



IN THE HIGH COURT OF JUDICATURE AT MADRAS

Dated : 25.04.2022

CORAM :

THE HON'BLE MR. JUSTICE R. MAHADEVAN
and

THE HON'BLE MR. JUSTICE J. SATHYA NARAYANA PRASAD

Tax Case Appeal No. 955 of 2009

Commissioner of Income Tax
Chennai

.. Appellant

Versus

M/s. Indbank Merchant Banking Services Ltd.,
3rd Floor, Krest Building
2, Jahangir Street
Chennai - 600 001
PAN No.AAAC12107B

.. Respondent

Appeal filed under Section 260-A of The Income Tax Act, 1961 against the order dated 22.09.2008 passed in ITA No.59/Mds/2007 on the file of Income Tax Appellate Tribunal Madras "A" Bench. Against the orders of the Commissioner of Income Tax (Appeals)-III, Chennai dated 16.10.2006 for the Assessment year 1998-1999 in ITA No.695/2005-2006/A-III.

Against the order dated 28.02.2006 passed by the Assistant Commissioner of Income Tax, Company Ward-II(3), Chennai for the Assessment year 1998-99.

For Appellant	:	Mr. Arun Kurian Joseph
For Respondent	:	Mr. G. Baskar

JUDGMENT

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

This tax case appeal is filed by the appellant/Revenue, calling in question the correctness of the order dated 22.09.2008 passed by Income Tax Appellate Tribunal Madras "A" Bench in ITA No.59/Mds/2007.



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2. On 17.09.2009, this tax case appeal was admitted on the following substantial questions of law:-

"1. Whether on the facts and in the circumstances of the case, the Tribunal was right in deleting the addition of Rs.3,51,917/- being interest accrued on non performing assets, even though the assessee is following a mercantile system of accounting?

2. Whether on the facts and in the circumstances of the case, the assessee is entitled to follow a hybrid system of accounting by showing the interest on non-performing assets only on receipt basis, while otherwise following a mercantile system of accounting contrary to the provisions of Section 145 of the Income Tax Act?

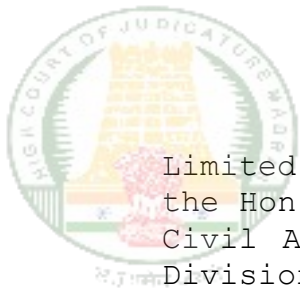
3. Whether the prudential norms issued by the RBI will have any bearing on computation for the purpose of Income Tax and whether it will have an overriding effect over the provisions of the Income Tax Act?

4. Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that interest under Section 234D cannot be charged in respect of the refund granted prior to the insertion of the Section 234D, when the regular assessment was completed only subsequent to the insertion of Section 234D?

5. Whether on the facts and in the circumstances of the case, no interest can be charged even for the period subsequent to the introduction of Section 234D mainly on the ground that the refund was granted prior to its introduction?

3. Heard the learned counsel for both sides. It is brought to the notice of this Court that as against the very same order dated 22.09.2008 of the Tribunal, the Department has filed two appeals namely T.C.A. No. 955 of 2009 and T.C.A. No. 956 of 2009, out of which, T.C.A. No. 956 of 2009 was dismissed, on account of low tax effect, by order dated 19.08.2019.

4. That apart, one of the issues involved in this case viz., "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 Delhi High Court in Commissioner of Income Tax vs. Vasisth Chay Vyapar



Limited [(2011) 330 ITR 044], which was subsequently affirmed by the Hon'ble 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 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



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, 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



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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 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



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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 decision, the substantial question of law Nos.1 to 3 raised in this appeal are answered in favour of the respondent / assessee and against the appellant / revenue.

6. Regarding the question of law nos.4 & 5, the learned counsel for the appellant placed reliance on the Judgment in Commissioner of Income Tax-I v. Reliance Energy Limited [358 ITR 371(SC)], wherein, it was held as follows:

"3.Learned counsel for the assessee places reliance on Explanation (2) inserted in Section 234D of the Act by the Finance Act, 2012 with effect from 01.06.2003.

4.Explanation (2) which has been inserted in Section 234D of the Act reads as under:-

"Explanation 2.-For the removal of doubts, it is hereby declared that the provisions of this section shall also apply to an assessment year commencing before the 1st day of June, 2003 if the proceedings in respect of such assessment year is completed after the said date"

5.The High Court was concerned with the appeal relating to the assessment year 1998-1999. It is admitted case that the assessment of that year was completed prior to 01.06.2003.

6.Having regard to the legal position which has been clarified by the Parliament by insertion of Explanation (2) in Section 234D, in the present case, retrospectively of Section 234D does not arise.

7.Having regard to above position, the view of the High Court in relying upon the decision of the Bombay High Court in M/s. Delta Air Lines Inc., (supra) cannot be said to be erroneous.



8.Special Leave Petition is dismissed"

7. In the light of the aforesaid decision, which squarely applies to the facts of the present case, wherein, the proceedings in respect of the assessment year was completed on 28.02.2006, which is, subsequent to the insertion of Section 234D of the Act by the Finance Act, 2012 i.e., on 01.06.2003, the substantial question of law Nos.4 and 5 relating to levy of interest on the excess refund amount under Section 234D, are answered in favour of the appellant / Revenue and against the respondent / assessee and the matter is remanded back to the Assessing Officer for fresh consideration and pass appropriate orders, on merits and in accordance with law, after issuing due notice and affording an opportunity of hearing to the respondent / assessee, within a period of eight weeks from the date of receipt of a copy of this order.

8. Accordingly, the Tax case Appeal stands disposed of.
No costs.

Sd/-

Assistant Registrar (CS III)

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Sub Assistant Registrar

rsh/dhk

To

1. The Commissioner of Income Tax
Chennai

2.Income Tax Appellate Tribunal Madras "A" Bench
Chennai.

3.The Commissioner of Income Tax
Appeals-III, Chennai.

4.The Assistant Commissioner of Income Tax
Company ward-II(3), chennai.

TCA No. 955 of 2009

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