[2009] 117 ITD 20 (MUM.)

IN THE ITAT MUMBAI BENCH 'I'

Mukand Global Finance Ltd.*

v.

Deputy Commissioner of Income-tax, Range 3(2), Mumbai

SUNIL KUMAR YADAV, JUDICIAL MEMBER AND J. SUDHAKAR REDDY, ACCOUNTANT MEMBER

IT APPEAL NO. 4078 (MUM.) OF 2004

[ASSESSMENT YEAR 2000-01]

NOVEMBER 27, 2007

ORDER

Per Sunil Kumar Yadav, Judicial Member. - This appeal by the assessee is directed against the order of the CIT(A) on various grounds, which are as under:

> "1. *Setting-off of loss on sale of flat (Deemed Short-Term Capital Gain).*— On the facts and in the circumstances of the case and in law, the ld. Commissioner of Income-tax (Appeals) erred in confirming the action of ld. Assessing Officer in not setting off loss of Rs. 34,43,668, being deemed short-term loss, against income under the head "Profits and Gains of Business and Profession".
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> 2. *Provision for non-performing assets*
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> 2.1 On the facts and in the circumstances of the case and in law, the ld. Commissioner of Income-tax (Appeals) erred in confirming the disallowance of deduction of Rs. 1,01,40,295 in respect of provisions for non-performing assets.
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> 2.2 In doing so, the ld. Commissioner of Income-tax (Appeals) was not justified in the following respects:
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> (*a*) In not appreciating the fact that the provision of non-performing assets was made on the basis of prudential norms prescribed by the Reserve Bank of India for Non-Banking Finance Companies;
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> (*b*) In not appreciating the fact that the said sum represented provision for doubtful debts and, accordingly, was allowable as deduction under section 36(1)(*vii*).
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> 2.3 In view of the above grounds of appeal, the appellant prays that the provision for non-performing assets amounting to Rs. 1,01,40,295 ought to be allowed as a deduction under section 36(1)(*vii*).
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> 3. *Addition of Rs. 3,79,303 on account of lease equalization charge* - On the facts and in the circumstances of the case and in law, the ld. Commissioner of Income-tax (Appeals) erred in confirming the addition of Rs. 3,79,303 in respect of Lease Equalization Charge.
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> 4. *Determination of indexed cost in respect of shares of IL & FS* - On the facts and in the circumstances of the case and in law, the ld. Commissioner of Income-tax (Appeals) erred in confirming the action of Assessing Officer adopting cost Inflation Index pertaining to assessment year 1994-95 instead of pertaining to assessment year 1989-90 determining indexed cost of IL & FS shares sold during the year.

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*Partly in favour of assessee.

5. *Treatment of whole lease rent as income* - Without prejudice to grounds of appeal in relation to allowance of depreciation on leased assets taken in earlier years ld. Commissioner of Income- tax (Appeals) erred in confirming treatment by Assessing Officer of whole amount of lease rent received as income instead of restrict-ing the taxability to only interest component out of lease rent received.

6. *Disallowance of interest under section 14A of Income-tax Act* - The ld. Commissioner of Income-tax (Appeals) erred in confirm- ing disallowance of a sum of Rs. 10,73,358 under section 14A of Income-tax Act.

7. *Computation of Book Profits under section 115JA*

7.1 On the facts and in the circumstances of the case and in law, the ld. Commissioner of Income-tax (Appeals) (while computing Book Profits) erred in confirming the action of Assessing Officer of addition of Rs. 1,01,40,295 being provision of Non-performing assets.

7.2 Without prejudice to the foregoing grounds of appeal and on the facts and in the circumstances of the case and in law, the ld. Commissioner of Income-tax (Appeals) erred in not directing the Assessing Officer to reduce Rs. 46,29,010 being provision for Non-performing assets written back.

7.3 On the facts and in the circumstances of the case and in law, the ld. Commissioner of Income-tax (Appeals) erred in confirming the action of Assessing Officer in disallowing Rs. 10,73,358 being interest determined to be attributable for earning income which is exempt from tax.

8. The orders of both the Assessing Officer and ld. CIT(A) are bad in law and on facts."

2-3. We have heard the rival submissions and carefully perused the orders of the lower authorities and documents placed on record.

4. Apropos ground No. 1, the facts borne out from the record are that during the year under consideration the assessee sold a building forming part of block of assets and has incurred a loss of Rs. 34,43,668 and claimed it as deemed business loss *vide* footnote 4 of the computation of income. It was stated in the footnote that the company has sold a flat being the only asset in the block of buildings for a total consideration of Rs. 21,65,000 which has resulted in cessation of the block of assets (buildings) thereby resulting in a loss of Rs. 34,43,688 which is deemed to be short-term capital loss under section 50 of the Income-tax Act. The assessee claimed a set off of the aforesaid loss against the business income on the ground that although the said loss is deemed to be short-term capital loss, the said loss has been incurred in the course of business of the assessee and deduction in respect thereof be allowed from the business income. In support of his contention he placed reliance upon the order of the Tribunal in the case of *J.K. Chemicals Ltd.* v. *Asstt. CIT* [IT Appeal Nos. 8206 & 8648 (Bom.) of 1989] for assessment year 1986-87. The Assessing Officer was not convinced with the contention of the assessee and he, accordingly, disallowed the set off of this loss against the income under the head 'Capital gain'.

5. Assessee preferred an appeal before the CIT(A) and reiterated its contentions but the CIT(A) was not convinced with it. The CIT(A) re-examined the issue in the light of the order of the Tribunal in the case of *J.K. Chemicals* (*supra*) and has held that in that case assessee has

sold all the entire plant and machinery and has treated the surplus arising out of the sale as business income whereas the Assessing Officer has taken a view that the excess amount was liable to be computed as short-term capital gain under section 50 of the Income-tax Act (hereinafter referred as 'Act') and not as business income. In that situation, the Tribunal has held that though the computation was to be made as short-term capital gain under section 50 of the Act but the same has to be dealt with under the head "Profit and gains of business or profession". Thus in that case the matter related to income resulting on sale of assets but in the instant case there is no income resulting from the sale of asset, *i.e.,* building and the sale resulted in a loss as the sale consideration is less than the written down value of the asset in question. The CIT(A), accordingly, held that in the given situation the provisions of section 50 cannot be invoked. It is rather a case of claim of deduction under section 32(1)(*iii*) of the Act. Since the assessee has not written off the deficiency in its books of account deduction cannot be allowed while computing the income under the head 'Business or profession'. The CIT(A), accordingly, rejected the claim of the assessee. Since the CIT(A) has adjudicated the issue in the light of legal provisions, we deem it proper to extract it hereunder: -

> "2.2 I have considered the foregoing submissions and I have also perused the impugned order of assessment. At the outset I may point out that the decision of the ITAT in the case of *J.K. Chemicals* v. *Asstt. CIT* relied upon by the learned A.R. is not applicable to the facts of the instant case. The facts of the case before the ITAT were that the assessee in that case sold off the entire plant and machinery and had treated the surplus arising out the sale as business income whereas the Assessing Officer had taken the view that the excess amount was liable to be computed as short-term capital gains under section 50 and not as business income. The ITAT held that though the computation was to be made as short-term capital gains under section 50 but the same has to be dealt with under the head "Profits and gains of business or profession". Thus in the case before the ITAT the matter related to income resulting on sale of assets under section 50. In the appellant's case there is no income resulting on sale of asset, *i.e.* building and the sale admittedly resulted in a loss inasmuch as the sale consideration is less than written down value of the asset in question. In such a situation when a loss is incurred on sale of an asset, section 50 has no application. Section 50 deals with a "special provision for *computation of capital gains* in case of depreciable assets." [Emphasis supplied]
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> 2.3 A plain reading of the entire section goes to show that it will be applicable only when the sale consideration on transfer of an asset exceed the aggregate of the amounts enumerated in clauses (*i*), (*ii*) of sub-section (1) of section 50. Section 50 lays down that such excess shall be deemed to be short-term capital gain. That section does not at all deal with the sale of assets resulting in a loss. Therefore, the submissions of the learned A.R. in the instant case with reference to section 50 are misconceived and the contention raised is on a legally incorrect premise. I may also add that the Assessing Officer is also equally confused about the provisions of section 50 inasmuch as he has observed that the "loss so incurred is a short-term capital loss by virtue of section 50". It is seen that both the Assessing Officer as well as the appellant have lost sight of the provisions of clause (*iii*) of sub-section (1) of section 32 of the Income-tax Act, 1961. Clause (*iii*) reads as under:

“(*iii*) in the case of any building, machinery, plant or furniture in respect of which depreciation is claimed and allowed under clause (*i*) and which is sold, discarded, demolished or destroyed in the previous year (other than the previous year in which it is first brought into use), the amount by which the money payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, fall short of the written down value thereof:

Provided that such deficiency is actually written off in the books of the assessee.

Explanation - For the purpose of this clause,-

(1) “moneys payable” in respect of any building, machinery, plant or furniture includes -

(*a*) any insurance, salvage or compensation money payable in respect thereof;

(*b*) where the building, machinery, plant or furniture is sold, the price for which it is sold,

So, however, that where the actual cost of a motor car is, in accordance with the proviso to clause (1) of section 43, taken to be twenty-five thousand rupees, the moneys payable in respect of such motor car shall be taken to be a sum which bears to the amount for which the motor car is sold or, as the case may be, the amount of any insurance, salvage or compensation moneys payable in respect thereof (including the amount of scrap value, if any) the same proportion as the amount of twenty-five thousand rupees bears to be the actual cost of the motor car to the assessee as it would have been computed before applying the said proviso;

(2) “sold” includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme or amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian company.”

2.4 In the appellant’s case the asset which has been sold is a building and the sale consideration is less than the written down value of the asset. As such, the matter is governed by section 32 and not section 50. Section 32(1)(*ii*) as reproduced above enjoins that where moneys payable in respect of any asset being building etc. falls short of the written down value thereof, the deficiency shall be allowed as a deduction for computing the assessee’s income under Chapter IV of the Income-tax Act. Therefore, the loss incurred by the appellant on sale of the building in question was liable to be considered with reference to section 32 and not section 50. But in the instant case the loss can be considered for set off only if the same was written off in the books of account as has been clearly laid down in the proviso under clause (*iii*) (*supra*). Since the appellant has not written off the deficiency as mentioned above, I hold that the same cannot be allowed as a deduction while computing the income under the head “Business or profession”. In this view of the matter the ground raised by the appellant is rejected.”

6. Now the assessee has preferred an appeal before the Tribunal with the submission that it is the case of short-term capital loss and is to be computed as per section 50 of the Income-tax Act. Section 50 is not restricted to computation of capital gains in case of depreciable assets. The provision of section 50 can be invoked in both the situations where profit or loss on the sale of depreciable assets accrued to the assessee.

He has also invited our attention to the other provisions of Chapter IV in support of his contention that the Legislature has used the words 'capital gain' in most of the sections but it does not restrict the meaning to the gain only. It rather includes the loss accrues to the assessee on transfer of assets. The learned counsel for the assessee further contended that the issue is squarely covered by the order of the Tribunal in the case of *J.K. Chemicals* (*supra*). He has also placed reliance upon the judgment of the Supreme Court in the case of *CIT* v. *J. H. Gotla* [1985] 156 ITR 323[1] in support of his contention that where the plain literal interpretation of a statutory provision produces manifestly unjust result which could never have been intended by the Legislature, the court might modify the language used by the Legislature so as to achieve the intention of the Legislature and produce a rational construction.

7. The learned DR, on the other hand, has submitted that the provisions of section 50 can only be invoked for computing the capital gain on sale of depreciable assets. The language employed in the section clearly states that the proviso to this section can only be invoked when there is a gain on sale of a capital asset. Its sub-section (1) makes it more clear that the provision can only be invoked for computing the capital gain only on depreciable assets. According to it where the full value of consideration received or accruing as a result of transfer of the asset together with the full value of such consideration received or accruing as a result of the transfer of any capital asset falling within the block of assets during the previous year, exceeds the aggregate of the expenditure incurred wholly and exclusively in connection with such transfer or transfers and the written down value of the block of assets acquired during the previous year and the actual cost of any asset falling within the block of assets acquired during the previous year, such excess shall be deemed to be capital gains arising from the transfer of short-term capital assets. The language of this section is quite unambiguous and clear and there cannot be another meaning except that it can only be invoked where there is a capital gain in case of transfer of a depreciable asset.

8. The learned DR further invited our attention that where the assessee suffered a loss on its sale of depreciable asset, it would fall within the purview of section 32(1)(*iii*) of the Act. Section 32 deals with depreciation on different assets owned by the assessee for its use for the purpose of business or profession and clause (*iii*) of sub-section (1) deals with the situation where the assessee sells its building, machinery, plant or furniture in respect of which depreciation is claimed and allowed under clause (1). According to this clause the amount by which the money payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, falls short of the written down value thereof deduction of the same shall be allowed to the assessee from its business income provided that such deficiency actually written off in the books of account of the assessee. Since the assessee's case falls within clause (*iii*) of section 32(1) of the Act, its claim of loss can only be exempted under the said clause and not under section 50 of the Income-tax Act. The learned DR further

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contended that the order of the Tribunal was passed on different set of facts. As such the ratio laid down in that case cannot be applied to the present case. He, however, supported the order of the CIT(A).

9. Having heard the rival submissions and from a careful perusal of the orders of the lower authorities and relevant provisions of the Act in the light of the judgment referred to by the parties, we find that undisputedly assessee has sold a flat being the only asset of the block of building and suffered a loss. Assessee claimed it to be a short-term capital loss and claimed its set off against the business income as per provisions of section 50 whereas the revenue has held that the claim of loss of the assessee cannot be considered under section 50. It can only be considered under section 32(1)(*iii*) of the Act. Since the assessee has not actually written off the deficiency in its books of account, assessee is not entitled for deduction under section 32 also. Before adjudicating the controversial issue we deem it proper to examine the scope of section 50 and section 32(1)(*iii*) of the Income-tax Act. The title of section 50 is "Special provision for computation of capital gains in case of depreciable assets". Assessee has raised a controversy that the words 'capital gains' included capital loss also. The intention of the Legislature where the words 'capital gain' include capital loss can be examined not by reading the title but by full reading of section 50. We, therefore, prefer to extract the relevant provision of section 50 as under before interpreting it: -

> "50. Notwithstanding anything contained in clause (42A) of section 2, where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed under this Act or under the Indian Income-tax Act, 1922 (11 of 1922), the provisions of sections 48 and 49 shall be subject to the following modifications :—
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> (1) where the full value of the consideration received or accruing as a result of the transfer of the asset together with the full value of such consideration received or accruing as a result of the transfer of any other capital asset falling within the block of the assets during the previous year, exceeds the aggregate of the following amounts, namely :—
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> (*i*) expenditure incurred wholly and exclusively in connection with such transfer or transfers;
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> (*ii*) the written down value of the block of assets at the beginning of the previous year; and
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> (*iii*) the actual cost of any asset falling within the block of assets acquired during the previous year,
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> such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets;
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> (2) where any block of assets ceases to exist as such, for the reason that all the assets in that block are transferred during the previous year, the cost of acquisition of the block of assets shall be the written down value of the block of assets at the beginning of the previous year, as increased by the actual cost of any asset falling within that block of assets, acquired by the assessee during the previous year and the income received or accruing as a result of such transfer or transfers shall be deemed to be the capital gains arising from the transfer of short-term capital assets."

10. From a plain reading of this section we find that it is a *non obstante* clause and has overriding effect over section 2(42A) which defines short-term capital asset under different situations. Its sub-section (1) deals with the mode of calculation of the capital gain of depreciable asset. If we read it carefully we would find that through the mode of computation, given in this section only profit earned on transfer of block of assets can be worked out. According to it where the full value of consideration received or accrued as a result of transfer of asset together with the value of such considerations received or accrued as a result of transfer of another capital asset falling within the block of assets during the previous year exceed the aggregate of the expenditure wholly and exclusively incurred in connection with such transfer, written down value of the block of assets at the beginning of the previous year and the actual cost of any of assets falling within the block of assets acquired during the previous year, such excess shall be deemed to be the capital gain arising from the transfer of short-term capital asset. Meaning thereby the provisions of section (1) can only be invoked where the entire block of assets including the new assets which are acquired during the previous year and falls within the same block of assets are transferred and the sale proceeds exceed the aggregate of expenditure on transfer, written down value of the asset and the actual cost of new asset acquired during the previous year. This provision would not apply to those excess where part of the block of assets are transferred. Sub-section (2) deals with those types of cases where any block of assets ceased to exist for the reason that all the assets in that block are transferred during the previous year, the cost of acquisition of the block of assets shall be the written down value of the block of assets at the beginning of the previous year, as increased by the actual cost of any asset falling within that block of assets, acquired by the assessee during the previous year and the income received or accruing as a result of such transfer or transfers shall be deemed to be the capital gains arising from the transfer of short-term capital assets. Provision of this section does not apply to those cases where the block of assets are transferred and the full value of consideration is less than the written down value of the block of assets at the beginning of the previous year, expenditure incurred wholly and exclusively in connection with such transfer and the actual cost of any asset falling within the block of assets acquired during the previous year. Meaning thereby the loss suffered on transfer of block of assets cannot be computed under section 50 of the Income-tax Act. This type of situation is dealt with by the provisions of section 32(1)(*iii*) of the I.T. Act according to which deduction of the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, fall short of the written down value thereof in case the said building, machinery, plant or furniture is sold, discarded, demolished or destroyed in the previous year subject to actual written off of such deficiency in the books of the assessee. In order to interpret the language employed in this clause we extract the same hereunder:

"32(1)(*iii*) In respect of depreciation of.....

(*iii*) in the case of any building, machinery, plant or furniture in respect of which depreciation is claimed and allowed under clause (*i*) and which is sold, discarded, demolished or destroyed in the previous year (other than the previous year in which it is first brought into use), the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, fall short of the written down value thereof:

Provided that such deficiency is actually written off in the books of the assessee.

Explanation.—For the purposes of this clause,—

(1) "moneys payable" in respect of any building, machinery, plant or furniture includes—

(*a*) any insurance, salvage or compensation moneys payable in respect thereof;

(*b*) where the building, machinery, plant or furniture is sold, the price for which it is sold,

so, however, that where the actual cost of a motor car is, in accordance with the proviso to clause (1) of section 43, taken to be twenty-five thousand rupees, the moneys payable in respect of such motor car shall be taken to be a sum which bears to the amount for which the motor car is sold or, as the case may be, the amount of any insurance, salvage or compensation moneys payable in respect thereof (include- ing the amount of scrap value, if any) the same proportion as the amount of twenty-five thousand rupees bears to the actual cost of the motor car to the assessee as it would have been computed before applying the said proviso;

(2) "sold" includes a transfer by way of exchange or a compul- sory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation, o f any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian company or in a scheme of amalgamation of a banking company, as referred to in clause (*c*) of section 5 of the Banking Regula-tion Act, 1949 (10 of 1949) with a banking institution as referred to in sub-section (15) of section 45 of the said Act, sanctioned and brought into force by the Central Government under sub-section (7) of section 45 of that Act, of any asset by the banking company to the banking institution."

11. If both the sections, *i.e.,* section 32(1)(*iii*) and section 50, are read together one would find that these sections deals with different types of situations on transfer of capital assets of the assessee. Section 50 deals with those cases where the profit accrued to the assessee on transfer of its any block of assets whereas section 32(1)(*iii*) deals with those cases where the assessee suffered a loss on sale of any building, machinery, plant and furniture.

12. Turning to the facts of the case we find that the assessee has undisputedly sold its flat, which is the only block of assets under the head 'Building' and its sale was resulted into a loss inasmuch as sale consideration is less than the written down value of the asset in question. In such a situation where loss is incurred on sale of block of assets of the assessee section 50 has no application and the assessee's case falls within the provision of section 32(1)(*iii*) of the Act and the loss is to be computed as per sub-clause (*iii*) and deduction of the same be allowed to the

assessee from the business profit provided such deficiency is actually written off in the books of the assessee. In the instant case the CIT(A) has disallowed the claim of the assessee under section 32(1)(*iii*) of the Act because assessee has not written off the deficiencies in its books of account. During the course of hearing nothing is placed on behalf of the assessee in this regard. He has simply harped upon that its case is covered by section 50 of the Act and the capital gain includes capital loss whereas section 50 deals only with those types of cases where the profit accrued to the assessee on transfer of block of assets. Under these circumstances we are of the view that the CIT(A) has properly adjudicated the issue and we find no infirmity therein. Accordingly we confirm his order.

13. Ground No. 2 is with regard to disallowance of deduction of Rs. 1,01,40,295 in respect of provision for non-performing assets. In this regard the learned counsel for the assessee, during the course of hearing, opted not to press this ground and we, accordingly, dismiss the same being not pressed.

14. Ground No. 3 relates to confirmation of addition of Rs. 3,79,303 in respect of lease equalization. Assessee has claimed deduction on account of lease equalization of Rs. 3,79,303 but the same was disallowed by the Assessing Officer after treating it to be capital expenditure. Before the CIT(A) it was contended that observation of the Assessing Officer is factually incorrect because the assessee has not claimed the impugned expenditure. What the assessee has done is that it has credited a sum of Rs. 3,79,303 to profit and loss account being lease equalization and has reduced the sum while computing the income. Since the accounting year 1997-98, the company has adopted the recommendation of the Institution of Chartered Accountants of India contained in the Guidance Note on Accounting for Leases. Accordingly, the difference between annual lease charge (*i.e.* lease rental net of finance charge) and depreciation is debited/credited to the annual lease equalization account in the Profit and Loss Account and credited to the lease terminal adjustment account. The balance outstanding in the lease terminal adjustment account is adjusted in the net book value of the leased asset in the Balance Sheet. This method of accounting is accepted by the Assessing Officer in earlier years and there is no valid reason to disallow the claim of the assessee in this year as it is only a journal entry and there is no element of profit. Having not convinced with the explanation of the assessee, CIT(A) confirmed the disallow- ance. Now the assessee is before us and has reiterated his contentions.

15. During the course hearing the learned DR could not explain how the profit of the assessee is being affected by passing these journal entries. Since the assessee has been following this method of accounting for the last so many years, this method cannot be disturbed in the impugned year without establishing that by pass-ing these journal entries the profit of the assessee is being affect-ted. We, therefore, find no merit in this disallowance. Accord- ingly, we set aside the order of the CIT(A) and delete the addition.

16. Ground No. 4 relates to the determination of indexed cost in respect of shares of the IL&FS. Assessee has claimed indexa- tion from the assessment year 1979-80 in order to compute capital gain but the Assessing Officer has adopted indexation from assessment year 1994-95. The facts in this regard borne out from the record are that during the previous year relevant to the assessment year 2000-01 assessee-company has sold 50,000 shares of IL&FS Venture Corporation Ltd. The said shares were purchased by the assessee-company from its holding company, Mukand Ltd. during the year ended 31-3-1994 while Mukand Ltd. had acquired the said shares in the year ended 31-3-1989. While computing the long-term capital gains, the cost of acquisition of the shares deemed to be the cost of acquisition of the said shares to the holding company as increased by the cost of improvement incurred by the company in accordance with the provisions of section 49(1)(*iii*)(*e*) of the Income-tax Act. Assessee adopted the date of acquisition of the shares as the date on which they were acquired by the holding company and applied indexation to compute the capital gain. The Assess- ing Officer has taken the base year with reference to the date of acquisition by the assessee-company. In support of this treatment the Assessing Officer has relied on the wordings of clause (*v*) of section 48 of the Income-tax Act.

17. Assessee preferred an appeal before the CIT(A) with the submission that section 47 provides that transaction of sale of shares by the holding company to subsidiary company shall not be regarded to be transfer while section 49 provides that in such a case the cost of the previous owner shall be deemed to be cost of acquisition. He further contended that if the reasonings of the Assessing Officer are accepted it would lead to an anomalous situation where the actual cost of assessment year 1989-90 is taken while base year for indexation is taken as assessment year 1994-95. The assessee contended before the CIT(A) that the rule of harmonious construction should be applied for determining the base year for ascertaining the indexed cost and, accordingly, the year in which the holding company acquired the said shares should be considered as base year. The CIT(A) re-examined theissue in the light of assessee’s contention, but was not convinced with it and confirmed the view of the Assessing Officer. While disallowing the claim of the assessee the CIT(A) held that since the shares held by the assessee-company as stock-in-trade were admittedly purchased in March 1994 the base year for indexation has been rightly taken by the Assessing Officer as assessment year 1994-95. We, however, for the sake of reference extract the relevant portion of the order of the CIT(A) as under: -

> “6.2 I have considered the foregoing submissions. The learned A.R. has contended that section 47 provides that the transaction of sale of shares by a holding company to its subsidiary company shall not be regarded to be transfer and that section 49 provides that in such a case the cost to the previous owner shall be deemed to be the cost of acquisition. On going through the provisions of section 47 it is seen that in that section there is no reference to the transaction of shares by a holding company to a subsidiary company. The appellant had purchased 50,000 shares from Mukand Limited for a price. These shares were held by the appellant as

> stock-in-trade. The purchase was made in 1994. Therefore, section 47 has no application. It is not a case of "transfer of a capital asset by a company to its subsidiary company". It is a clear cut case of purchase of stock-in-trade by the appellant for a price. Therefore, I do not find any merit in what has been contended before me by the learned A.R. I also find that the appellant's contention that the rule of harmonious construction should be applied in the appellant's case is misconceived. I do not find any lack of harmony or any ambiguity in the relevant provisions. I also fully agree with the Assessing Officer that he has rightly relied on the wording of clause (*v*) of section 48 of the Income-tax Act. Since the shares held by the appellant as stock-in-trade were admittedly purchased in March, 1994 the base year for indexation has been rightly taken by the Assessing Officer as assessment year 1994-95. There was no reason for the Assessing Officer to go back to the year 1989 when the shares were acquired in March, 1994. This ground of appeal is, accordingly, rejected and the action of the Assessing Officer is upheld."

18. Now the assessee preferred an appeal before the Tribunal and reiterated its contentions. The learned counsel for the assessee further contended that the revenue authorities have not properly appreciated the relevant provisions of the Act and has disallowed the claim of the assessee arbitrarily.

19. The learned DR, on the other hand, has submitted that the assessee is trying to take shelter under the provision of section 47 and section 49 of the Act, in support of his contention that the cost and date of acquisition should be the same as in the hands of the holding company whereas the assessee, through its own letter dated 4-2-2003 appearing on page 17, has admitted that it had purchased the shares from the holding company, Mukand Ltd. during the year ended on 31-3-1994. Meaning thereby, the assessee has purchased these shares against sale consideration of certain price and that should be the cost of acquisition in the hands of the assessee. Since it is not a case of transfer of capital assets by the holding company to its subsidiary company, provisions of section 49 cannot be invoked. According to section 49 sub-section (1)(*iii*)(*e*) read with section 47(*iv*) the cost of acquisition of assets on its transfer by the holding company to its subsidiary company shall be deemed to be the cost for which the previous owner of the property acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be. In the instant case the shares were admittedly purchased by the assessee from its holding company against certain sale consideration. Though it may be a capital asset but it is not a case of transfer of the capital asset without any consideration by the holding company to its subsidiary company. If the transfer of shares is affected against some sale consideration, that sale consideration shall be the cost of acquisition in the hands of the assessee and not the cost paid by the holding company at the time of its acquisition.

20. Having given a thoughtful consideration to the rival submissions and from a careful perusal of the records we find that in the instant case it is not a normal transfer of capital asset by the holding company to its subsidiary company as envisaged in section 47(*iv*) of the Act. Through its letter dated 4-2-2003 appearing at page 17 of the compilation of the assessee filed before the Assessing Officer, assessee has categorically stated that the 50,000 shares of IL & FS Venture Corporation, which

were sold during the impugned assessment year, were purchased by it from its holding company, *i.e.,* Mukand Ltd. during the year ended 31-3-1994. Assessee, while computing the long-term capital gain has adopted the cost of acquisition of the said shares as the cost of acquisition of the shares in the hands of the holding company as increased by the cost of improvement incurred by the company in accordance with section 49(1)(*iii*)(*e*) of the Income-tax Act. The cost of acquisition adopted by the assessee was not accepted by the revenue authorities and according to them it is not a case of normal transfer of capital asset by a holding company to a subsidiary company as envisaged in section 47(*iv*) of the Act. Now the question arises before us is what would be the cost of acquisition of the shares sold by the assessee-company during the impugned assessment year which was acquired by it on purchase from the holding company? Since the language used in this section is quite relevant we extract the relevant provision of section 47 and section 49(1)(*iii*)(*e*) of the Income-tax Act :—

"47. Nothing contained in section 45 shall apply to the following transfers:—

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(*iv*) any transfer of a capital asset by a company to its subsidiary company, if—

(*a*) the parent company or its nominees hold the whole of the share capital of the subsidiary company, and

(*b*) the subsidiary company is an Indian company;

49(1) Where the capital asset became the property of the assessee—

** ** **

(*e*) under any such transfer as is referred to in clause (*iv*) [or clause (*v*)] [or clause (*vi*)] [or clause (*via*)] [or clause (*viaa*)] [or clause (*vica*) or clause (*vicb*)] of section 47.

the cost of acquisition of the asset shall be deemed to be the cost for which the previous owner of the property acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be."

21. From a bare reading of these sections, we find that computation of capital gain on transfer of those assets which fall under section 47 would not be governed by the normal provisions of section 45 of the Income-tax Act. Cost of acquisition of the capital asset falling within the ambit of section 47(*iv*), (*v*), (*vi*), (*via*) and (*viab*) are to be computed as per provisions of section 49 of the Act. With regard to transfer of capital asset by a holding company to its subsidiary company it has been stated in sections 47(*iv*) and 49(1)(*iii*)(*e*) that the cost of acquisition of a capital asset, which has been transferred by a holding company to its subsidiary company, if the holding company or its nominee hold whole of the share capital of the subsidiary company and the subsidiary company is an Indian company, shall be deemed to be the cost for which the holding company acquired the said capital asset as increased by the cost of any improvement of the asset incurred or borne by the holding company or the subsidiary company in whose hands cost of acquisition is to be computed. If we read both these provisions we would find that the cost of acquisition in the hands of the holding company shall be deemed to be the cost of acquisition in the hands of the subsidiary company in case of transfer of capital asset by the holding

company. This proposition would not be applicable if the capital assets are sold by the holding company to the subsidiary company. Once the capital assets are sold to the subsidiary company the sale value of the capital asset shall be the cost of acquisition in the hands of the subsidiary company.

22. We have also examined the provisions of sections 47 and 49 of the Act. It can only be invoked where the holding company transfers its capital asset without any considerations to its subsidiary company but when the transfer of capital asset takes the character of sale and purchase, the sale consideration shall be the cost of acquisition in the hands of the buyer. This deeming provision can only be invoked where the cost of asset at the relevant point of time could not be determined and more so the consideration was not passed on from the buyer to the seller. Once the capital assets are sold and purchased between the holding company and the subsidiary company the transaction would not fall within the ambit of sections 47 and 49 of the Act. We have also examined judgments of different High Courts in the cases of *Telerad (P.) Ltd.* v. *P.N. Mittal, Asstt. CIT* [1980] 126 ITR 1[1] (Guj.) and *CIT* v. *Stanes Motors (South India) Ltd.* [1976] 105 ITR 289 (Mad.). In those cases the entire capital assets or part of it were transferred by the holding company to its subsidiary company without any consideration. In these cases the cost of acquisition in the hands of the subsidiary company was deemed to be the cost for which the previous owner of the property acquired and as increased by the cost of any improvement of the asset incurred or borne by the previous owner or the subsidiary company, as the case may be. As such the ratio laid down in these cases cannot be applied to the present case.

23. Now the next issue comes as to what would be the period of indexation for computing the capital gain on transfer of assets by the subsidiary company? In those cases where the cost of acquisition shall be deemed to be the cost for which the holding company acquired it the year of acquisition for the purpose of indexation, shall be the year in which the capital was acquired by the holding company and the indexation may be computed accordingly. But in this case where the capital asset is sold by the holding company to its subsidiary company, the year of indexation in the hands of the subsidiary company shall be the year of transfer of capital asset in favour of the subsidiary company on its sale. In the instant case undisputedly the capital asset was purchased by the subsidiary company from its holding company. As such the year of purchase of the capital asset shall be the year of acquisition of the asset and the indexation would be taken as assessment year 1994-95 in which the capital asset was purchased and not the year in which it was acquired by the holding company. On careful perusal of the order of the CIT(A) we find that the CIT(A) has categorically held that the provisions of section 47 has no application to the present case as assessee has purchased the shares from its holding company for a price. We find no infirmity in this observation of the CIT(A) in the light of the foregoing discussion. The CIT(A) further observed that it is a case of purchase of stock in trade by the assessee for a price and in this

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1. 3 Taxman 591.

regard we do not find any fact borne out from the records. Had it been a case of trading of shares and shares were purchased as stock in trade there would not be any question of computation of capital gain. At one stage the CIT(A) held this purchase of the shares as stock in trade and at other point he computed the capital gain on the sale of shares as per *Explanation 5* of section 48 of the Income-tax Act and finally he has agreed that capital gain is to be computed and for indexation the assessment year would be taken as 1994-95. We agree with this finding of the CIT(A). In the light of the foregoing discussion we do not agree with the observation of the CIT(A) that the purchases were made as stock in trade. These purchases are a part of investment and on its sale capital gain is accrued to the assessee and for computing the capital gain the cost of acquisition shall be the purchase price of the shares and the year for indexation shall be the year in which it was purchased, *i.e.,* 1994-95. We, accordingly, confirm the orders of the lower authorities as they have rightly computed the capital gain accrued on the sale of shares.

24. Next ground relates to the treatment of whole lease rent as an income. In this regard the learned counsel for the assessee has submitted that in earlier assessment years, *i.e.,* for 1996-97 to 1999-2000 the Tribunal has examined identical issue and restored the matter to the file of the Assessing Officer with the direction that the interest income accrued to the assessee may be brought to tax in place of rental income assessed by him after affording opportunity of hearing to the assessee. Copy of the order is placed on record. For the sake of reference we extract the relevant observation of the Tribunal :—

> "(6) We have considered the factual position and in our view, if the lease transaction is to be held as only a finance agreement, then full effect must be given to such finance agreement. Even the learned CIT(A) accepted the alternative claim in principle: he did not allow any relief for the reason that the main ground regarding depreciation was not withdrawn by the assessee. Now the learned counsel appearing for the assessee has not pressed the main ground of appeal. The department has treated the transaction as financial transaction with a view to earn interest income. Therefore, it would be fair and reasonable if only such interest income is brought to charge to tax. The rental income received by the assessee is partly in respect of capital price of the plant and machinery and partly rent for using the machinery. If the transaction is treated to be financial transaction such capital reimbursement cannot be taxed. We, therefore, restore this issue to the Assessing Officer with the direction that interest income accruing to the assessee may be brought to charge of tax in place of rental income assessed by him after allowing opportunity of hearing to the assessee."

25. Since the matter is squarely covered by the aforesaid order of the Tribunal, we, following the same, set aside the order of the CIT(A) and restore the matter to the file of the Assessing Officer with similar direction that interest income accruing to the assessee may be charged to tax in place of rental income assessed by him as the lease transaction is held to be a financial arrangement, after affording opportunity of being heard to the assessee.

26. Ground No. 6 relates to disallowance of interest under section 14A of the Act.

27. During the course of assessment proceedings the Assessing Officer has noticed that the assessee has received dividend income which is exempted from tax and he, accordingly, disallowed the interest on borrowed funds invested in shares. The assessee preferred an appeal before the CIT(A) and raised preliminary objection that provisions of section 14A cannot be invoked in the light of the proviso inserted by the Finance Act, 2002 with retrospective effect from 11-5-2001. The learned counsel for the assessee further stated that in the instant case the refund of Rs. 41,23,167 was issued under section 143(1)(*a*) and now as a result of the addition refund already granted shall be reduced by Rs. 4,13,224. As such provisions of section 14A cannot be invoked in the light of the proviso to section 14A according to which the Assessing Officer is not empowered to invoke the provisions of section 14A either to reassess under section 147 or pass an order enhancing the assessment or reducing the refund already made or otherwise increasing the liability under section 154 for any assessment year beginning on or before 1-4-2001. Since as a result of invocation of section 14A the refund is reduced the Assessing Officer is not empower- red to invoke the said provision.

28. The learned counsel for the assessee further contended that on merit the assessee is a non-banking finance company carry- ing on the business of investment and trading in shares, finance- ing and leasing. The funds borrowed by the company from time to time were utilized for such business activities of the assessee-company as such interest payable on borrowed funds is allowable under section 36(1)(*iii*) of the Income-tax Act.

29. The CIT(A) re-examined the issue in detail but was not convinced with assessee's contentions on both counts. The CIT(A) has held that the contentions of the assessee with regard to the applicability of section 14A are quite misconceived as the proviso is applicable to situation wherein assessment order, in respect of an assessment year, has already been passed and subsequently reassessment is sought to be made under section 147 or the income assessed or refund issued, as the case may be, sought to be enhanced or reduced by passing an order under section 154 of the Act. Since in the instant case both the situations are missing the proviso to section 14A cannot be invoked. He has also examined the issue on merit but was not convinced with assessee's contentions. He, accordingly, held that the expenditure incurred in relation to earning of dividend income will be required to be reduced to work out the dividend income which does not form part of the total income. He accordingly confirmed the disallowance made by the Assessing Officer.

30. Now the assessee has preferred an appeal before the Tribunal and has reiterated its contentions.

31. The learned DR, on the other hand, has placed heavy reliance upon the order of the CIT(A).

32. Having given a thoughtful consideration to the rival submissions and from a perusal of record and the provisions of section 14A we find that section 14A was brought on the statute by the Finance Act, 2002 with retrospective effect from 1-4-2001. After the introduction of provision 14A a strong apprehension was raised on behalf of the corporate sector and different assessees that this provision may be misused and assessment may be reopened. In order to avoid misuse of this provision proviso to this section was introduced by the Finance Act, 2002 with retrospective effect from 11-5-2001 and through this proviso a restriction was imposed upon the Assessing Officer that he shall not be empowered either to reassess under section 147 or pass order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before 1-4-2001. Meaning thereby that the proviso to section 14A is applicable to a situation where the assessment order for an assessment year beginning on or before 1-4-2001 has already been passed and subsequently reassessment is sought to be made under section 147 or the income assessed or refund issued, as the case may be, sought to be enhanced or reduced by passing an order under section 154 of the Act. For invoking the proviso to this section there should be an assessment order passed which is sought to be reopened or rectified by the subsequent act of the Assessing Officer. In the instant case undisputedly there is no assessment order passed under section 143(3) of the Act. Only an intimation was issued through which refund was granted. It has been repeatedly held by the Apex Court and various High Courts that intimation under section 143(1)(*a*) cannot be called to be an assessment order. It is merely an intimation. As such the proviso to section 14A cannot be invoked in the instant case.

33. During the course of hearing the learned counsel for the assessee has placed reliance upon the order of the Tribunal's SMC Bench in the case of *V. Uppalaiah* v. *Dy. CIT* [2005] 94 ITD 178 (Hyd.) in support of his contention that intimation issued under section 143(1)(*a*) is an assessment order and proviso to section 14A would be invoked where an attempt is made to reduce the refund granted through intimation under section 143(1)(*a*) of the Act. We have carefully gone through this judgment but we find that the findings of the Tribunal (SMC Bench) that the intimation is an assessment order is contrary to the ratio laid down by the various High Courts in the following cases :—

(*i*) *MTNL* v. *Chairman, CBDT* [2000] 246 ITR 173[1] (Delhi).

(*ii*) *CIT* v. *K.V. Mankaram & Co.* [2000] 245 ITR 353[2] (Ker.).

(*iii*) *Bharat V. Patel* v. *Union of India* [2004] 268 ITR 116[3] (Guj.).

(*iv*) *CIT* v. *ABAD Fisheries* [2002] 258 ITR 641[4] (Ker.)

34. In these aforesaid judgments of all the High Courts have categorically held that the intimation under section 143(1)(*a*) cannot be

1. 112 Taxman 337.
2. 111 Taxman 439.
3. 134 Taxman 178.
4. 125 Taxman 616.

called to be an assessment order for all practical purposes. It is only an intimation. In proviso to section 14A reference was made for reassessment under section 147 or a rectification under section 154 of the Act. But in the instant case regular assessment was framed after issuance of notice under section 143(2) which can-not be called to be reassessment under section 147 or rectifica- tion under section 154 of the Act. As such assessee's case does not fall within any of the prohibitory conditions. We, accordingly, hold that the revenue authorities have rightly invoked section 14A of the Act and no assistance can be drawn from the order of the Tribunal (SMC) in the case of *V. Uppalaiah* (*supra*) in favour of the assessee. We, therefore, find ourselves in agreement with the order of the CIT(A) in this regard. So far as the disallowance on merit is concerned, we find that undisputedly assessee is a non-banking finance company and is engaged in the business of investment and trading in shares and finance and leasing. The dividend income was accrued to the assessee on both the types of shares, either kept as stock-in-trade or in investment. Though the dividend income earned on its shares which are kept in stock in trade is also exempted from tax but the interest paid on the borrowed funds invested in trading of shares cannot be disallowed because it was borrowed for the purpose of business and is an allowable expenditure under section 36(1)(*iii*) of the Act. Disallo- wance of interest on borrowed funds can only be made where the borrowed funds were invested in shares and the shares were held by the assessee to be investment or capital asset. In the instant case, revenue authorities have disallowed the interest on borrowed funds which were invested in shares without looking to the nature of shares whether they were kept as stock-in-trade or as an investment. We, therefore, of the view that this issue requires fresh adjudication by the Assess- ing Officer to identify the borrowed funds, which were invested in shares, held as investment and only with regard to these borrowed funds disallowance under section 14A can be made. The interest paid on the borrowed funds which were invested in shares kept as stock-in-trade deserves to be allowed as revenue expenditure under section 36(1)(*iii*) of the Act. We, accordingly, set aside the order of the CIT(A) in this regard and restore the matter to the file of the Assessing Officer with the direction to readjudicate the issue afresh in terms indicated above after affording opportunity of being heard to the assessee.

35. Next ground relates to computation of book profit under section 115JA of the Act.

36. In this regard it is noticed by the Assessing Officer that the assessee has computed its income under section 115JA at Rs. 1,24,50,037 but the assessee has not made certain disallowance while computing the book profit. The Assessing Officer, accordingly, added a sum of Rs. 1,01,40,295 which was made as provision for Non-Performing Asset (NPA) and recomputed the book profit at 30 per cent at Rs. 71,02,795. Assessee preferred an appeal before the CIT(A) with the submission that the Assessing Officer has wrongly observed that the provision for NPA is a contingent liability whereas during the previous year relevant to assessment year 2000-01 an amount of Rs.

1,01,40,295 has been determined as provision for Non-performing Asset and has debited to the Profit and Loss Account. The said provision has been made on the basis of prudential norms prescribed by the Reserve Bank of India for non-banking finance companies. He further contended that the Reserve Bank of India has after careful study of empirical data have devised prudential norms for *inter alia* determining the profitability and net worth of Non-Banking Finance Companies (NBFCs). These are not *ad hoc* norms which can be just considered as regulatory but they go to the very root of determining the commercial profits and net worth of NBFCs. In the case of NBFCs the loans and advances are in the nature of current assets and any provisions for diminution of value of current assets is not in the nature of provision of liability and hence clause (*c*) of *Explanation* to section 115JA is not applicable to provision for NPAs. He placed heavy reliance upon the judgment of jurisdictional High Court in the case of *CIT* v. *Echjay Forgings (P.) Ltd.* [2001] 251 ITR 15[1] (Bom.) in support of his contentions that the provisions for NPAs are an ascertained liability. Reliance on other judgment in the case of *CIT* v. *Eicher Ltd.* [2006] 287 ITR 170[2] (Delhi) was also placed.

37. The CIT(A) was not convinced with the contentions of the assessee and he disallowed the claim after having observed that the adjustment has to be made as per the narrations in the Profit and Loss Account and since the provision in respect of non-performing assets is not a liability and much less an ascertained liability, the Assessing Officer was right in making the adjustment and the same is confirmed.

38. Now the assessee has preferred an appeal before us and reiterated its contentions. The learned counsel has invited our attention to the order of the Special Bench of the Tribunal in the case of *Jt. CIT* v. *Usha Martin Industries Ltd.* [2007] 104 ITD 249 (Kol.) in support of his contention that provision for non-performing assets is not at all a liability. This provision was created on account of certain defaults in payment by the debtors. It is not in the form of liability which is to be cleared by the assessee. He has also argued in the alternative that the Assessing Officer be directed to reduce Rs. 46,29,010 being the provision for NPAs written back.

39. The learned DR, on the other hand, submitted beside placing heavy reliance on the order of the CIT(A), that the judgment referred to by the assessee are on different issues, *i.e.,* with regard to clause (*a*) of *Explanation* to section 115JA. Through this judgment the provision for doubtful debts, gratuities and bonus are considered to be ascertained liabilities but nowhere it has been held that the provision for NPAs is an ascertained liability. As such the judgments cannot be applied to the facts of the present case.

40. Having heard the rival submissions and from a careful perusal of the record we find that the assessee has made a provision non-performing assets while computing the total income of the assessee but the net profit computed as shown in the Profit & Loss Account for the relevant previous

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1. 116 Taxman 322.
2. [2007] 159 Taxman 293.

year in accor-dance with the provisions of Parts II and III of Schedule VI of the Companies Act was not increased by the said provision for non-performing assets in order to compute book profit under *Explanation* to section 115JA of the Act. The Assessing Officer treated this provision for non-performing assets as a provision for unascertained liability and increased the aforesaid net profit by this provision for NPAs to compute book profit under section 115JA of the Act. The learned counsel for the assessee has emphatically argued having relied upon the order of the Special Bench in the case of *Usha Martin Industries Ltd.* (*supra*) that provisions for non-performing asset is not a liability like a provision for bad and doubtful debts. The provision for non-performing asset was created when the debtors failed to make the payments of instalments in time. Similar was the position in the case of bad and doubtful debts where the assessee fails to recover the debts and made a provision for the same. Heavy reliance was placed upon the order of the Special Bench in the case of *Usha Martin Industries Ltd.* (*supra*) and from its careful perusal we find that the Tribunal has examined the issue with regard to provisions for bad and doubtful debts. Whether these debts of the previous year which are to be recovered something from the debtors by the assessee can be called to be a liability for the purpose of section 115JA of the Act and the Tribunal has held that the provisions for bad and doubtful debts not being a provision for liability but a provision for diminution of the value of the assets, *i.e.*, debts and as such clause (*c*) of section 115JA is not applicable. The Tribunal further held that the provisions made by the assessee not being excessive or unreasonable, it cannot be considered as a reserve under the clause (*b*) of *Explanation* and, therefore, the same could not be added back to the net profit for computing the book profit in the meaning of section 115JA. The relevant observation of the Tribunal is extracted hereunder for the sake of reference :—

> "As per section 115JA, the profit and loss account is to be prepared as per Parts II and III of Schedule VI to the Companies Act. Part III of Schedule VI defines the expression 'provision', which means any amount written off or retained, by way of providing for depreciation, renewals or diminution in the value of assets or retained by way of providing for any known liability, of which the amount cannot be determined with substantial accuracy. The identical definition of the word 'provision' is given by the Institute of Chartered Accountants of India in the guidance notes issued for its members. Similar definition is given in the books of accountancy by William Pickles. Thus, the provision can be for (*i*) depreciation; (*ii*) renewals; (*iii*) diminution in the value of assets; and (*iv*) for any known liability, of which the amount cannot be determined with substantial accuracy.
>
> The question was whether the provision for bad and doubtful debt was the provision for diminution in the value of asset or for known liability, of which the amount cannot be determined with substantial accuracy. The provision for bad and doubtful debt is made when the assessee is of the opinion that its entire debt may not be realized and part of the debt may become irrecoverable. However, when the amount of such irrecoverable debt cannot be ascertained with substantial accuracy, the provision is made for bad and doubtful debt. Debts are of two types. One-debt payable by the assessee, *i.e.,* where the assessee has to pay the amount to others. It would be liability in the hands of the assessee. Second debt receivable by

the assessee, *i.e.,* where the assessee has to receive the amount from others. It would be an asset in the hands of the assessee. Admittedly, the 'debt' under consideration was 'debt receivable' by the assessee. The provision for bad and doubtful debt, would always be made with reference to debt receivable where there is doubt about full realization of debt. The provision is made to cover up the probable diminution in the value of an asset, *i.e.,* debt which is amount receivable by the assessee. The following example would make the position more clear: In the accounts of an assessee, there are outstanding debts in the names of several parties totalling to Rs. 1 crore. The assessee is of the opinion that the entire debt of Rs. 1 crore might not be realized. It opines that only 90 per cent of the debt would be realized and, therefore, it made a provision for Rs. 10 lakhs for bad and doubtful debts. By making that provision, the assessee is valuing its asset, *viz.*, debt, at Rs. 90 lakhs as against the book figure of Rs. 1 crore. Thus, the provision for bad and doubtful debts is the provision for diminution in the value of asset, *i.e.,* debt. The provision for bad and doubtful debt cannot be said to be a provision for liability, because even if a debt is not recovered, no liability would be fastened upon the assessee. In that example if as against the outstanding debt of Rs. 1 crore only Rs. 90 lakhs has been realized, then due to non-realization of the debt of Rs. 10 lakhs, there is no question of any liability upon the assessee. The debt is the amount receivable by the assessee and not any liability payable by the assessee and, therefore, any provision towards irrecoverability of the debt cannot be said to be provision for liability. Once it is held that the provision for bad and doubtful debt is not a provision for any liability, the question whether the liability is ascertained liability or unascertained liability does not arise.

Therefore, the provision for bad and doubtful debt is not a provision for liability but it is a provision for diminution in the value of the assets. Once the provision is not for any liability, the question whether the liability is ascertained or unascertained does not arise. Therefore, clause (*c*) of the *Explanation* to section 115JA would not be applicable in respect of provision for bad and doubtful debts.

As regards the alternate argument of the revenue that the provision for bad and doubtful debt would be covered by clause (*b*) of the *Explanation* to section 115JA, it is seen that the expression 'reserve' has been defined in a negative manner by clause 7(1)(*b*) of Part III of Schedule VI of the Companies Act and it only says that the reserve shall not include any amount written off or retained by way of providing for depreciation, renewals, diminution in the value of assets or retained by way of providing for any known liability. Thus, if the provisions made by the assessee for depreciation, renewals and diminution in the value of the assets are for any known liability, if it is in excess of the amount which is reasonably necessary for the purpose for which the provision is made, the excess shall be treated as a 'reserve' and not a 'provision'. It would depend upon the facts of each case whether the provision made is in excess of the necessary requirement for the purpose for which the same is made. Therefore, whether the amount set apart by the assessee by way of provision was, in fact, provision or it was in the nature of reserve would have to be examined with reference to peculiar facts of each case.

The assessee had made the provision for bad and doubtful debts of Rs. 2.20 crores as on 31-3-1997. The provision as on 31-3-1996 was Rs. 64 lakhs. Thus, the additional provision of Rs. 1.56 crores was made for the year under consideration. The balance sheet of the assessee was duly audited and certified by the chartered accountants and it had nowhere

reported that the provision for bad and doubtful debt was excessive in the opinion of either directors or auditors. The total outstanding debt as on 31-3-1997 was more than Rs. 86 crores against which the provision for bad and doubtful debt was Rs. 2.20 crores, which was even less than 3 per cent of the total debt. The Assessing Officer, in the assessment order, had nowhere stated that the provision made by the assessee for bad and doubtful debt was excessive or unreasonable considering the purpose for which the provision was made. At the time of hearing, the revenue expect making a claim that the provision for bad and doubtful debts should be considered as 'reserve' under clause (*b*) of *Explanation* to section 115JA, had not proved how the provision made for bad and doubtful debt was excessive or unreasonable. Hence, the revenue's claim that the provision for bad and doubtful debt, in the case of the assessee, would fall within the clause (*b*) of the *Explanation* to section 115JA, could not be accepted. Accordingly, the order of the Commissioner (Appeals) deleting the addition of Rs. 1.56 crores made by the Assessing Officer in respect of provision for bad and doubtful debt was upheld."

41. If the facts of the case are examined in the light of the order of the Special Bench, we would find that in the instant case assessee has maintained an account for non-performing assets and whatever recovery of the outstanding debts is not properly effected and certain defaults in instalments are committed, assessee put those outstanding dues under the head "Non-Performing Assets" and accordingly he made a provision for non-performing assets while computing the total income of the assessee. In the case of bad and doubtful debts similar type of practice is being adopted by the assessees whenever they failed to recover the debt. We, therefore, of the view that same analogy can also be applied to the present case. In the case of bad and doubtful debts, Tribunal has categorically held that the provision for bad and doubtful debts is not a provision for any liability, it is rather a provision for diminution in the value of assets, *i.e.,* debts because even if a debt is not recovered no liability would be fastened upon the assessee. Debt is the amount receivable by the assessee and not any liability payable by the assessee and, therefore, any provision towards recoverability of the debt cannot be said to be the provision for the liability. Similar is the position with regard to provisions for non-performing assets. In that case also if the debt is not recovered no liability would be fastened upon the assessee. It is the amount receivable by the assessee and not the liability payable by the assessee. We, therefore, are of the view that the ratio laid down in the case of *Usha Martin Industries Ltd.* (*supra*) by the Special Bench strictly apply to the present case and following the same we hold that the provisions for non-performing assets is not a provision for liability. As such the question whether it is ascertained or unascertained becomes irrelevant. We, therefore, set aside the order of the CIT(A) and direct the Assessing Officer not to increase the net profit shown in the Profit and Loss Account for the relevant previous year prepared in accordance with the provisions of Parts II and III of Schedule VI of the Companies Act in order to compute the book profit under section 115JA of the Act. Accordingly this issue is disposed off.

42. In the result, appeal of the assessee is partly allowed for statistical purpose.