IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 03.07.2019

CORAM

THE HONOURABLE MR.JUSTICE T.S.SIVAGNANAM
and
THE HONOURABLE MRS.JUSTICE V.BHAVANI SUBBAROYAN

Tax Case Appeal No.1321 of 2009

The Kumbakonam Mutual Benefit Fund Ltd.,
145, T.S.R., Big Street,
Kumbakonam, Tamilnadu. .. Appellant/Appellant

-vs-

The Deputy Commissioner of Income tax,
Circle I, Kumbakonam, Tamilnadu. .. Respondent/Respondent

Tax Case Appeal filed under Section 260A of the Income-tax Act, 1961 against the order dated 29.05.2009 made in I.T.A.No.1595/Mds/2008 on the file of the Income-tax Appellate Tribunal Chennai Bench 'D', for the assessment year 2004-05. Appeal against the Order of the Commissioner of Income Tax (Appeals), No.4, Williams Road, Contonment Tiruchirappalli, 620 001. made in ITA.No. 500/06-07 dated 14.05.2008 in GIMO/PA No.AAADFT 0308 N for the Assessment year 2004-05 against the Order of Deputy Commissioner Income Tax in GIMO 8020-T1/2004-05 dated 29.12.2006 for the Assessment Year 2004-05.

For Appellant : Mr.Vijayaraghavan,
for M/s.Subbaraya Aiyar,
Padamanabhan & Ramamani

For Respondent : Mr.J.Narayanaswamy,
Senior Standing Counsel

JUDGMENT
(Delivered by T.S.Sivagnanam, J.)

This appeal, by the appellant/assessee under Section 260A of the Income-tax Act, 1961 (hereinafter referred to “as the Act”), is directed against the order dated 29.05.2009, passed by the Income-tax Appellate Tribunal Chennai Bench 'D' (for brevity, “the Tribunal”), in I.T.A.No.1595/Mds/2008, for the assessment year 2004-05.

2.The above appeal has been admitted, on 30.11.2009, on the following substantial question law:-

> “Whether, on the facts and in the circumstances of the case, the Tribunal was right in confirming inclusion of the interest income on 'non-performing assets' in the light of applicability of Accounting Standards AS9 read with Government Notification on Accounting Standards SO 69 dated 25.01.1996 in pursuance of Section 145(2) of the Income-tax Act?”

3.The assessee is a non-banking financial company stated to be in existence for over 100 years. For the assessment year under consideration, 2004-05, the assessee filed its return of income on 29.10.2004 admitting a total income of Rs.36,63,237/-. The return was processed under Section 143(1) of the Act. Thereafter, the case was selected for scrutiny and details were called for. The Assessing Officer upon scrutiny of the books of account, completed the assessment, by order dated 29.12.2006. In the assessment order, the Assessing Officer refers to Schedule 14 of the annual report, which pertains to “Notes on Accounts”. The Assessing Officer notes that the assessee has followed Accounting Standards-9 (AS-9) pertaining to 'Revenue recognition' and the amount non-recognised on the account is Rs.76.44 Lakhs in the year under consideration, as the market loans are due for collection. The Assessing Officer did not agree with the stand taken by the assessee and completed the assessment.

4.The assessee preferred appeal before the Commissioner of Income-tax (Appeals), Tiruchirappalli (for brevity, “the CIT (A)”), in I.T.A.No.500/06-07. By order dated 14.05.2008, the CIT(A) dismissed the appeal against which, the assessee preferred appeal before the Tribunal, which has been dismissed by the impugned order. This is how the assessee is before us by way of this appeal.

5.We have heard Mr.Vijaya Raghavan, learned counsel for M/s.Subbaraya Aiyar, Padmanabhan & Ramamani, learned counsel for the assessee; and Mr.J.Narayanaswamy, learned Senior Standing Counsel for the Revenue.

6.The Tribunal has referred to the finding recorded by the CIT(A) dated 14.05.2008, in which, the CIT(A) relied upon the decision in the case of CIT vs. India Equipment Leasing Ltd., reported in (2007) 293 ITR 0350.

7.To be noted that the said decision pertains to an assessment for the year 1994-95. The circulars issued by the Reserve Bank of India in exercise of power conferred under Section 45JA of the Reserve Bank of India Act, 1934, have been revised/superseded from time to time. At the relevant point of time, the circular which was taken note of by the Division Bench in India Equipment Leasing Ltd. (supra) was not issued by the Reserve Bank of India, but by the Central Board of Direct Taxes (CBDT) in circular dated 09.10.1984, and the said circular stated that interest on self-performing assets is to be excluded from income, if such interest is not received for three years.

8.In 1998, the Reserve Bank of India issued a circular under Section 45JA of the Act. The said provision empowers the Reserve Bank of India to give directions to all or any of the non-banking financial companies relating to income recognition, accounting standards, making of proper provision for bad and doubtful debts, capital adequacy based on risk weights for assets and credit conversion factors for off balance-sheet items and also relating to deployment of funds by a non-banking financial company or a class of non-banking financial companies or non-banking financial companies generally, as the case may be, and such non-banking financial companies shall be bound to follow the policy so determined and the directions so issued. Therefore, the direction issued by the Reserve Bank of India has statutory force and binds the non-banking financial companies.

9.The said circular defines a "non-performing asset" under Clause 2(1)(xii) to mean an asset, in respect of which, interest has remained overdue for a period of six months or more. There are other clauses under sub-clause (xi) and all of them uniformly stipulate overdue period of six months. Sub-clause (h) of Clause 2(1)(xii) states as follows:-

> "2(1)(xii)(h) – in respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower/beneficiary when any of the above credit facilities becomes non-performing asset."

10.So far as "income recognition" is concerned, the said circular states as hereunder:-

> "Income recognition
>
> 3. (1) The income recognition shall be based on recognised accounting principles.
>
> (2) Income including interest/discount or any other charges on NPA shall be recognised only when it is actually realised. Any such income recognised before the asset became non-performing

and remaining unrealised shall be reversed. (Effective from May 12, 1998)

(3) ....

(4) ....”

11.The circular of the CBDT, which was referred to in India Equipment Leasing Ltd. (supra) no doubt stipulates the three years' period. Nevertheless, in the year 1998, the circular issued by the Reserve Bank of India binds the NBFCs, stipulates six months' period for an asset to be classified as a 'non-performing asset' in respect of which interest remained overdue for a period of six months'.

12.In this appeal, we are concerned about the assessment year 2004-05. Therefore, the circular of the CBDT dated 09.10.1984, should not have been applied, as by then the statutory direction issued by the Reserve Bank of India dated 31.01.1998 was in vogue and held the field. That apart, the Ministry of Law, Justice and Company Affairs issued a notification dated 26.07.2001, in exercise of the powers conferred under Section 637 A(1) of the Companies Act, 1956. Clause (5) of the notification defines “non-performing asset” which reads as follows:-

> “(v) “Non-performing asset” will be that borrowal account where interest income and / or instalment of loan towards repayment of principal amount remained unrealised for 12 months.”

In the above circular, the period stipulated is 12 months.

13.The learned counsel appearing for the appellant would accept the fact that the assessee being a mutual benefit fund society, the notification issued by the Ministry of Law, Justice and Company Affairs, dated 26.07.2007, is to be applied to the assessee's case. The Tribunal took note of the finding recorded by the CIT(A) and observed that there is no material placed by the assessee to show that certain accounts have become sticky.

14.The CIT(A) in paragraph 4.1 of its order records that in the light of the decision in India Equipment Leasing Ltd. (supra), the assessee was directed to produce the list of borrowals out of the 86 borrowers in whose case, there has not been any movement in their respective accounts during the period 01.04.2000 to 31.03.2003. Based on the stand taken by the assessee, the CIT(A) states that there is no such borrower in whose case neither principal, nor the interest has been received by the assessee in the past three years and therefore, the CIT (A) concluded that the assessee does not have sticky loan accounts. However, what is required to be done is to examine whether within the previous year or relevant to the assessment year under consideration, there was any movement in the account because, the three years' period could have no application to the facts of the present case. This aspect was pointed out by the assessee in the grounds of appeal raised before the Tribunal stating that many borrowers are not made payment towards their loan account and hence the amount of Rs.76.44 Lakhs was wrongly arrived at.

15.In CIT vs. Elgi Finance Ltd., reported in (2007) 293 ITR 0357, it was held that the Tribunal having held that the assessee was justified in recognizing income from non-performing assets in consonance with the notification issued by the RBI and AS-9 issued by ICAI and therefore, there was no accrual of income during the relevant year and accordingly, declined to interfere with the order of the Tribunal.

16.In our view, the decision which should have been applied by the Tribunal to the facts of the present case is the decision in Elgi Finance Ltd. (supra) where there is a specific reference to AS-9. In fact, this aspect has been noted by the Assessing Officer himself in paragraph 1 of the assessment order dated 29.12.2006.

17.So far as the decision in India Equipment Leasing Ltd. (supra) is concerned, as pointed out by us earlier, that decision was rendered in a case relating to the assessment year 1994-95 at which time, the notification issued by the Reserve Bank of India dated 31.01.1998 and the notification issued by the Ministry of Law, Justice and Company Affairs dated 26.07.2001 were not in vogue. That apart, the decision also does not consider the effect of revenue recognition under AS-9. Therefore, we are of the view that the decision in India Equipment Leasing Ltd. (supra), could not have been applied to the facts of the present case.

18.The Tribunal has referred to the assessee's own case for the assessment year 2003-04 passed by the CIT(A). However, the said decision has been reversed by the Tribunal by order dated 30.10.2008. The Tribunal has also referred to the decision of this Court in the case of T.N.Power Finance and Infrastructure Development Corporation Ltd. vs. JCIT T.C.Nos.1012 and 1013 of 2005, dated 26.10.2005. The said case arose out of a case arising under Section 36(1)(vii) of the Act. In the said case, the Court referred to the decision of the Commissioner (Appeals) who appears to have held that the direction issued by the Reserve Bank of India cannot override the mandatory provisions of the Income-tax Act contained in Section 36(1)(viia) which stipulate for deduction not exceeding 5% of the total income only in respect of provision for bad and doubtful debts which are predominantly revenue in nature and not for provision for non-performing assets which are of predominantly capital in nature or trade related and not for provision for non-performing assets which are of predominately capital nature, and held that the Assessing Officer was right in disallowing the provision of Rs.30 lakhs debited in the profit and loss account of the assessee towards non-performing assets.

19.In our view, the said decision will not apply to the facts of the present case. However, with regard to the observation made by the Commissioner (Appeals), which was referred to by the Court in T.N.Power Finance and Infrastructure Development Corporation Ltd. (supra), regarding the effect of the circulars issued by the Reserve Bank of India, we are concerned about a direction issued by the Reserve Bank of India under Section 45JA of the Act and not a guideline issued by the Reserve Bank of India in respect of other matters. Under Section 45JA of the Act, the Reserve Bank of India has retained power to determine the policy and give directions to all or any of the non-banking financial companies relating income recognition, accounting standards, making of proper provision for bad and doubtful debts, etc. Therefore, the Commissioner (Appeals) in the said case was not right in observing that a direction issued under Section 45JA was in the nature of a guideline.

20.In any event, we are concerned with the assessment year 2004-05 and what is required to be seen is whether the assessee has got non-performing asset in terms of the definition in the notification issued by Ministry of Law, Justice and Company Affairs dated 26.07.2001. Needless to state that the applicability of the said notification can also be considered while undertaking such an exercise.

21.For the above reasons, the appeal filed by the assessee is allowed, the order passed by the Tribunal is set aside and the matter is remanded to the Assessing Officer for fresh consideration based on the observations and directions issued by us in the preceding paragraphs. Consequently, the substantial question of law is left open. No costs.

Sd/-

Assistant Registrar (CS-VIII)

//True Copy//

Sub Assistant Registrar

abr

To

1.The Deputy Commissioner of Income tax,
Circle I, Kumbakonam, Tamilnadu.

2.The Commissioner of Income Tax (Appeals),
No.4, Williams Road, Cantonment,
Tiruchirappalli-620 001.

3.The Income-tax Appellate Tribunal Chennai Bench 'D'.

+1cc to Mr.J.Narayana Swamy, Advocate, S.R.No. 56368
+1cc to Mr.Subbarayan Aiyar, Advocate, S.R.No. 55850

T.C.A.No.1321 of 2009

KS(CO)
GN(21/08/2019)