M/s SOUTHERN TECHNLOGIES LTD. vs JCIT

In context of "Whether the Department is entitled to treat the "Provision for NPA", which in terms of RBI Directions 1998 is debited to the P&L Account, as "income" under Section 2(24) of the Income Tax Act, 1961 ("IT Act" for short), while computing the profits and gains of the business under Sections 28 to 43D of the IT Act?" it is held that:

1) NBFCs have to accept the concept of "income" as evolved by RBI after deducting the Provision against NPA, however, as stated above, such treatment is confined to Presentation / Disclosure and has nothing to do with computation of taxable

income under the IT Act.

2) The point which we would like to make is whether such losses are contingent or actual cannot be decided only on the basis of presentation. Such presentation will not bind the authority under the IT Act. Ultimately, the nature of transaction has to be examined. In each case, the authority has to examine the nature of expense/ loss. Such examination and finding thereon will not depend upon presentation of expense/ loss in the financial statements of the NBFC in terms of the 1998 Directions. Therefore, in our view, the RBI Directions 1998 and the IT Act operate in different fields. The question still remains as to what is the nature of "Provision for NPA" in terms of RBI Directions 1998. In our view, provision for NPA in terms of RBI Directions 1998 does not constitute expense on the basis of which deduction could be claimed by NBFC under Section 36(1)(vii).

3) 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-à-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

4) If an item falls under Sections 30 to 36, but is excluded by an Explanation to Section 36(1)(vii) then Section 37 cannot come in. Section 37 applies only to items which do not fall in Sections 30 to 36. If a provision for doubtful debt is expressly excluded from Section 36(1)(vii) then such a provision cannot claim deduction under Section 37 of the IT Act….