

IN THE HIGH COURT OF DELHI

**ITA NO. 02 OF 2009
ITA NO.170 OF 2009
ITA NO. 317 OF 2010
ITA NO.1576 OF 2010**

DIRECTOR OF INCOME TAX

Vs

BRAHAMPUTRA CAPITAL FINANCIAL SERVICES LTD

A K Sikri and M L Mehta, JJ

Dated: May 18, 2011

JUDGEMENT

Per : A K Sikri:

1. In all these appeals, common questions of law are proposed which relate to different assessment years pertaining to the same assessee. The assessee herein is a Non Banking Financial Company (NBFC) which had given loan of Rs. 13,57,87,057/- to few companies, stated to be the group concerns of the assessee. This was interest bearing loan. However, in the assessment years in question, the assessee had not shown the interest in its profit and loss account on the ground that said loan had become Non Performing Asset (NPA) in terms of the guidelines issued by the Reserve Bank of India and, therefore, it was unlikely to receive the interest thereupon and thus interest had not accrued to the assessee in the relevant assessment years. The Assessing Officer, however, was of the opinion that since the assessee was following mercantile system of accounting, even if the interest was not actually received by the assessee on the aforesaid loan, it had accrued to the assessee in the relevant assessment years and was to be treated as income of the assessee within the meaning of Section 5 of the Income Tax Act (hereinafter referred to as 'the Act') and made additions. This view of the AO was upheld by the CIT (A) but has been reversed by the ITAT vide its impugned orders. The Revenue preferred appeal against the impugned order proposing various questions of law in these appeals but the following question of law proposed by the Revenue would cover all the aspects: -

"Whether ITAT was correct in law in deleting the addition of Rs. 2,15,53,466/- made by the Assessing Officer on account of interest accrued to the assessee as per mercantile system of accounting?"

2. The facts which are necessary to determine as to whether the aforesaid question of law as proposed is a substantial question of law arising for consideration or not, may now be noted.

3. The assessee had given interest bearing loans to following parties, which is reflected in the balance sheet for the period ending 31st March, 2003.

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| 1. Jindal Equipment Leasing & Consultancy Services Ltd. | Rs. 7,32,72,000 |
| 2. Mansarovar Investment Ltd. | Rs. 5,10,17,630 |
| 3. Goswamis Credits & Investment Ltd. | Rs. 1,14,97,427/- |
| | Rs. 13,57,87,057 |

Further it was contended in the notes attached with the return that certain loans given by the company have become Non-Performing Asset (NPA) and as per NBFC Prudential Norms (RBI), Directions, 1998, interest income on NPA shall be recognized only when it is as actually realized. It has been further stated that accordingly, interest income on loans given which has become NPA has not been accounted for and same shall be offered for taxation as and when received. Since the assessee had given above mentioned loans on interest and it was following mercantile system of accounting, as per Assessing Officer, it was required to declare interest income on the above loan on accrual basis only irrespective of date of actual receipt of interest and this accrued interest for the year under consideration should have been declared by it as its income earned from interest in this year, which it has not done. Accordingly, it was asked to give details of NPAs (including details of deposits, when given, rate on which the said loans were given and interest accrued) on which interest income was not declared. It was also asked to file copies of loan agreements and to explain and show cause as to why the accrued interest on such loan should not be taken as its income for the year under concern as it was maintaining its accounts on mercantile/accrual basis. It was also asked to prove with evidences that these loans have actually become NPA. In response, details of loan outstanding as on 31st March, 2003 alongwith copies of agreements regarding loans indicating rates of interest thereupon have been filed. It has also been stated that loans to Jindal Equipment Leasing and Consultancy Services Ltd. and Mansarovar Investment Ltd. were advanced in the F.Y. 96-97 and the assessee accrued interest on the loan till the F.Y. 97-98. As the amount of interest for F.Y. 97-98 remained outstanding for more than six months, the advances became NPA as per the definition of NBFC's Prudential Norms (RBI) Directions 1993. As regards loans given to Goswamis Credits & Investment Ltd. it was stated that loan was given in the F.Y. 1998-99 and the assessee accrued interest on this loan till F.Y. 2000-01 and since, the interest for F.Y. 2000-01 remained outstanding for more than six months, the advances became NPA as per the definition of NBFC's Prudential Norms (RBI) Direction 1998. It has further stated that it is a NBFC and has been granted certificate of registration by the RBI under Section 45-IA of the RBI Act 1394 and therefore, it is bound to follow the directions/instructions/guidelines issued by the RBI from time to time including NBFC's Prudential Norms (RBI) Directions 1998 and in terms of said directions/norms, advances on which interest remained outstanding for more than six months were required to be treated as NPA, as defined in para 2 (xii) of RBI Act. It has been further stated that as per para 3 of the said Act, interest/discount or any other charges, on NPA shall be recognized only when it is actually realized. It has further stated that non recognition of interest income on loan/advances is in accordance with the aforesaid norm and direction issued by the RBI and since, it is bound by the aforesaid directions, it did not recognize interest income on the advances which has been classified as a NPA in accordance with the said norms. It has further cited Section 45 Q (Chapter III B) of the RBI Act to emphasize that provisions of this chapter will have overriding effect on any other law and thus interpreted it as having overriding effect on I.T. Act also. It has also cited Section 45JA of RBI Act to state that the RBI has been empowered to determine

policy and issue directions from time to time to all or any of the NBFCs relating to income recognition and accounting standards etc. and on the basis of it, stated that a NBFC is bound to follow the policy determined by the RBI, which has issued NBFC's Prudential Norms (RBI) Direction 1998, according to which interest or any other charges on NPA shall be recognized only when it is actually realized.

4. It is clear from the above that the submission of the assessee before the authorities below that since the recoverability of principle amount of loan itself was doubtful, decision was taken as a prudent businessman and interest income was not accounted for in the books of account. As per the assessee, under these circumstances, there was no real accrual of interest and interest was not taxable in the hands of the assessee having regard to the principles of real income. It was also submitted before the lower authorities that even in accordance with the accounting standard AS-9, issued by the Institute of Chartered Accountants of India dealing with the effect of uncertainty on revenue recognition, the guidance note on Accrual Basis of Accounting issued by ICAI according to which where ultimate collection with reasonable certainty is lacking, the revenue recognition is to be postponed to extent of uncertainty involved. For this purpose, reliance was placed upon the RBI Directive; accounting standard issued by ICAI (AS-9) and the guidelines of the RBI including NBFC Prudential Loan (RBI) Directions, 1998. The Tribunal has accepted the aforesaid contentions of the assessee holding that there was no accrual of real income and, therefore, it did not become income in the hands of the assessee under Section 5 of the Act. The Tribunal has also held that merely because the assessee and the borrower were known to each other would not be sufficient to render the financial position of borrower company better so as to increase the likelihood of interest payment to the assessee company.

5. Identical issue came up before this Court in batch of appeals leading case being Commissioner of Income Tax Vs. M/s Vasisth Chay Vypapar Ltd. (ITA 552/2005 decided on 29.11.2010.), this theory of "real income" was discussed in detail. That was also a case of NBFC where loan/advance given by the said assessee had become NPA and keeping in view the guidelines of RBI interest was not treated as accrued. After taking note of various judgments on the subject, the question was answered in favour of the assessee and against the Revenue. The legal position is summarized in para 17 of the said judgment which reads as under: -

"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 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 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."

6. The aforesaid judgment clearly applies to the present case as well. Following that judgment, we are of the view that no substantial question of law arises in these appeals and are accordingly dismissed.