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IN THE HIGH COURT OF JUDICATURE AT MADRAS

Dated : 07.12.2021

CORAM :

THE HONOURABLE MR. JUSTICE R. MAHADEVAN
and
THE HONOURABLE MR. JUSTICE MOHAMMED SHAFFIQ

Tax Case Appeal Nos. 1307, 1308 and 1309 of 2010

The Commissioner of Income Tax-I
Coimbatore

.. Appellant in all
the Appeals

Versus

M/s. Elgi Finance Limited
India House
Trichy Road
Coimbatore - 18
(PAN No.AAACE4564E)

.. Respondent in all
the appeals

TCA No. 1307 of 2010:- Appeal filed under Section 260-A of The Income Tax Act, 1961 against the order dated 11.06.2010 passed in I.T.A. No. 1879/Mds/2004 on the file of Income Tax Appellate Tribunal, "B" Bench, Chennai. for the Assessment year 1995-1996

TCA No. 1308 of 2010:- Appeal filed under Section 260-A of The Income Tax Act, 1961 against the order dated 11.06.2010 passed in I.T.A. No. 1880/Mds/2004 on the file of Income Tax Appellate Tribunal, "B" Bench, Chennai. for the Assessment year 1996-1997

TCA No. 1309 of 2010:- Appeal filed under Section 260-A of The Income Tax Act, 1961 against the order dated 11.06.2010 passed in I.T.A. No. 1881/Mds/2004 on the file of Income Tax Appellate Tribunal, "B" Bench, Chennai. for the Assessment year 1997-1998.

Against the order The Income Tax (Appeals)I, Coimbatore, Dated 30/06/2004, 23/06/2004 in made in Appeal No.94,92,&93/ 03-04 and against the order of the Assistant Commissioner of Income Tax Company Circle-I(I) i/c Combatore, dated 28/03/2003 and made in PA.No./G.I.R.No.AAA CE4564E in TCA 1307/2010 and CD-2239 (in TCA 1308 and 13/09/2010 for the Assessment year 1995-1996, 1996-1997 and 1997-1998 respectively.



For Appellant : Mr. M. Swaminathan, Senior Standing Counsel
for Mrs. K.G.Usha Rani, Junior Standing Counsel
in all the Appeals

For Respondent : Mrs. Lakshmi Sriram
in all the Appeals

COMMON JUDGMENT

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

These tax case appeals have been filed by the appellant/Revenue, calling in question the correctness of the order dated 11.06.2010 passed by the Income Tax Appellate Tribunal, 'B' Bench, Chennai, in I.T.A.Nos.1879, 1880 and 1881/MDS/2004, relating to the assessment years 1995-1996, 1996-1997 and 1997-1998, respectively. On 08.02.2011, TC (A) No. 1307 of 2010 was admitted on the following substantial questions of law:-

"1. Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that interest on Non-performing "Asset was not to be included in the total income of the assessee on accrual basis, even though the assessee was following Mercantile System of accounting is valid.

2. Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that the disallowance of deposit mobilization expenses amounting to Rs.52,52,593/- even though the aforesaid sum was never disallowed by the assessing officer either in the original assessment or the re-assessment was made by the Assessing Officer? and

3. Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in holding that the re-opening of the Assessment under Section 148 of the Income Tax Act, 1961 was issued beyond the four years, even though, before the Assessing Officer issue of brokerage was never considered in the original assessment or re-assessment nor were the details produced by the assessee in the course of assessment."

2. Similarly, on 08.02.2021, TCA Nos. 1308 and 1309 of 2010 were also admitted by this Court on the following substantial question of law:-



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(i) Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that interest on Non-performing Asset was not to be included in the total income of the assessee on accrual basis, even though the assessee was following Mercantile System of accounting is valid?

3. When these appeals are taken up for consideration today, the learned counsel for the appellant/Revenue brought to the notice of this court the Circular No.17/2019 dated 08.08.2019 issued by the Central Board of Direct Taxes, wherein, it is stipulated that appeals shall not be filed/pursued by the Department before the High Court in cases where the tax effect does not exceed Rs.1,00,00,000/- (Rupees One Crore). It is also submitted that the tax effect in these appeals is less than the threshold limit.

4. Notwithstanding the above, one of the issues involved in these appeals namely "whether interest on Non-performing Asset was not to be included in the total income of the assessee on accrual basis, even though the assessee was following Mercantile System of accounting is valid" is covered by the decision of the Division Bench of the Delhi High Court in the case of Commissioner of Income Tax vs. Vasisth Chay Vyapar Limited reported in (2011) 330 ITR 044, which was subsequently confirmed by the Honourable Supreme court in the order dated 13.12.2017 passed in Civil Appeal No. 5811 of 2012 etc., batch. The decision of the Division Bench of the Delhi High Court can profitably be extracted hereunder:-

"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, eligible 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 well. The assessee has



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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 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 Technology (supra). No doubt, in first blush, reading of the judgment gives an indication that the Court has held that RBI Act does not override 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,



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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 (i) (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 in so far 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:-

.....

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



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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."

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. TRO Vs. Custodian, Special Court Act (supra) is one such case apart from other cases of different High Courts. When the judgment of the Supreme Court in Southern Technology (supra) is read in manner we have read, it becomes easy to reconcile the ratio of Southern Technology with TRO Vs. Custodian, Special Court Act.

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."

5. In the light of the above coupled with the legal position enunciated by the Honourable Supreme Court, the substantial questions of law raised in these appeals are answered against the revenue and in favour of the assessee and hence the present appeals are dismissed. No costs.

Sd/-

Assistant Registrar(CS II)

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Sub Assistant Registrar

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TO

1. The Income Tax Appellant,
Tribunal B Bench Chennai.
2. The Commissioner of Income Tax (Appeals) I,
Coimbatore.
3. The Assistant Commissioner of Income Tax
Company Circle-I(I) i/c Coimbatore.
4. The Commissioner of Income Tax I,
Coimbatore.

+3cc to Mrs. Lakshmi Sriram, Advocate, S.R.No.64595
+1cc to Mr. M. Swaminathan, Advocate, S.R.No.65370

TCA Nos. 1307-1309/2010

SSD(CO)
CT/03/01/2022