

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 27.7.2020

CORAM

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

TAX CASE APPEAL NO.446 OF 2018
(heard through video conferencing)

The Commissioner of Income
Tax, Tiruchirapalli.

...Appellant

Vs

M/s.Tiruchirapalli District Central
Cooperative Bank Ltd.,
C/O Sri.S.Sridhar, Chennai-20.

...Respondent

APPEAL under Section 260A of the Income Tax Act, 1961 against the order dated 03.3.2017 made in ITA.No.832/Mds/2013 on the file of the Income Tax Appellate Tribunal, Chennai 'D' Bench for the assessment year 2007-08, against the appellate order dated 26.02.2013 made in ITA No.422/11-12 on the file of the Commissioner of Income Tax (Appeals), Circle-1(1), Tiruchirapalli, assessment year 2007-08, against the order passed by the Assistant Commissioner of Income Tax circle 1(1) Tiruchirapalli in PAN/GIR No.AAAAT5036C, dated 30.12.2011 for the Assessment year 2007-08.

For Appellant : Ms.S.Premalatha, JSC for
Mr.M.Swaminathan, SSC

For Respondent : Mr.A.S.Sriraman

Judgment was delivered by T.S.SIVAGNANAM, J

We have heard Ms.S.Premalatha, learned Junior Standing Counsel appearing on behalf of Mr.M.Swaminathan, learned Senior Standing Counsel appearing for the Revenue and Mr.A.S.Sriraman, learned counsel appearing for the respondent - assessee.

2. This appeal by the Revenue under Section 260A of the Income Tax Act, 1951 (for short, the Act) is directed against the order dated 03.3.2017 made in ITA.No.832/Mds/2013 on the file of the Income Tax Appellate Tribunal, Chennai 'D' Bench (for brevity, the Tribunal) for the assessment year 2007-08.

3. The appeal has been admitted on 17.7.2018 on the following substantial question of law :

"Whether the Tribunal was right in holding that overdue interest on non performing assets is not taxable on accrual basis by referring to the guideline of the Reserve Bank of India which had nothing to do with the computation of taxability of the provisions of non-performing assets under the Income Tax Act, 1961?"

4. The assessee is a cooperative bank having its head quarters in Trichy. For the assessment year under consideration namely 2007-08, the assessee filed their return of income dated 12.11.2007 admitting NIL income. The assessment was completed after scrutiny. The Commissioner of Income Tax, in exercise of his power under Section 263 of the Act, set aside the assessment vide his order dated 02.3.2011 on the ground that it was erroneous and prejudicial to the interest of the Revenue.

5. Subsequently, a notice dated 29.8.2011 under Section 143(2) of the Act was issued and the assessee appeared through their representative and furnished the details called for. One of the issues was with regard to the claim for deduction on loans and advances, which the assessee claimed that they were not entitled for deduction by providing for bad and doubtful debts. For the queries raised by the Assessing Officer, the assessee stated that the overdue interest on investment, which would become non performing as per the guidelines of the Reserve Bank of India (RBI) was not recognized, that there was no certainty with regard to receipt of such income, that if the interest was not received within the specified date, on which, it had become due, the same was treated as overdue interest and that the assessee was following the mercantile system of accounting and interest had to be offered on accrual basis.

6. The Assessing Officer held that the exception available under Section 43D of the Act was available only to public financial institutions and not to cooperative societies, as the cooperative societies came to be included only by the Finance Act, 2017 with effect from 01.4.2018. Accordingly, the Assessing Officer completed the assessment by rejecting the stand taken by the assessee, by order dated 30.12.2011.

7. Aggrieved by the said order of assessment dated 30.12.2011, the assessee filed an appeal before the Commissioner of Income Tax (Appeals), Trichy [hereinafter called the CIT(A)]. We find that the CIT(A) did not give independent reasons, but verbatim extracted the findings rendered by the Assessing Officer and conveyed his approval by order dated 26.2.2013. As against the same, the assessee carried the matter on appeal to the Tribunal, which, by the impugned order, allowed the appeal filed by the assessee. Aggrieved by that, the Revenue is before us.

8. The issue before us is no longer res integra and has been decided in various decisions of other Hon'ble High Courts, some of which were affirmed by the Hon'ble Supreme Court. Though there are several decisions, it may be sufficient to refer to the decision of the Punjab & Haryana High Court in the case of PCIT, Ludhiyana Vs. Ludhiyana Central Cooperative Bank [reported in (2018) 99 Taxmann.com 81] wherein an identical question came up for consideration. In the said decision, after taking note of the decisions on the issue and the findings rendered by the Assessing Officer in the case on hand, it has been held in favour of the assessee. The relevant portions read thus :

"30. In all fairness to learned counsel for the revenue, the contention that Section 43D of the Act itself recognises taxability of such interest and that when a specific provision in the nature of section 43D of the 7/10/2020 www.taxmann.com 15/15 Act has been made, and entities like the assessee are excluded from the purview thereof, the assessee cannot indirectly claim benefit which would amount to a benefit similar to that under section 43D of the Act, requires to be discussed. In this regard, it may be noted that the benefit claimed by the assessee is not under any provision of the Act. The assessee being bound by the RBI Guidelines which are issued under the provisions of the 1934 Act has not shown the interest on NPA as income. By virtue of the provisions of section 45Q of the 1934 Act, the provisions of Chapter IIIB thereof have an overriding effect over other laws. Therefore, notwithstanding the provisions of section 43D of the Act, since the provisions of section 45Q of the 1934 Act have an overriding effect vis-à-vis income recognition principles in the Companies Act, the Assessing Officer is bound to follow the RBI Directions so far as income recognition is concerned. The interest on principal loan amount which has been classified as NPA cannot be held to have "accrued" so as to tax them under the Act. The contention that the assessee cannot indirectly claim the benefit which would amount to a benefit similar to that under section 43D of the Act, therefore, does not merit acceptance.

31. The similar issue was considered in Shri Mahila Sewa

Sahakari Bank Ltd.'s case(supra) in the case of Cooperative Banks by the Gujarat High Court where the issue was decided in favour of the assessee through a detailed judgment. Against the judgment of the Gujarat High Court, the Apex Court approving the said decision dismissed the C.A.No.8977 of 2017 filed by the revenue on 13.12.2017. It may further be noticed that the Parliament has amended Section 43D of the Act by Finance Act, 2017 effective from 1.4.2018 whereby specifically including "a cooperative bank other than a primary agricultural credit society or a primary cooperative agricultural and rural development bank" in the said provision."

9. Ms.Premalatha, learned Junior Standing Counsel for the appellant - Revenue has placed reliance on the decision of the Hon'ble Supreme Court in the case of State Bank of Travancore Vs. CIT [reported in (1986) 24 Taxmann 337] wherein it had been held that the concept of real income theory had to be applied. In fact, in the decision of the Punjab & Haryana High Court in the case of Ludhiyana Central Cooperative Bank, the very same contention was considered and answered against the Revenue in the following terms :

"28. The concept of reality of the income and the actuality of the situation are relevant factors which go to the making up of the accrual of income but once accrual takes place and income accrues, the same can not be defeated by any theory of real income. Reference may be made to Calcutta Co. Ltd. v. CIT [1959] 37 ITR 1 (SC).

29. Three decisions, two of the Madras High Court and one of the Punjab and Haryana High Court, which shall presently be noticed, were pressed into service on behalf of the assessee to suggest that the concept of real income can be so applied as to make, where the chances of realisation of accrued income are less, it non est."

10. In the decision of the Hon'ble Supreme Court in the case of CIT Vs. Jamnagar District Cooperative Bank Ltd. [reported in (2018) 256 Taxmann 212], the Hon'ble Supreme Court dismissed the appeal filed by the Revenue and affirmed the decision of the Gujarat High Court in the case of PCIT Vs. Kutch District Cooperative Bank Ltd. [reported in (2018) 94 Taxmann.com 298].

11. In the decision in the case of Kutch District Cooperative Bank Ltd., an identical question was considered by the Division Bench of the Gujarat High Court and after taking note of the decisions in the case of (i) CIT Vs. Vasisth Chay Vyapar Ltd. [reported in (2011) 330 ITR 440 (Delhi)], (ii) CIT Vs. Deogiri Nagar Sahakari Bank Ltd. [reported in (2015) 379

ITR 24 (Bombay)] and (iii) PCIT-5 Vs. Shri Mahila Sewan Sahakari Bank Ltd. [reported in (2016) 72 Taxmann.com 117 (Gujarat)], the Court answered the substantial question of law in favour of the assessee. In fact, in the said decision, the Court also pointed out that the decision of the Hon'ble Supreme Court in the case of Southern Technologies Ltd. Vs. JCIT [reported in 320 ITR 577] was also taken note of in the decision of the Delhi High Court in the case of Vasisth Chay Vyapar Ltd.

12. In fact, before us, the learned Junior Standing Counsel appearing for the Revenue has referred to the decision in the case of Southern Technologies Ltd., and this decision is an answer to the said submission.

13. A similar question was decided in favour of the assessee in the decision of the Madhya Pradesh in the case of Bhind District Cooperative Central Bank Ltd. Vs. ITD [reported in (2019) 109 Taxmann.com 396] wherein the relevant portions are extracted as hereunder :

"11. After hearing learned counsel for the parties, we notice that the issue is squarely covered by the judgment in Pr. CIT v. Shri Mahila Sewa Sahakari Bank Ltd. [2016] 72 taxmann.com 117/242 Taxman 60/[2017] 395 ITR 324 (Gujarat), Pr. CIT v. Ludhiana Central Co-op. Bank Ltd., [2018] 99 taxmann.com 81/[2019] 410 ITR 72 (Punj. & Har.), CIT v. Deogiri Nagari Sahakari Bank Ltd, [2017] 79 taxmann.com 396/[2015] 379 ITR 24 (Bombay), CIT v. Vasisth Chay Vyapar Ltd., [2010] 8 taxmann.com 145/[2011] 196 Taxman 169/330 ITR 440 (Delhi).

12. In Shri Mahila Sewa Sahakari Bank Ltd (supra) it was held that the Co-operative Banks were acting under the directives of the Reserve Bank of India with regard to prudential norms set out. And that the taxing interest on NPA cannot be justified on the real income theory. The decision in Shri Mahila Sewa Sahakari Bank Ltd (supra) was subjected to challenge before the Supreme Court in Principal CIT v. Mahila Sahakari Bank Ltd. [Civil Appeal No.8977/2017, by the Revenue, which was dismissed on 13-12-2017].

13. Similarly, the decision in Vasisth Chay Vyapar Ltd (supra) wherein it was held "the assess being an NBFC was governed by the provisions of the RBI Act. In such a case, interest income could not be said to have accrued to the assessee having regard to the provisions of section 45Q of the RBI Act and Prudential Norms issued by the RBI in exercise of its statutory powers. As per these Norms, the ICDs had become 7/10/2020 www.taxmann.com 3/3 NPA and on such NPA where the interest was not received and possibility of recovery was almost nil, interest could not be treated to have been accrued in favour of the assessee" was also upheld by Supreme Court in CIT v. Vasisth Chay Vyapar Ltd.,

[2018] 90 taxmann.com 365/253 Taxman 401/[2019] 410 ITR 244.

14. Recently a Division Bench of High Court of Bombay in Pr. CIT v. Solapur District Central Co-op. Bank Ltd. [2019] 102 taxmann.com 440/261 Taxman 476 in seisin with the similar issue as crops up for consideration in present case, observed:- '5 Having heard the learned Counsel for the parties, we notice that the issue is squarely covered by the judgments of Gujarat High Court and Punjab & Haryana High Courts. The Gujarat High Court in case of Pr.CIT v. Shri Mahila Sewa Sahakari Bank Ltd. 395 ITR 324 had undertaken the detailed exercises to examine an identical situation. The Court held that, the Cooperative Banks were acting under the directives of the Reserve Bank of India with regard to the prudential norms set out. The Court was of the opinion that, taxing interest on NPA cannot be justified on the real income theory. The decision of the Gujarat High Court in Shri Mahila Sewa Sahakari Bank Ltd., (supra) was carried in Appeal by the Revenue to the Supreme Court and such appeal was dismissed. Later on, similar issue came up before Gujarat High Court in case of Pr. CIT v. Sarangpur Cooperative Bank Ltd. 406 ITR 302, the Court followed the earlier decision in case of Shri Mahila Sewa Sahakari Bank Ltd., (supra) and dismissed the Revenue's appeal. Once again, the issue was carried to the Supreme Court by the Revenue. The Appeal was dismissed by an order dated 28th April, 2018. 6 Identical issue was also examined by the Punjab & Haryana High Court in case of Pr. CIT v. Ludhiana Central Coop. Bank Ltd. 410 ITR 72. The decision of the Gujarat High Court in Shri Mahila Sewa Sahakari Bank Ltd., (supra) was cited before the Court. The Court noted that appeal against such judgment of the High Court, was dismissed by the Supreme Court. The Court concluded as under: "Adverting to the factual matrix, it may be noticed that the Tribunal while relying upon the various pronouncements had decided the issue regarding taxability of interest on NPA in favour of the assessee as being taxable in the year of receipt. The Tribunal had upheld the deletion made by the CJT(A) on account of addition of Rs.3,02,82,000 regarding interest accrued on NPA. No illegality or perversity could be demonstrated by learned counsel for the Revenue in the aforesaid findings recorded by the Tribunal." 7 The issue is thus, covered by the decisions of two High Courts as noted above wherein identical situation came up for consideration. Against the judgment of the Gujarat High Court, the appeals have been dismissed by the Supreme Court. Thus, the Supreme Court can be seen to have approved the decision of the Gujarat High Court in case of Shri Mahila Sewa Sahakari Bank Ltd., (supra). We, therefore, do not see any reason to entertain these Appeals, since no question of law can be stated to have arisen.'

15. The issue in the case at hand is also not different as was

in the case of Shri Mahila Sewa Sahakari Bank Ltd (supra). The appellant-assessee acting under the directives of the Reserve Bank of India with regard to prudential norms set out, taxing interest on NPA, therefore, cannot be justified on the real income theory.

16. In view whereof, the substantial question of law is answered in favour of the appellant-assessee. The order passed by the Assessing Officer, Appellate Authority and Tribunal are set aside. The deduction as claimed for on the uncharged interest on NPA is allowed to the extent above."

In the aforementioned decision, the Court had taken into consideration that the assessee therein, as in the case of the assessee before us, was acting under the directives of the RBI with regard to prudential norms set out and therefore, taxing interest on NPA could not be charged on the real income theory.

14. The earliest among the decisions on the said point in favour of the assessee is by the High Court of Karnataka in the case of CIT Vs. Canfin Homes Ltd. [reported in (2012) 347 ITR 382]. In fact, the contentions now advanced by Ms.Premalatha, learned Junior Standing Counsel were also advanced before the Karnataka High Court and the matter was decided in favour of the assessee in the following terms :

"4. In order to appreciate this contention, it is necessary to look into the said section as it stands today.

'145. Method of accounting.--(1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(2) The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assessee or in respect of any class of income.

(3) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) or accounting standards as notified, under sub-section (2), have not been regularly followed by the assessee the Assessing Officer may make an assessment in the manner provided in section 144.'

5. A reading of the aforesaid provision makes it very clear that section 145(1) is subject to the provisions of sub-section (2). Sub-section (2) provides that the Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assessee or in respect of any class of income. Therefore, it is clear the requirement of complying with cash or mercantile system of accounting is

subject to the directions to be issued by the Central Government in the matter of accounting standards. After the amendment to section 145 the Board has issued accounting standards to be followed by way of a Notification No. SO 69(E), dated 25-1-1996. Clause (4) of the accounting standards reads as under:-

'4. Accounting policies adopted by an assessee should be such so as to represent a true and fair view of the state of affairs of the business, profession or vocation in the financial statements prepared and presented on the basis of such accounting policies. For this purpose, the major considerations governing the selection and application of accounting policies are prudence, substance over form and materiality.'

6. Clause 6 defines 'accrual' for the purpose of paragraphs (1) to (5) in the said accounting standards. 'Accrual' refers to the assumption, that revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate. Relying on this definition in the accounting standard, the revenue contends it is immaterial whether any revenue is actually received or not. If it is shown to accrued that is sufficient to charge the said income. In this context it is also necessary to take note of the guidelines dated 28-4-1995 issued by the National Housing Bank with reference to non-performing asset which is the subject-matter of these proceedings. It states the policy on income recognition to be objective should be based on record of recovery. Income from non-performing asset (NPA) may not be recognized merely on the basis of accrual. An asset becomes non-performing when it ceases to yield income. The income from NPAs, therefore, should be recognized only when it is actually received. NPA is an asset in respect of which interest has remained unpaid and has become 'past due'. An amount is to be treated as 'past due' when it remains unpaid for 30 days beyond the due date. Interest on NPAs should not be booked as income if such interest has remained outstanding for more than six months on and from March 31, 1995. In fact this question arose for consideration before the Apex Court in the case of State Bank of Travancore v. CIT [1996] 158 ITR 102 / 24 Taxman 337 where it has been held that, the concept of reality of the income and 7/10/2020 www.taxmann.com 4/4 the actuality of the situation are relevant factors which go to the making up of accrual of income but once accrual takes place and income accrues, the same cannot be defeated by any theory of real income. The concept of real income cannot be so used as to make accrued income non-income simply because after the event of accrual, the assessee neither decides to treat it as a bad debt nor claims deduction under section 36(2) of the Act, but still enters the same with a diminished hope of recovery in the suspense account. Extension of the concept of real income to

this field to negate accrual after the amount had become payable is contrary to the postulates of the Act.

7. Again the Apex Court in the case of UCO Bank v. CIT [1999] 237 ITR 889 / 104 Taxman 547 held that, under the accounting practice, interest which is transferred to the suspense account and not brought to the profit and loss account of the company is not treated as income. The question whether in a given case such "accrual" of interest is doubtful or not, may also be problematic. If, therefore, the Board has considered it necessary to lay down a general test for deciding what is a doubtful debt, and directed that all Income-tax Officers should treat such amounts as not forming part of the income of the assessee until realized, this direction by way of a circular cannot be considered as travelling beyond the powers of the Board under section 119 of the Income-tax Act. Such a circular is binding under section 119. Such circulars are meant for ensuring proper administration of the statute and, they are designed to mitigate the rigours of the application of a particular provision of the statute in certain situations by applying a beneficial interpretation of the provision in question.

8. Therefore, it is clear, if an assessee adopts 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 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.

9. For the aforesaid reasons we do not see any merit in the appeal. Accordingly, the appeals is dismissed."

In the aforementioned decision, the Court aptly pointed out that the contention of the Revenue that in respect of the non performing assets, even though it does not yield any income, as the assessee adopted a mercantile system of accounting, he has to pay tax on the Revenue, which accrued notionally, was without any basis.

15. In the decision of the Delhi High Court in the case of Vasisth Chay Vyapar Ltd., the following was the substantial question of law, which was answered :

"Whether the ITAT erred in law and on merits by deleting the additions of income made as interest earned/acquired on the loan advanced to M/s Shaw Wallace by considering the interest as doubtful and unrealisable?"

The Court, after taking note of all the decisions on the point, including the decisions referred to by the Revenue namely Southern Technologies Ltd., held as hereunder :

"15. We have considered the respective submissions in their proper perspective. Before we embark on the discussion on these 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 :- "45Q. Chapter IIIB to override other laws.—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 7/11/2020 www.taxmann.com 6/8 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 time of sale or rendering of service even though payments are made by instalments.

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 account as 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 year 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 insofar 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 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.

18. As noted above, Mr. Sabharwal, argued that the case of the assessee was to be dealt with for the purpose of taxability as per the provisions of the Act and not the RBI Act which was the accounting method that the assessee was supposed to follow. We have already held that even under the Income-tax Act, interest income had not accrued. Moreover, this submission of Mr. Sabharwal is based entirely on the judgment of the Supreme Court in the case of Southern Technologies Ltd.'s (supra). No doubt, in first blush, reading of the judgment gives an indication that the Court has held that RBI Act does not override 7/11/2020 www. Taxmann. com 7/8 the provisions of the Income-tax Act. However, when we examine the issue involved therein minutely and deeply in the context in which that had arisen and certain observations of the Apex Court contained in that very judgment, we find that the proposition advanced by Mr. Sabharwal may not be entirely correct. In the case before the Supreme Court, the assessee a NBFC debited Rs. 81,68,516 as provision against NPA in the profit and loss account, which was claimed as deduction in terms of section 36(1)(vii) of the Act. The Assessing Officer did not allow the deduction claimed as aforesaid on the ground that the provision of NPA was not in the nature of expenditure or loss but more in the nature of a reserve, and thus not deductible under section 36(1)(vii) of the Act. The Assessing Officer, however, did not bring to tax Rs. 20,34,605 as income (being income accrued under the mercantile system of accounting). The dispute before the Apex Court centered around deductibility of provision for NPA. After analyzing the provisions of the RBI Act, their Lordships of the Apex Court observed that insofar as the permissible deductions or exclusions under the Act are concerned, the same are admissible only if such deductions/exclusions satisfy the relevant conditions stipulated therefor under the Act. To that extent, it was observed that the Prudential Norms do not override the provisions of the Act. However, the Apex Court made a distinction with regard to "Income Recognition" and held that income had to be recognized in terms of the Prudential Norms, even though the same deviated

from mercantile system of accounting and/or section 45 of the Income-tax Act. It can be said, therefore, that the Apex Court approved the 'real income' theory which is engrained in the Prudential Norms for recognition of revenue by NBFC. The following passage from the judgment of the Apex Court would bring out the distinction noticed by the Apex Court between permissible deductions/ exclusions, on the one hand, and income recognition on the other :-

"31. Before concluding on this point, we need to emphasise that the 1998 Directions has nothing to do with the accounting treatment or taxability of "income" under the Income-tax Act. The two, viz., Income-tax Act and the 1998 Directions operate in different fields. As stated above, under the mercantile system of accounting, interest/hire charges income accrues with time. In such cases, interest is charged and debited to the account of the borrower as "income" is recognized under accrual system. However, it is not so recognized under the 1998 Directions and, therefore, in the matter of its Presentation under the said Directions, there would be an add back but not under the Income-tax Act necessarily. It is important to note that collectability is different from accrual. Hence, in each case, the assessee has to prove, as has happened in this case with regard to the sum of Rs. 20,34,605, that interest is not recognized or taken into account due to uncertainty in collection of the income. It is for the Assessing Officer to accept the claim of the assessee under the IT Act or not to accept it in which case there will be add back even under real income theory as explained hereinbelow.

38. The point to be noted is that the Income-tax Act is a tax on "real income", i.e., the profits arrived at on commercial principles subject to the provisions of the Income-tax 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 Income-tax 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 Profit and Loss 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 Income-tax Act, profits to be assessed under the Income-tax 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 Income-tax 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 Income-tax 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". 7/11/2020 www.taxmann.com 8/8 40. Applicability of section 145.—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 Income-tax 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 Income-tax 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 Assessing Officer comes to the conclusion that such change would result in understatement of profits. However, here is the case where the Assessing Officer 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 Income-tax Act has no role to play in the present dispute." (Emphasis supplied)

19. We have also noticed the other line of cases wherein the Supreme Court itself has held that when there is a provision in other enactment which contains a non obstante clause, that would override the provisions of Income-tax Act. Custodian appointed under the Special Court Act, 1992's case (supra) is one such case apart from other cases of different High Courts. When the judgment of the Supreme Court in Southern Technologies Ltd.'s

case (supra) is read in manner we have read, it becomes easy to reconcile the ratio of Southern Technologies Ltd. (supra) with Custodian appointed under the Special Court Act, 1992 (supra).

20. Thus viewed from any angle, the decision of the Tribunal appears to be correct in law. The question of law is thus decided against the revenue and in favour of the assessee. As a result, all these appeals are dismissed."

16. The Revenue, in the said case, raised identical contentions as raised before us stating that the case of the assessee was to be dealt with for the purpose of taxability as per the provisions of the Act and not as per the provisions of the RBI Act, which was the accounting method that the assessee was supposed to follow. The contention was rejected on the ground that even under the Act, interest income had not accrued. The Court further noted that the submission of the Revenue was entirely based on the judgment of the Hon'ble Supreme Court in the case of Southern Technologies Ltd., and proceeded to explain as to what was the decision and the effect of the said decision with regard to the assessee/cooperative bank in the paragraph quoted above. The above mentioned decision in the case of Vasisth Chay Vyapar Ltd., was affirmed by the Hon'ble Supreme Court in the decision reported in (2019) 410 ITR 244. In the light of the above discussion, the substantial question of law framed in this case has to be necessarily answered in favour of the assessee and against the Revenue.

17. Accordingly, the above tax case appeal is dismissed and the substantial question of law framed for consideration is answered against the Revenue and in favour of the assessee. No costs.

Sd/-

Assistant Registrar

//True Copy//

Sub Assistant Registrar

RS

To

1.The Income Tax Appellate Tribunal,
Chennai 'D' Bench, Chennai.

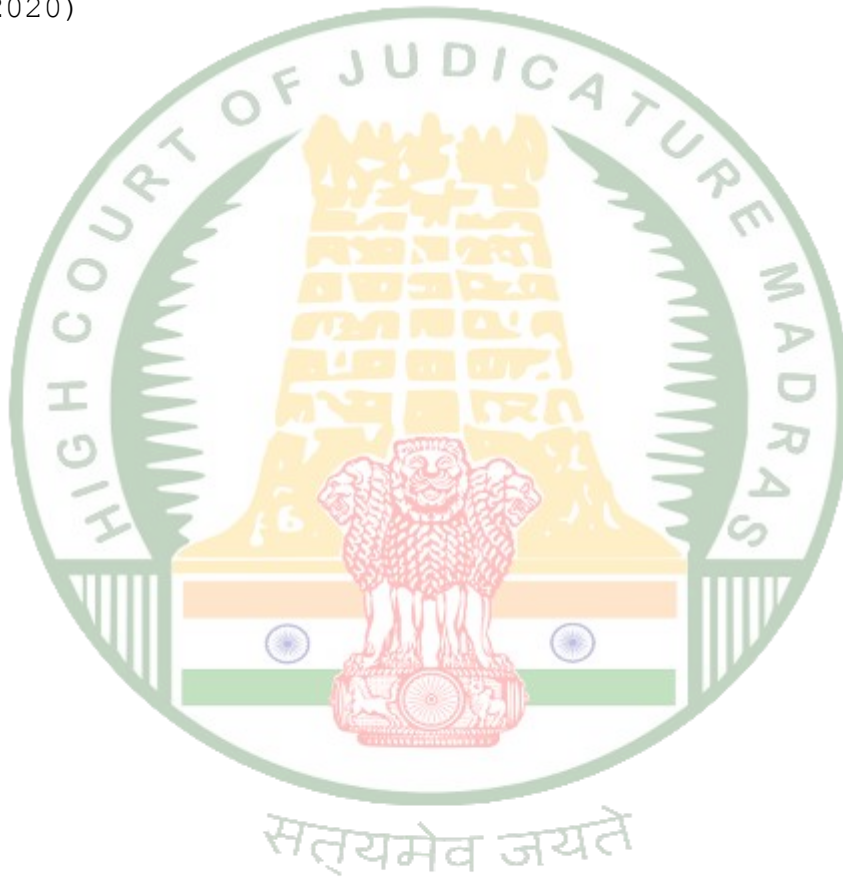
2.The Assistant Commissioner of Income Tax
Circle-1, Trichy.

3.The Commissioner of Income Tax(Appeals)
No.44, Williams Road, Cantonment,
Tiruchirapalli.

4.The Commissioner of Income Tax,
Tiruchirappalli.

TCA.No.446 of 2018

RLD (CO)
CB (07/10/2020)



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