

In the High Court of Judicature at Madras

Dated: 29.06.2015

Coram

The Honourable **Mr.JUSTICE R.SUDHAKAR**
and

The Honourable **Ms.JUSTICE K.B.K.VASUKI**

Tax Case (Appeal) Nos.2160 to 2162 of 2008,and
1223, 1229 and 1235 of 2007

Commissioner of Income Tax
Chennai

.... Appellant in the above T.C.(A)s)

Vs.

M/s.Shriram Investment Ltd.,
No.4 Lady Desikachari Road,
Chennai - 600 004.

.... Respondent in T.C.(A)No.2160 of 2008

M/s.Shriram City Union Finance Ltd.,
No.4 Lady Desikachari Road,
Chennai - 600 004.

.... Respondent in T.C.(A)No.2161 of 2008

M/s.Shriram Transport Finance Company Ltd.
4 Lady Desikachari Road,
Chennai - 600 004.

.... Respondent in T.C.(A)No.2162 of 2008

M/s.Shriram Investment Ltd.,
Mookambika Complex,
No.4 Lady Desikachari Road,
Mylapore, Chennai - 600 004.

.... Respondent in T.C.(A)No.1223 & 1229 of 2007

M/s.Shriram Transport Finance Company Ltd.
123 Angappa Naicken Street
Chennai - 600 001.

.... Respondent in T.C.(A)No.1235 of 2007

APPEALS under Section 260A of the Income Tax Act against the orders dated 19.12.2007 and 21.04.2006 in I.T.A.Nos.840, 838 and 839/Mds/2006 and I.T.A.Nos.198/Mds/2002, 469/Mds/2005 and 1160/Mds/2005 respectively on the file of the Income Tax Appellate Tribunal Madras 'C' and 'B' Bench, Chennai.

For Appellant : Mr.J.Narayanasamy
Standing Counsel for Income Tax

For Respondents: Mr.R.Sivaraman

COMMON JUDGMENT

(Judgment of the Court was delivered by R.SUDHAKAR,J.)

All the above Tax Case (Appeals) are filed by the Revenue as against the order of the Income Tax Appellate Tribunal. The assessment involved in the above Tax Case (Appeals) relate to the assessment years 2002-03, 2002-03, 2002-03, 2001-02, 1998-99 and 2001-2002 respectively.

2. At the time of admission in T.C.(A) Nos.2160 to 2162 of 2008, the following order was passed:

*"The appeals are filed by formulating four questions of law for admission. Learned counsel for the revenue submits that the fourth question of law as to whether the Tribunal was right in allowing deduction of the provision for bad and doubtful debts from the book profits under section 115JB of the Income Tax Act, is covered against the revenue by the judgment of this Court in the case of **CIT v. HCL Comnet Systems and Servivces Ltd., (2008) 305 ITR 409.***

In respect of questions of law 1 to 3, learned counsel for the revenue submits that he has filed an additional question of law and that the appeals may be admitted on that question of law alone. He also submits that the appeals in T.C.(A) No.2662 to 2666 of 2009 are connected with these appeals, which were admitted on 06.01.2009.

Hence, these appeals are admitted on the following substantial question of law:

"Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that additional finance charges could be shown for Income Tax purposes on receipt basis, through the assessee has accounted for the same in the regular accounts on accrual basis, and therefore, were

not includible in the taxable business income, ignoring the special provisions contained in section 43D of the Income Tax Act and Rules made thereunder, specifying the class of assesseees and categories of bad and doubtful debts in respect of which exclusion could be made."

3. In T.C.(A)Nos.1223 and 1229 of 2007, the following substantial questions of law has been raised:

" 1. Whether on the facts and circumstances of the case, the Tribunal was right in holding that the assessee is entitled to account for only the "additional finance charges" on a cash basis, while it is otherwise following the mercantile system of accounting and also accounting for the very same transaction on a mercantile basis under Company Law?

2. Whether on the facts and circumstances of the case, the Tribunal was right in holding that the assessee may be permitted to follow a mercantile system of accounting with respect to Company Law and a hybrid system of accounting with respect to Income Tax?

3. Whether on the facts and circumstances of the case, the Tribunal was right in allowing the provision for bad and doubtful debts from the book profits under Section 115JA on the ground that it is allowable under normal computation for the purpose of

income tax?"

4. In T.C.(A)No.1235 of 2007, the following substantial questions of law has been raised:

" 1. Whether on the facts and circumstances of the case, the Tribunal was right in holding that the assessee is entitled to account for only the "additional finance charges" on a cash basis, while it is otherwise following the mercantile system of accounting and also accounting for the very same transaction on a mercantile basis under Company Law?

2. Whether on the facts and circumstances of the case, the Tribunal was right in holding that the assessee may be permitted to follow a mercantile system of accounting with respect to Company Law and a hybrid system of accounting with respect to Income Tax?

3. Whether on the facts and circumstances of the case, the Tribunal was right in holding that the CIT(A) was wrong in enhancing the amount of additional finance charges to be brought to tax in the relevant assessment year on accrual basis?

4. Whether on the facts and circumstances of the case, the Tribunal was right in allowing the provision for bad and doubtful debts from the book profits under Section 115JB on the ground that it is allowable under normal computation for the purpose of income tax?"

5. It is also submitted by both the learned Standing Counsel appearing for the Revenue and the learned counsel appearing for the assessee that the issue with regard to Additional Finance Charges involved in the above appeals is covered by a decision of this Court dated 15.06.2015 in T.C.(A)No.1222 and 1225 to 1228 of 2007, wherein the issue has been answered in favour of the assessee and against the Revenue.

6. In the decision dated 15.6.2015 in T.C.(A)No.1222 and 1225 to 1228 of 2007, while dealing with the issue with regard to the Additional Finance Charges, this Court followed the earlier decision of this Court, in the case of **Commissioner of Income Tax V. M/s.Annamalai Finance Ltd.** reported in **[2005] 275 ITR 451**, wherein, this Court held as follows:

"The change of method of accounting of overdue charges from the mercantile basis to cash system, method of accounting, as followed by an assessee, does not create any income; but the method of accounting only recognizes income. Therefore, either to apply the accrual system or cash system, recognition of income is a paramount factor. In the present case, the disputed amount is the

overdue charges receivable `by the assessee from various parties on the basis of hire-purchase and lease agreements. As per the terms of the agreements, overdue charges are payable by the parties concerned to the assessee when they make defaults in paying the instalments as per the schedule of payments. **When the instalment itself is overdue, is not collected, there is no basis for making out a case that the additional overdue charges payable by the parties would be collectible with certainty. The terms of the agreements which enable the assessee-company to demand overdue charges is only an enabling provision and that enabling provision does not guarantee the collection of overdue charges. It only gives a cause of action to the assessee. In such cases it is very difficult to recognize income against overdue charges.**

We are, therefore, of the considered opinion that the Tribunal has rightly deleted the additions made towards overdue charges, acknowledging the change of method of accounting of overdue interest alone on cash basis.”

(emphasis supplied)

7. Following the above-said decision, this Court, in T.C.(A)No.1222 and 1225 to 1228 of 2007 observed as follows:

"23. We find that what has been decided by this Court in the earlier decision is the manner in which the AFC charges should be treated for the purpose of income tax. We have extracted in the earlier portion of this order that it has been held that in respect of AFC, there is an element of uncertainty and therefore, it has to be treated as income only on receipt. There is no departure on the part of the assessee from the mercantile system of accounting insofar as the income that arises from EMI. Once the issue has been resolved by this Court that AFC or ODC partakes the character of uncertain income, it cannot be brought within the purview of taxable income, unless and until it comes to the hands of the assessee. The department has accepted that proposition of law in the above cited case. No appeal is also filed as conceded by the learned Standing Counsel for the revenue."

8. In the light of the above, following the decision of this Court reported in **[2005] 275 ITR 451 (CIT V. Annamalai Finance Ltd.)** and the decision of this Court **dated 15.6.2015 in T.C.(A)No.1222 and 1225 to 1228 of 2007**, we hold that the terms of the agreements, which enable the assessee to demand overdue charges is only an enabling provision and the recovery of overdue charges is not certain. We, therefore, of the considered opinion that the Tribunal has rightly upheld the order of the Commissioner of Income Tax (Appeals)

deleting the additions made towards Additional Finance Charges, also known as Overdue charges.

9. Accordingly, the questions of law with regard to additional finance charges are answered in favour of the assessee and against the Revenue.

10. The second issue that has to be considered is whether the assessee is entitled to deduction under Section 115JA/115JB, as the case may be, of the Income Tax Act.

11. Even though in T.C.(A)Nos.2160 to 2162 of 2007, learned Standing Counsel appearing for the Revenue, at the time of admission, conceded that the issue has been covered by a decision of this Court in the case of **CIT v. HCL Comnet Systems and Services Ltd., (2008) 305 ITR 409**, in view of the subsequent developments that Section 115JA/115JB of the Income Tax Act has been amended with retrospective effect, the issue has to be answered in T.C.(A)Nos.2160 to 2162 of 2007 also.

12. The assessee/respondent have claimed deduction for provision for bad and doubtful debts for the assessment years in question. The Assessing Officer held that the provision for unascertained liabilities has to be added to the book profit and it could not be claimed as deduction. Aggrieved by the same, the assessee filed appeals before the Commissioner of Income Tax (Appeals), who, by following the earlier order, allowed the appeals. As against the same, the Revenue filed appeals before the Tribunal. The Tribunal following the decision of the Tribunal in respect of the assessee's own case, dismissed the appeals. Aggrieved by the same, the Revenue is before this Court.

13. Heard learned Standing Counsel appearing for the Revenue and the learned counsel appearing for the assessee and perused the materials placed before this Court.

14. Before going into the issue, the provisions that are necessary to decide the issue need to be seen. Section 115 JA amended vide Finance (No.2) Act, 2009 with retrospective effect from 1.4.1998 and Section 115JB of the Income Tax Act, amended vide Finance (No.2) Act, 2009 with retrospective effect from 1.4.2001 read as follows:

Deemed income relating to certain companies.

115JA. (1) Notwithstanding anything contained in any other provisions of this Act, where in the case of an assessee, being a company, the total income, as computed under this Act in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 1997 but before the 1st day of April, 2001 (hereafter in this section referred to as the relevant previous year) is less than thirty per cent of its book profit, the total income of such assessee chargeable to tax for the relevant previous year shall be deemed to be an amount equal to thirty per cent of such book profit.

(2) Every assessee, being a company, shall, for the purposes of this section prepare its profit and loss account for the relevant previous year in accordance with the provisions of Parts II and III of Schedule VI⁵³ to the Companies Act, 1956 (1 of 1956) :

Provided that while preparing profit and loss account, the depreciation shall be calculated on the same method and rates which have been adopted for calculating the depreciation for the purpose of preparing the profit and loss account laid before the company at its annual general meeting in accordance with the provisions of section 210 of the Companies Act, 1956 (1 of 1956) :

Provided further that where a company has adopted or adopts the financial year under the Companies Act, 1956 (1 of 1956), which is different from the previous year under the Act, the method and rates for calculation of depreciation shall correspond to the method and rates which have been adopted for calculating the depreciation

for such financial year or part of such financial year falling within the relevant previous year.

Explanation.—For the purposes of this section, "book profit" means the net profit as shown in the profit and loss account for the relevant previous year prepared under sub-section (2), as increased by—

(a) the amount of income-tax paid or payable, and the provision therefor; or

(b) the amounts carried to any reserves by whatever name called; or

(c) the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities; or

(d) the amount by way of provision for losses of subsidiary companies; or

(e) the amount or amounts of dividends paid or proposed; or

(f) the amount or amounts of expenditure relatable to any income to which any of the provisions of Chapter III applies;

(g) the amount or amounts set aside as provision for diminution in the value of any asset,

if any amount referred to in clauses (a) to (g) is debited to the profit and loss account, and as reduced by,—

(i) the amount withdrawn from any reserves or provisions if any such amount is credited to the profit and loss account :

Provided that, where this section is applicable to an assessee in any previous year (including the relevant previous year), the amount withdrawn from reserves

created or provisions made in a previous year relevant to the assessment year commencing on or after the 1st day of April, 1997 but ending before the 1st day of April, 2001] shall not be reduced from the book profit unless the book profit of such year has been increased by those reserves or provisions (out of which the said amount was withdrawn) under this Explanation; or (ii) the amount of income to which any of the provisions of Chapter III applies, if any such amount is credited to the profit and loss account; or (iii) the amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of account.

Explanation.—For the purposes of this clause,—

- (a) the loss shall not include depreciation;*
- (b) the provisions of this clause shall not apply if the amount of loss brought forward or unabsorbed depreciation is nil; or*
- (iv) the amount of profits derived by an industrial undertaking from the business of generation or generation and distribution of power; or*
- (v) the amount of profits derived by an industrial undertaking located in an industrially backward State or district as referred to in subsection (4) and sub-section (5) of section 80-IB], for the assessment years such industrial undertaking is eligible to claim a deduction of hundred per cent of the profits and gains under sub-section (4) or sub-section (5) of section 80-IB]; or*
- (vi) the amount of profits derived by an industrial undertaking from the business of developing, maintaining and operating any infrastructure facility as defined in the*

Explanation to sub-section (4) of section 80-IA and subject to fulfilling the conditions laid down in that subsection]; or

(vii) the amount of profits of sick industrial company for the assessment year commencing from the assessment year relevant to the previous year in which the said company has become a sick industrial company under sub-section (1) of section 17 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) and ending with the assessment year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.

Explanation.—For the purposes of this clause, "net worth" shall have the meaning assigned to it in clause (ga)59 of sub-section (1) of section 3 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986); 60[or]

(viii) the amount of profits eligible for deduction under section 80HHC, computed under clause (a), (b) or (c) of sub-section (3) or sub-section (3A), as the case may be, of that section, and subject to the conditions specified in sub-sections (4) and (4A) of that section;

(ix) the amount of profits eligible for deduction under section 80HHE, computed under sub-section (3) of that section.

(3) Nothing contained in sub-section (1) shall affect the determination of the amounts in relation to the relevant previous year to be carried forward to the subsequent year or years under the provisions of sub-section (2) of section 32 or sub-section (3) of section 32A or clause (ii)

of sub-section (1) of section 72 or section 73 or section 74 or sub-section (3) of section 74A.

(4) Save as otherwise provided in this section, all other provisions of this Act shall apply to every assessee, being a company, mentioned in this section.

Special provision for payment of tax by certain companies.

115JB. (1) *Notwithstanding anything contained in any other provision of this Act, where in the case of an assessee, being a company, the income-tax, payable on the total income as computed under this Act in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 2007, is less than ten per cent] of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of ten per cent.*

(2) Every assessee, being a company, shall, for the purposes of this section, prepare its profit and loss account for the relevant previous year in accordance with the provisions of Parts II and III of Schedule VI⁷⁰ to the Companies Act, 1956 (1 of 1956) :

Provided *that while preparing the annual accounts including profit and loss account,—*

- (i) the accounting policies;*
- (ii) the accounting standards adopted for preparing such accounts including profit and loss account;*
- (iii) the method and rates adopted for calculating the*

depreciation, shall be the same as have been adopted for the purpose of preparing such accounts including profit and loss account and laid before the company at its annual general meeting in accordance with the provisions of section 210 of the Companies Act, 1956 (1 of 1956) :

Provided further *that where the company has adopted or adopts the financial year under the Companies Act, 1956 (1 of 1956), which is different from the previous year under this Act,—*

- (i) the accounting policies;*
- (ii) the accounting standards adopted for preparing such accounts including profit and loss account;*
- (iii) the method and rates adopted for calculating the depreciation, shall correspond to the accounting policies, accounting standards and the method and rates for calculating the depreciation which have been adopted for preparing such accounts including profit and loss account for such financial year or part of such financial year falling within the relevant previous year.*

Explanation 1.—For the purposes of this section, "book profit" means the net profit as shown in the profit and loss account for the relevant previous year prepared under sub-section (2), as increased by—

- (a) the amount of income-tax paid or payable, and the provision therefor; or*
- (b) the amounts carried to any reserves, by whatever name called, other than a reserve specified under section 33AC; or*
- (c) the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities;*

or

(d) the amount by way of provision for losses of subsidiary companies; or

(e) the amount or amounts of dividends paid or proposed ; or

(f) the amount or amounts of expenditure relatable to any income to

which section 10 (other than the provisions contained in clause (38) thereof) or section 11 or section 12 apply; or

(g) the amount of depreciation,

(h) the amount of deferred tax and the provision therefor, if any amount referred to in clauses (a) to (h) is debited to the profit and loss account, and as reduced by —

(i) the amount withdrawn from any reserve or provision (excluding a reserve created before the 1st day of April, 1997 otherwise than by way of a debit to the profit and loss account), if any such amount is credited to the profit and loss account:

Provided that where this section is applicable to an assessee in any previous year, the amount withdrawn from reserves created or provisions made in a previous year relevant to the assessment year commencing on or after the 1st day of April, 1997 shall not be reduced from the book profit unless the book profit of such year has been increased by those reserves or provisions (out of which the said amount was withdrawn) under this Explanation or Explanation below the second proviso to section 115JA, as the case may be; or]

(ii) the amount of income to which any of the provisions

of section 10 (other than the provisions contained in clause (38) thereof) or section 11 or section 12 apply, if any such amount is credited to the profit and loss account; or

(iia) the amount of depreciation debited to the profit and loss account (excluding the depreciation on account of revaluation of assets); or

(iib) the amount withdrawn from revaluation reserve and credited to the profit and loss account, to the extent it does not exceed the amount of depreciation on account of revaluation of assets referred to in clause (iia); or

(iii) the amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of account.

Explanation.—For the purposes of this clause,—

(a) the loss shall not include depreciation;

(b) the provisions of this clause shall not apply if the amount of loss brought forward or unabsorbed depreciation is nil; or

(iv) the amount of profits eligible for deduction under section 80HHC, computed under clause (a) or clause (b) or clause (c) of sub-section (3) or sub-section (3A), as the case may be, of that section, and subject to the conditions specified in that section; or

(v) the amount of profits eligible for deduction under section 80HHE computed under sub-section (3) or sub-section (3A), as the case may be, of that section, and subject to the conditions specified in that section; or

(vi) the amount of profits eligible for deduction under section 80HHF computed under sub-section (3) of that section, and subject to the conditions specified in that

section; or

(vii) the amount of profits of sick industrial company for the assessment year commencing on and from the assessment year relevant to the previous year in which the said company has become a sick industrial company under sub-section (1) of section 1781 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) and ending with the assessment year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.

Explanation.—For the purposes of this clause, "net worth" shall have the meaning assigned to it in clause (ga) of sub-section (1) of section 382 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986); or

(viii) the amount of deferred tax, if any such amount is credited to the profit and loss account."

15. Learned Standing Counsel appearing for the Revenue submitted that the effect of introduction of Clause (i) to Explanation (1) to Section 115 JB and Clause (g) to Explanation to Section 115JA(2) of the Income Tax Act has been considered by this Court in the case of ***Commissioner of Income Tax V. Tamil Nadu Small Industries Development*** reported in ***(2014) 90 CCH 347***, wherein this Court accepted the plea of the Revenue and allowed the appeal.

16. In the case of ***Commissioner of Income Tax V. Tamil Nadu Small Industries Development*** reported in ***(2014) 90 CCH 347***, while dealing with the effect of amendment to Section 115JB and 115JA, as the case may be, this Court observed that the amendment to Section 115JA/115JB would be made applicable for that assessment year. Further, this Court following the decision of this Court dated 30.10.2012, in T.C.(A)No.2511 of 2006, held as follows:

"12. The objection raised by the learned counsel for the respondent/assessee that this amendment would come into effect for the Assessment Year 1999-2000 cannot be sustained as evidenced from the reading of Sec.115JA itself i.e., Deemed income relating to certain companies that "where in the case of an assessee, being a company, the total income as computed under this Act in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 1997 is deemed to be the relevant previous year". The previous year relevant to the assessment year is 97-98. Therefore, the Amendment to Sec.115JA will be made applicable for the Assessment Year 1998-99, the period in the present appeal.

13. We find no error in the Revenue's plea that the amount claimed as deduction of provision for bad and doubtful debts representing unascertained liability should not be deducted from the book profit for the purpose of determining the income, in view of retrospective

*amendment vide Explanation (g) to Sec.115JA with effect from 01.04.1998 applicable to the Assessment Year 1998-99. The decision in the case of Commissioner of Income Tax v. **HCL Comnet** Systems and Services Ltd., (2008) 305 ITR 409 will not come to the aid of assessee in view of above amendment with retrospective effect as per Explanatory Notes to Finance Act (No.2) 2009 vide C.B.D.T Circulars mentioned above.*

14. Accordingly, we answer the question of law in favour of the Revenue."

17. It is seen that by Finance (No.2) Act, 2009, clause (g) to Explanation (1) to Section 115JA(2) of the Income Tax and clause (i) to Explanation (1) to Section 115JB of the Income Tax Act were introduced with retrospective effect from 01.04.1998 and 01.04.2001 respectively. In view of the introduction of the above clauses, the book profit should be arrived at by increasing the net profit shown in the profit and loss account by amounts set aside to provisions made for meeting liabilities other than ascertained liabilities. Therefore, the amendment to Section 115JA and Section 115JB of the Income Tax Act is applicable from the assessment year 1998-99 and 2001-2002 respectively.

18. In the light of the retrospective amendment, vide clause (g) to Explanation (1) to Section 115JA(2) and clause (i) to Explanation (1) to Section 115JB, as the case may be, the amount claimed as deduction of provision for bad and doubtful debts representing unascertained liability could not be deducted from the book profit for the purpose of determining the income.

19. Accordingly, the issue with regard to Section 115JA or 115JB of the Income Tax Act, as the case may be, is answered in favour of the Revenue and against the assessee.

20. For the foregoing reasons, the following order is passed:

i) The question of law with regard to "Additional Finance Charges" is answered against the Revenue and in favour of the assessee and

ii) the question of law with regard to "Bad and Doubtful Debts" is answered in favour of the Revenue and against the assessee.

In the result, the above Tax Case (Appeals) are disposed of accordingly. No costs.

Index :Yes/No
Internet :Yes/No
sl

(R.S.,J) (K.B.K.V.,J)
29.06.2015

To
The Income Tax Appellate Tribunal Madras 'B' Bench, Chennai.
The Income Tax Appellate Tribunal Madras 'C' Bench, Chennai.

R.SUDHAKAR,J.
AND
K.B.K.VASUKI,J.

sl

T.C.(A) Nos.2160 to 2162 of 2008,and
1223, 1229 and 1235 of 2007

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