year, as the case may be, even though actual realization may take place at a later date.

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18. We have already held that non-operational sticky loans in respect of which mercantile actual of interest was shown in the suspense account and not the profit and loss account, would not, in law, be payable on mercantile accrual basis. Interest on such loans would have to be accounted for and paid as and when it is realised. Question number 3 is answered accordingly and in favour of the assessee."

15. In view of the above, without further delving, question No.1 is answered against the appellant-revenue and in favour of the assessee.

16. So far as second question is concerned, Mr. Mehta, placed reliance on a decision in "**H.P. MINERAL AND IND. DEVELOPMENT CORPORATION VS. CIT**"(Supra), wherein, the High Court of Himachal Pradesh has held as follows;

"14. It is obvious that the decision must be taken immediately after the previous year. In this case the decision to waive off the loan was taken at a much later stage. The resolution to waive off the loan was passed after the income had already accrued. Once the income had accrued the passing of resolution after the close of accounting year would be of no consequence. The decision to waive off the interest should have been taken during the accounting year or prior thereto. The concept of real income would not apply in such a case. If the debt had become bad the deduction can be claimed only in compliance with the provisions of the Act and the Rules. Once the provisions of the Act were applicable and the income had already accrued the concept of real income cannot be brought into use to defeat the provisions of the Act."

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17. In this case, it cannot be said that temporary loans and the facts cannot be pressed into service in case of "**H.P. MINERAL AND IND. DEVELOPMENT CORPORATION VS. CIT**"(Supra). The concept of real income has been decided long back. In this case, it was not any doubtful loan and the interest has not been kept, although, the

Tribunal has held, as noted herein above. Therefore, such a decision will not apply to the facts of the present case. The assessee in this case was and had never decided to waive off any loan or interest, but, has filed suits and bad debts can be written-off in terms of Section 37 of the Act. Thus, in the case of "**H.P. MINERAL AND IND. DEVELOPMENT CORPORATION VS. CIT**"(Supra), the decision to waive interest was taken at a much later stage, and therefore, the Court held against the assessee, therein. Thus, second question is also answered in negative against the appellant-revenue and in favour of the assessee. The facts of this case, permitted the tribunal to interpret provisions of Section 34 of the Act in its true spirit. The A.O. as well as the CIT(A) has mis-read the provisions of Section 34 of the Code of Civil Procedure, which is made applicable to the interest. Therefore, no fault can be found with the Tribunal.

18. In the result, both the questions are answered against the appellant-revenue and in favour of the assessee. These appeals *sans merit* and are **DISMISSED**. No order as to costs.

(K.S.JHAVERI, J.)

(K.J.THAKER, J)

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