

\$~

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: 26.04.2018
Pronounced on: 01.05.2018

+ **ITA 107/2012 & CM APPL. 9127/2018**

CIT

..... Appellant

Through: Ms. Vibhooti Malhotra, Advocate.

versus

BRAHMAPUTRA CAPITAL & FINANCIAL SERVICES LTD

..... Respondent

Through: Mr. Ajay Vohra, Sr. Adv. with
Ms. Kavita Jha, Mr. Vaibhav
Kulkarni and Mr. Udit Naresh,
Advocates.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE A. K. CHAWLA

S. RAVINDRA BHAT, J.

1. The following question of law was framed in this appeal, under Section 260A of the Income Tax Act, 1961:

“Did the Income Tax Appellate Tribunal (ITAT) fall into error in holding that the sum of ₹ 2,53,15,466/- brought to tax on account of notional interest was not justified.”

2. The assessee herein had advanced certain amounts to various concerns, i.e. M/s Jindal Equipment Leasing & Consultancy Services Ltd. and Mansarovar Investment Ltd. during the previous year relevant to assessment year 1997-98. Interest was accrued on the said loans upto

assessment year 1998-99. Further, the Petitioner had advanced interest bearing loans to M/s Goswami Credits & Investment Ltd. during the previous year relevant to assessment year 1999-2000. Interest was accrued on the said loan till assessment year 2001-02. The assessee had not received interest for more than six months from its said debtors. As a Non-Banking Financial Company (NBFC) the assessee is bound by directions of the Reserve Bank of India. Such directions, require NBFCs to declare such advances as Non Performing Assets (NPA), when accrued interest on them is not paid by the debtor for six months, continuously. The assessee therefore treated the advances to its debtors as ICD, as NPA, and did not show interest income, which it said, was unrealizable. The Assessing Officer (AO), however, added interest as the assessee's income holding that it had "accrued" to it even if it was actually unpaid as the assessee followed the mercantile system of accounting. The CIT (A) affirmed the AO's order. The ITAT deleted such interest income.

3. The revenue argues that in respect of the three entities, the decision not to reflect revenue recognition, and treat the interest payable as NPA could not be allowed and the ITAT erred in holding that under RBI's norms, the revenue recognition method adopted was in order. It was highlighted that there was cross shareholding of three entities which were given the credit facility which sets them apart from normal defaulting debtors. It was also submitted that the financial health of the three debtor companies was not essentially sound; furthermore, nearly 40% of the amounts advanced by the assessee were to the three companies. As such the revenue had a right to hold that the transactions were not at arms's

length and therefore, the explanation that the advances were NPAs could not be legitimately accepted.

4. Counsel for the assessee contested the arguments of the revenue. It was pointed out that the present appeal had been decided against the assessee earlier. Its appeal by special leave was tagged to the revenue's appeals against the decision of this court in *Commissioner of Income Tax v. Vishisht Chay Vyapar Ltd.* 330 ITR 440. In that decision (*Vishisht Chay Vyapar*) the division bench had ruled that RBI's prudential banking norms, embodied in its directions to banking and non banking entities, were as binding as accounting standards under Section 145 of the Income Tax Act, and reflection of income on notional basis, did not reflect the realistic assessment of real income. It was submitted that the Supreme Court, which also required this court to review its previous order, (allowing the revenue's present appeal), approved the said judgment in *Vishshit Chay Vyapar (supra)*. Learned counsel therefore, submitted that there is no infirmity in the tribunal's reasoning, and that the revenue had accepted the treatment of such NPAs earlier, by the assessee.

5. In *Vishshist Chay Vyapar (supra)* this court had earlier ruled as follows:

“15. We have considered the respective submissions in proper their perspective. Before we embark on the discussion on these ITA 139/2008, ITA 466/2008, ITA 537/2008, ITA 408/2003 arguments, it would be useful to extract the relevant provisions of the RBI Act and NBFCs Prudential Norms (Reserve Bank) Directions 1998. Section

45Q of the RBI Act, which starts with non-obstante Clause, reads as under:-

"Chapter IIIB to override other laws.

45Q. The provisions of this Chapter shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law".

16. It is not in dispute that on the application of the aforesaid provisions of the RBI and the directions, the ICD advanced to M/s Shaw Wallace by the assessee herein had become NPA. It is also not in dispute that the assessee company being NBFC is bound by the aforesaid provisions. Therefore, under the aforesaid provisions, it was mandatory on the part of the assessee not to recognize the interest on the ICD as income having regard to the recognized accounting principles. The accounting principles which the assessee is indubitably bound to follow are AS-9. Relevant portion of the said accounting stand reads as under:-

9. Effect of Uncertainties on Revenue Recognition

9.1 Recognition of revenue requires that revenue is measurable and that at the time of sale or the rendering of the service it would not be unreasonable to expect ultimate collection.

9.2 Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g., for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognize

revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognized at the ITA 139/2008, ITA 466/2008, ITA 537/2008, ITA 408/2003 time of sale or rendering of service even though payments are made by installments.

9.3 When the uncertainty relating to collectability arises subsequent to the time of sale or the rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

9.4 An essential criterion for the recognition of revenue is that the consideration receivable for the sale of goods, the rendering of services or from the use of others of enterprise resources is reasonably determinable. When such consideration is not determinable within reasonable limits, the recognition of revenue is postponed.

9.5 When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognized."

17. In this scenario, we have to examine the strength in the submission of learned counsel for the Revenue that whether it can still be held that income in the form of interest though not received had still accrued to the assessee under the provisions of Income Tax Act and was, therefore, exigible to tax. Our answer is in the negative and we give the following reasons in support:-

(1) First of all we would discuss the matter in the light of the provisions of Income Tax Act and to examine as to whether in the given circumstances, interest income has accrued to the assessee. It is stated at the cost of repetition that admitted position is that the assessee had not received any interest on the said ICD placed with Shaw Wallace since the assessment year 1996-97 as it had become NPAs in accordance with the Prudential norms which was entered in the books of accounts as ITA 139/2008, ITA 466/2008, ITA 537/2008, ITA 408/2003 well. The assessee has further successfully demonstrated that even in the succeeding assessment years, no interest was received and the position remained the same until the assessment years 2006-07. Reason was adverse financial circumstances and the financial crunch faced by Shaw Wallace. So much so, it was facing winding up petitions which were filed by many creditors. These circumstances, led to an uncertainty in so far as recovery of interest was concerned, as a result of the aforesaid precarious financial position of Shaw Wallace. What to talk of interest, even the principal amount itself had become doubtful to recover. In this scenario it was legitimate move to infer that interest income thereupon has not “accrued”. We are in agreement with the submission of Mr. Vohra on this count, supported by various decisions of different High Courts including this court which has already been referred to above.

(2) In the instant case, the assessee company being NBFC is governed by the provisions of RBI Act.

In such a case, interest income cannot be said to have accrued to the assessee having regard to the provisions of section 45Q of the RBI and Prudential Norms issued by the RBI in exercise ITA 139/2008, ITA 466/2008, ITA 537/2008,

ITA 408/2003 of its statutory powers. As per these norms, the ICD had become NPA and on such NPA where the interest was not received and possibility of recovery was almost nil, it could not be treated to have been accrued in favour of the assessee.”

6. The Division Bench also noted and applied the reasoning in *Southern Technologies v Jt. Commissioner of Income Tax* 320 ITR 577, where the Supreme Court had, earlier held as follows:

“38. The point to be noted is that the IT Act is a tax on "real income", i.e., the profits arrived at on commercial principles subject to the provisions of the IT Act. Therefore, if by Explanation to Section 36 (1) (vii) a provision for doubtful debt is kept out of the ambit of the bad debt which is written off then, one has to take into account the said Explanation in computation of total income under the IT Act failing which one cannot ascertain the real profits. This is where the concept of "add back" comes in. In our view, a provision for NPA debited to P&L Account under the 1998 Directions is only a notional expense and, therefore, there would be add back to that extent in the computation of total income under the IT Act.

39. One of the contentions raised on behalf of NBFC before us was that in this case there is no scope for "add back" of the Provision against NPA to the taxable income of the assessee. We find no merit in this contention. Under the IT Act, the charge is on Profits and Gains, not on gross receipts (which, however, has Profits embedded in it). Therefore, subject to the requirements of the IT Act, profits to be assessed under the IT Act have got to be Real Profits which have to be computed on ordinary principles of

commercial accounting. In other words, profits have got to be computed after deducting Losses/ Expenses incurred for business, even though such losses/ expenses may not be admissible under Sections 30 to 43D of the IT Act, unless such Losses/ Expenses are expressly or by necessary implication disallowed by the Act. Therefore, even applying the theory of Real Income, a debit which is expressly disallowed by Explanation to Section 36 (1) (vii), if claimed, has got to be added back to the total income of the assessee because the said Act seeks to tax the "real income" which is income computed according to ordinary commercial principles but subject to the provisions of the IT Act. Under Section 36 (1) (vii) read with the Explanation, a "write off" is a condition for allowance. If "real profit" is to be computed one needs to take into account the concept of "write off" in contradistinction to the "provision for doubtful debt".

Applicability of Section 145

40. At the outset, we may state that in essence RBI Directions 1998 are Prudential/ Provisioning Norms issued by RBI under Chapter IIIB of the RBI Act, 1934. These Norms deal essentially with Income Recognition. They force the NBFCs to disclose the amount of NPA in their financial accounts. They force the NBFCs to reflect "true and correct" profits. By virtue of Section 45Q, an overriding effect is given to the Directions 1998 vis-a-vis "income recognition" principles in the Companies Act, 1956. These Directions constitute a code by itself. However, these Directions 1998 and the IT Act operate in different areas. These Directions 1998 have nothing to do with computation of taxable income. These Directions cannot overrule the "permissible deductions" or "their exclusion" under the IT Act. The

inconsistency between these Directions and Companies Act is only in the matter of Income Recognition and presentation of Financial Statements. The Accounting Policies adopted by an NBFC cannot determine the taxable income. It is well settled that the Accounting Policies followed by a company can be changed unless the AO comes to the conclusion that such change would result in understatement of profits. However, here is the case where the AO has to follow the RBI Directions 1998 in view of Section 45Q of the RBI Act. Hence, as far as Income Recognition is concerned, Section 145 of the IT Act has no role to play in the present dispute."

7. In view of the above reasoning, this court, in the absence of any findings that the cross holdings of the debtor companies was the predominant or sole reasoning for the assessee's inability to recover its dues, is bound by the reasoning in *Vishisht Chay Vyapar* (supra); more so, given that the Supreme Court has given its imprimatur on that ruling. For these reasons, the revenue's appeal has to fail; the question of law is answered against it and the appeal dismissed.

S. RAVINDRA BHAT, J

A. K. CHAWLA, J

MAY 01, 2018