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\* **IN THE HIGH COURT OF DELHI AT NEW DELHI**+ **ITA No. 922/2008**

COMMISSIONER OF INCOME TAX DELHI IV ..... Appellant  
Through: Ms. Prem Lata Bansal, Advocate.

versus

VIKEM METALKAT PVT. LTD.  
(NOW KNOWN AS ECOCAT INDIA (P) LTD.) ..... Respondent  
Through: Mr. S. Krishnan Advocate.

% DATE OF DECISION: August 26, 2010

**CORAM:****HON'BLE MR. JUSTICE A.K. SIKRI****HON'BLE MS. JUSTICE REVA KHETRAPAL**

1. Whether reporters of local papers may be allowed to see the judgment?
2. To be referred to the Reporter or not?
3. Whether judgment should be reported in Digest?

Yes

**A.K. SIKRI, J. (ORAL)**

1. For the assessment year 2001-02, the assessee Company filed a return declaring income at ₹ 10,208/-. During the assessment, the assessing officer noticed that the assessee had invested an amount of Rs.130 lakhs in 12% optionally convertible debentures of PAL Enterprises Pvt. Ltd. However, interest of Rs.15,60,000/- (calculated at the rate of 12% on Rs.130 lakhs) was not credited in the profit and loss account. On query by the assessing officer, the assessee stated that there



assessing officer rejected this contention of the assessee on the ground that the assessee was following mercantile system of accounting and, therefore, the interest income was to be taxed on accrual basis. He accordingly made addition of Rs.15,60,000/- treating it to be an income under the head "Income from other sources". The CIT(A) confirmed the action of the assessing officer and dismissed the appeal of the assessee preferred against the order of the assessing officer. However, the ITAT deleted the addition vide impugned judgment dated 19.10.2007. The ITAT has followed its own order passed in the case of *Pranav Vikas (India) Ltd.* in ITA No.3322/Del/2004, which is the sister concern of the assessee and the said Pranav Vikas has also invested the amount with same PAL Enterprises Pvt. Ltd. and under the same circumstances, the said Company has also not treated the same as income as it was uncertain to receive any interest.

2. Insofar as Pranav Vikas case is concerned, no appeal was filed by the revenue, but that was because of low tax effect. However, we have gone through the detailed judgment passed by the Tribunal in the case of *Pranav Vikas*. The facts which emerge therefrom and are applicable to present case also are as under:

3. The assessee herein had received interest free advance from Premier Automobile Ltd. (PAL) for development of certain products, i.e., air-conditioning and since the project of development of the said



group, namely, M/s. PAL Enterprises Pvt. Ltd. The assessee credited the interest receivable at the rate of 12% per annum on the aforesaid debentures for few years. Though in fact said interest was not actually received, it was done as the assessee was following mercantile system of accounting.

4. However, in the assessment year in question, the assessee received a letter from M/s. PAL Enterprises Pvt. Ltd. expressing their inability to provide for any interest expenditure due to deep financial crisis and requesting the assessee Company to treat said investment as interest free. It was in these circumstances that the Board of Directors of the assessee Company decided not to provide for said interest income as there was no possibility of receiving the same. It was also decided that appropriate measures should be taken to realize the interest receivable which was already provided for in the books of accounts in the earlier years as well as the principal amount of investment.

5. Taking note of these facts and discussing various judgments of the Supreme Court as well as various High Courts, the Tribunal came to the conclusion that even when the assessee was following mercantile system of accounting, in the facts of this case, it could not be said that the interest income had “accrued to the assessee when real income theory is to be applied”. It was observed that whether the income has really accrued or arisen to the assessee must be judged in the reality of the

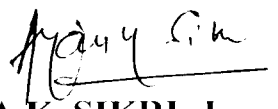


reality of the situation, no income has resulted because the income did not really accrued. In the present case, both PAL as well as PAL Enterprises Pvt. Ltd. became sick units and the cases were referred to BIFR due to adverse financial position. Once the reference is admitted by the BIFR treating the company as a sick company, it is clear that the BIFR has satisfied itself that networth of that company has eroded. Then the next exercise which has to be taken by the BIFR is to see as to whether such a company can be revived or not. This process normally takes time and even if there is a feasibility of revival, the creditors have to normally give up substantial part of the debts which are due to them from such a sick company in the scheme which is ultimately prepared and approved by BIFR. Keeping in view such circumstances, if the Board of Directors hold the opinion that the recovery had become uncertain, we are of the opinion that real income theory, which has in a way exception to the accrual theory in mercantile system of accounting, would be applicable. In *CIT vs. Goyal M.G. Gases Pvt. Ltd.*, ITA No.538/2007, in identical circumstances where the company in which investment was made had become sick and approached the BIFR, this Court accepted the view of the Tribunal that real accrual of the income had not taken place and dismissed the appeal of the revenue observing that no substantial question of law arises. Following that judgment, we are of the opinion that in the peculiar facts of this case, the position



therefore there was no accrual of the interest income in that particular year.

6. This appeal is accordingly dismissed.

  
A.K. SIKRI, J.

  
REVA KHETRAPAL, J.

**AUGUST 26, 2010**  
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