* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA No.660 of 2010**
ITA No.1570 of 2006
ITA No.1493 of 2006
ITA No.1457 of 2006
ITA No.1445 of 2006
ITA No.1444 of 2006

RESERVED ON: June 01, 2011
% PRONOUNCED On: July 11, 2011

\+ **ITA No.660 of 2010**

COMMISSIONER OF INCOME TAX, Delhi-IV . . . Appellant

VERSUS

IFCI LIMITED . . .Respondent

\+ **ITA No.1570 of 2006**

COMMISSIONER OF INCOME TAX . . . Appellant

VERSUS

INDUSTRIAL FINANCE CORPORATION OF INDIA LTD. . . .Respondent

\+ **ITA No.1493 of 2006**

COMMISSIONER OF INCOME TAX . . . Appellant

VERSUS

INDUSTRIAL FINANCE CORPORATION OF INDIA LTD. . . .Respondent

\+ **ITA No.1457 of 2006**

COMMISSIONER OF INCOME TAX . . . Appellant

VERSUS

INDUSTRIAL FINANCE CORPORATION OF INDIA LTD. **. . .Respondent**

\+ **ITA No.1445 of 2006**

COMMISSIONER OF INCOME TAX **. . . Appellant**

VERSUS

INDUSTRIAL FINANCE CORPORATION OF INDIA LTD. **. . .Respondent**

\+ **ITA No.1444 of 2006**

COMMISSIONER OF INCOME TAX **. . . Appellant**

VERSUS

INDUSTRIAL FINANCE CORPORATION OF INDIA LTD. **. . .Respondent**

Counsel for the Revenue : Ms. Prem Lata Bansal, Sr. Advocate with Mr. Deepak Anand, Advocate.

Counsel for the Assessee : Mr. Ajay Vohra, Advocate with Ms. Kavita Jha, Advocate and Mr. Somnath Shukla, Advocate.

CORAM :-
HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MR. JUSTICE M.L. MEHTA

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?

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2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. For orders, see ITA No.1572 of 2006

(A.K. SIKRI)
JUDGE

(M.L. MEHTA)
JUDGE

JULY 11, 2011
pmc

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA No.1572 of 2006**
ITA No.660 of 2010
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RESERVED ON: June 01, 2011
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\+ **ITA No.1572 of 2006**

COMMISSIONER OF INCOME TAX . . . **Appellant**

VERSUS

INDUSTRIAL FINANCE CORPORATION OF INDIA LTD. . . .**Respondent**

\+ **ITA No.660 of 2010**

COMMISSIONER OF INCOME TAX, Delhi-IV . . . **Appellant**

VERSUS

IFCI LIMITED . . .**Respondent**

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COMMISSIONER OF INCOME TAX . . . **Appellant**

VERSUS

INDUSTRIAL FINANCE CORPORATION OF INDIA LTD. . . .**Respondent**

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VERSUS

INDUSTRIAL FINANCE CORPORATION OF INDIA LTD. . . .Respondent

Counsel for the Revenue : Ms. Prem Lata Bansal, Sr. Advocate with Mr. Deepak Anand, Advocate.

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1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. In all these appeals, the assessee is common, viz., Industrial Finance Corporation Limited, a Government of India undertaking. These appeals pertain to the Assessment Years 1993-94 to 1998-99. With the consent of the parties, ITA No.1572 of 2006 was treated as lead case which concerns Assessment Year 1996-97. The main issue which is raised by the appellant/Revenue in this appeal relates to deduction under Section 36(1)(viii)/Section 41(4A) of the Income Tax Act (hereinafter referred to as 'the Act'). In fact, this is the issue which arises in all other appeals as well. Since it has been discussed in detail by the Income Tax Appellate Tribunal ('Tribunal' for brevity) in this appeal, that became the justification of this appeal as a lead case. We shall, thus, take

note of the facts in this appeal to decide the question. However, other issues which have arisen in this appeal as well as other appeals would also be discussed separately by us in the course of this judgment.

2. For this assessment year, the assessee had declared income at ₹253.83 Crores. The assessee had claimed an amount of ₹12,906.18 lacs as deduction being special reserve created under Section 36(1)(viii) of the Act. The assessee had an opening balance of ₹26,963.00 lacs as on 01.04.1996. The AO found that out of these special reserves, the assessee transferred ₹50 Crores to bad and doubtful debts accounts. The AO disallowed this amount of ₹50 Crores as he found that the assessee had separately claimed the bad and doubtful debts in Profit & Loss Account as actually written off and this amount of ₹50 Crores could not be allowed as deduction under Section 36(1)(viii) of the Act to avoid double deduction.

3. The CIT (A) upheld this order of the AO. The Tribunal has, however, allowed the deduction.

4. We may first point out the position of two accounts, viz., special reserve account and bad and doubtful debts account which is .

It reflected in the annual accounts for the Financial Year 1995-96. Understanding of the same would help us in appreciating the controversy. During the year, the assessee created special reserve under Section 36(1)(viii) of the Act amounting to ₹12,906.18 lacs. The assessee had an opening balance of ₹26,963 lacs as on 01.04.1995. Out of these amounts, the assessee transferred a sum of ₹50 Crores to provision for bad and doubtful loans and thus, the assessee carried forward a sum of ₹34,869.18 lacs by way of special reserve under Section 36 (1) (viii) of the Act. This balance appears in the annual accounts of the assessee in Schedule II under the head "Reserve and Surplus". Thus the position of the special reserve account in the books of the assessee stood as under:

	₹ in lakhs
Balance as on 01.04.1995	26,963.00
Reserve created during the year	12,906.18
Transferred to bad & doubtful debts	5,000.00
Balance as on 31.3.1996	34,869.18

5. The sum of ₹12,906.18 lacs added by the assessee to special reserve has been debited by the assessee by way of appropriation of profit as per Profit & Loss Account. In the computation of income chargeable to tax, this amount has been claimed as deduction under Section 36(1)(viii) of the Act.

6. As to the "provision for bad and doubtful loans" account to which the sum of ₹50 Crores has been transferred by the assessee from special reserve account, the assessee had an opening balance of ₹25,012.14 lacs. The assessee credited thereto not only the sum of ₹50 Crores transferred from special reserve account, but also the sum of ₹570 lacs provided for under the provisions of Section 36(1)(viia)(c) by way of an expenditure debited to Profit & Loss Account. The aggregate sum of ₹30,582.14 lacs as at the end of the year on 31.03.1996 has been reduced by the assessee from outstanding loans amounting to ₹11,15,921.06 lacs and only the net amount of ₹10,85,338.92 lacs has been shown as loans outstanding as per Schedule V of the balance-sheet. In addition to the sum of ₹30,582.14 lacs adjusted to loans recoverable under the caption "provision for bad and doubtful loans", the assessee has further written off outstanding loans by the sum of ₹18,624.61 lacs being the aggregate amount of bad debts written off in the books of accounts of the assessee. This sum of ₹18,624.61 lacs had been claimed as deduction by the assessee over and above the sum of ₹570 lacs provided under Section 36(1)(viia)(c) of the Act and the special reserve of

₹12,906.18 lacs created under the provisions of section 36(1)(viii) of the Act. The sum effect is that the assessee had reduced the amount of loans by a sum of ₹18,624.61 lacs by way of write off and by the sum of ₹30,582.14 lacs by way of "provision for bad and doubtful loans".

7. The AO vide order dated 26.02.1999 disallowed deduction for bad debts written off amounting to ₹18,624.61 lacs, *inter alia*, on the following grounds:

(a) The assessee could not claim deduction for both the amount of provision of bad and doubtful debts created during the relevant previous year under Section 36(1)(viia)(c) of the Act as also the amount of bad debts actually written off.

(b) The amount of claim of deduction of bad debts written off was to be reduced by the cumulative amount of provision for bad and doubtful debts allowed deduction under Section 36(1)(viia)(c) of the Act for Assessment Years 1992-93 to 1996-97 to the extent of ₹34,31,90,547.

(c) Alternatively, the amount of deduction claimed for bad debts written off had to be reduced by the

amount withdrawn from special reserve created under Section 36(1)(viii) of the Act and credited to the profit and loss account in Assessment Years 1995-96 and 1996-97, aggregating to ₹22,500 lacs.

(d) Further without prejudice, the amount of deduction claimed for bad debts written off needed to be reduced by the amount standing to the credit of provision for bad and doubtful debts in the books of account of the assessee upto 31.3.1996, aggregating to ₹30,582.14 lacs.

8. Being aggrieved by the aforesaid order dated 26.02.1999, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals). The CIT(A) held that the deduction on account of bad debts written off had to be reduced to the extent of –

(a) The amount of ₹5000 lacs withdrawn from special reserve and credited to the profit and loss account.

(b) Amount of ₹570 lacs being provision for bad and doubtful debts claimed deduction under Section 36(1)(viia)(c) of the Act.

According to the CIT(A), if the deduction for bad debts was not to be reduced to the extent of the aforesaid amounts, the assessee would have enjoyed double deduction which, according to the CIT(A) is contrary to the provisions of law. The CIT(A), however, held that "in absence of specific provisions enabling the AO in this regard, the benefits claimed or granted, even if erroneously as per the interpretation of Section 36(1)(vii) pertaining to the earlier years could not have been withdrawn during the current assessment year. Therefore, insofar as denying the benefit of writing off of the bad debts to the extent of reserves withdrawn in the earlier years and the deductions claimed under Section 36(1)(viia)(c), is not as per law and cannot be supported. Nothing, however, prevents the AO from considering such action as deemed fit in the earlier assessment years. The order of the CIT(A) was accepted by the Revenue and no appeal filed thereagainst. The assessee, however, challenged the order of the CIT(A) on the following grounds:

(a) Reducing deduction of amount of bad debt written off by the amount of ₹5,000 lacs transferred from special reserve to provision for bad and doubtful loans;

(b) Upholding adjustment of ₹570 lacs being provision for bad and doubtful debts allowable under Section 36(1)(vii) of the Act against bad debts written off.

9. The Tribunal reversed the order of the CIT(A) qua the first issue, viz., reducing the amount of bad written off by sum of ₹5,000 lacs transferred from special reserve to provisions for bad and doubtful loans. With regard to the second issue, the Tribunal upheld the order of the CIT(A) for which the assessee has filed separate appeal bearing ITA No.1931 of 2010.

10. It is in this backdrop, in the appeal filed by the Revenue, we have to consider as to whether the sum of ₹50 Crores transferred by the assessee from special reserve account to provision for bad and doubtful account is to be allowed as deduction or not. To answer this question, we will have to take note of the relevant provisions of the Act, viz., Section 36(1)(vii) of the Act. These are as under:

"Section 36: Other Dedication:

(1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28 –

(vii) - Subject to the provisions of sub-section (2), the amount of any bad debt or part thereof which is written off

as irrecoverable in the accounts of the assessee for the previous year:

Provided that in the case of an assessee to which clause (viia) applies, the amount of the deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under that clause;

(viia)(c) - A public financial institution or a State financial corporation or a State industrial investment corporation, an amount not exceeding five per cent of the total income (computed before making any deduction under this clause and Chapter VI-A)."

11. Learned counsel for the Revenue sought to justify the order of the AO explaining that Section 36(1)(viii) as it stood during the assessment year 1996-97 reads as under:

"(viii) In respect of any special reserve created and maintained by a financial corporation which is engaged in providing long-term finance for industrial or agricultural development or development of infrastructure facility in India or by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes, an amount not exceeding forty per cent of the profits derived from such business of providing long-term finance (computed under the head "Profits and gains of business or profession" before making any deduction under this clause 590a]) carried to such reserve account :

Provided that the corporation or as the case may be the company is for the time being approved by the Central Government for the purposes of clause:

Provided further that where the aggregate of the amounts carried to such reserve account from time to time exceeds twice the amount of the paid up share capital and general reserves of the corporation or, as the case may be, the company, no allowance under this clause shall be made in respect of such excess;"

12. The unamended provision allowed the deduction to a financial institution for an amount not exceeding 40% of the total income carried to a special reserve. For claiming this deduction, this clause requires that the reserve to the extent of 40% of the total income be credited by debit to profit and loss account. By the Finance Act 1997, the phrase "and maintained" is inserted after the work "created" in Section 36(1)(vii) with effect from 01.04.1998. By the same Finance Act, 1997, sub-clause (v) of Section 36(2) is also made applicable with retrospective effect from 01.04.1992 to all the assessees to which clause (viia) of sub-Section (1) of Section 36 applied, which was earlier applicable to only banks. Finance Act 1997 has also made provisions by proviso to Section 36(1)(vii) applicable to all the assessees with retrospective effect from 01.04.1992, which was earlier applicable to banks only. Simultaneously, sub-section (4A) was inserted in Section 41 by the Finance Act, 1997 with effect from 01.04.1998 whereby any amount subsequently withdrawn from the special reserve created by the assessee under Section 36(1)(viii) in respect of which, deduction had been allowed earlier is deemed to be the profit and gains of business or profession and is made

chargeable to tax in the year in which such amount is withdrawn. Sub-section (4A) of Section 41 reads as under:

> **"Section 41, Profits Chargeable to Tax**
>
> (4A) Where a deduction has been allowed in respect of any special reserve created and maintained under clause (viii) of sub-section (1) of section 36, any amount subsequently withdrawn from such special reserve shall be deemed to be the profits and gains of business or profession and accordingly be chargeable to income-tax as the income of the previous year in which such amount is withdrawn."

13. In an attempt to justify the approach of the AO, the learned counsel for the Revenue argued that in the present case, the assessee has claimed deduction of ₹129.06 Crores being the amount transferred to special reserve under Section 36(1)(viii) of the Act. The AO noticed that the assessee had transferred a sum of ₹50 Crores from this account to the provision for bad and doubtful debt under Section 36(1)(viia) of the Act. It was further noticed that the assessee had claimed entire amount of ₹186.246 Crore as bad and doubtful debts under Section 36(1)(vii) of the Act without adjusting first against the provision created under Section 36(1)(viia). According to her, the AO rightly took the view that the assessee was entitled to deduction of only ₹79.0618 Crores (₹129.0618 – ₹50 Crores) under Section 36(1)(viii) of the Act. As per Section 36(1)(viii), deduction is allowable to the assessee for the amount of

reserve created by it. In fact, the assessee had created a reserve only to the extent of ₹79.0618 Crores and not ₹129.0618 Crores as ₹50 Crore was transferred to other account.

14. The learned counsel for the Revenue further argued that by inserting the phrase "and maintained" in the said sub-section, intention of the Legislature is made clear that the assessee has not only to create the reserve but has also to maintain the same in the account, which was otherwise clear from 2nd proviso. No other meaning can be attributed to the provisions of 2nd proviso. Insertion of Section 41(4A) is also a step towards the clarification. It was never intended by the Legislature to allow the deduction of entire amount, even if part of the same has been withdrawn by the assessee. Hence, the provisions of Section 41 (4A) are to be given retrospective effect as the same are clarificatory in nature.

15. The submission of the learned counsel for the assessee, on the other hand, is that prior to Assessment Year 1998-99, the only requirement for claiming deduction under Section 36(1)(viii) of the Act was creation of reserve equivalent to 40% of the total

income by debit to the profit and loss account. There was no further requirement, implicit or explicit, that such reserve should be maintained intact for certain number of years or such reserve should be used for specified purposes. It is only from the Assessment Year 1998-99 that the Act has provided for such reserve to be maintained intact and in case of any withdrawal from such reserve, the amount withdrawn is deemed to be income liable to tax in the year of withdrawal.

16. It is clear from the reading of the provisions of Clause (viii) of Sub-section (1) of Section 36 that the words "and maintained" were inserted only by way of Amendment made with effect from 01.04.1998. As per the unamended provision, which is applicable to these cases, only requirement was for creation of reserve equivalent of 40% by debit to the profit and loss account. In this scenario, the moot question is as to whether the amendment is prospective or it is only clarificatory in nature and is to be given retrospective effect. The Kerala High Court had the occasion to deal with precisely this very aspect in two cases, viz., ***Kerala Finance Corporation Vs. Commissioner of Income Tax [261 ITR 708*** and ***Commissioner of Income Tax Vs. Kerala Finance Corpn.***

[220 CTR 399]. The view of the Kerala High Court is that the Amendment in Section 41(4A) of the Act was prospective and would be applicable from the Assessment Year 1998-99 only and cannot be applied for Assessment Years prior thereto. The analysis made by the Kerala High Court to these provisions resulting into the aforesaid conclusion can be traced to the following discussion:

> "Thus, it can be seen that while the Legislature had amended section 36(1)(viii) and intended to confer the benefit under that Section only if that special reserve created in maintained, the consequence of withdrawing the amount from the special reserve in the previous year is taken care of by sub-section (4A) of Section 41. In other words, if any deduction has been allowed in respect of any special reserve under Section 36(1)(viii) of the Income-tax Act and it is subsequently withdrawn, then it shall be deemed to have been profits and gains of the business and are chargeable to income-tax. Thus, the creation and maintenance of the reserve funds has been made a condition for availing the benefit under section 36(a)(viii) and the consequence of withdrawing any such amount after deduction is made, is also made by fiction of law, deemed to be the profit and gains of business chargeable to tax as the income of the previous year in which amount is withdrawn.
>
> Going by the plain language of the section as it stood at the relevant point of time, it can be seen that reaction of a special reserve was sufficient to entitle the assessee to claim the benefit under section 36(1)(viii) of the Income-tax Act and that the work "and maintained" was inserted only with effect from 01.04.1998 and it is not given any retrospective effect either expressly or impliedly. The Circular issued by the Department as quoted above also clarifies the position that it was intended only to operate subsequent to assessment year in question, after the same was amended and not before."

17. The identical issue has been dealt with by the Authority for Advance Rulings as well in the case of ***Rural Electrification Corporation Ltd.,*** in Re (Appeal No.AAR No.759 of 2007) referring to and relying upon the aforesaid judgments of the Kerala High Court. So much so, the Department itself has clarified the Legislative intent behind Section 41(4A) of the Act. As can be found in Circular No.763 dated 18.02.1998 issued by the Central Board of Direct Taxes (CBDT), which makes the following reading :

> "21.2 In order to incorporate the condition regarding maintenance of the reserve, Clause (viii) has been amended by substituting the words special reserve created with the words "special reserve created and maintained". An amendment has been made in Section 41 in order to bring to tax any amount withdrawn from such special reserve in the year in which the amount is withdrawn. For this purpose, a new sub-section (4A) has been introduced in this Section, and a reference to this sub-section is also made in sub-section (5) of this Section.
>
> 21.3 This amendment will take effect form 1st April, 1998, and will, accordingly, apply in relation to the assessment year 1998-99 and subsequent years."

18. In view of the aforesaid, we do not find any reason to differ with the view taken by Kerala High Court which is fortified by Circular of CBDT itself. We, thus, answer the question in favour of the assessee and against the Revenue.

19. The other issue raised in this appeal pertains to allowing expenditure incurred by the assessee in connection with swapping of foreign currency fund, which could not be disputed by the learned counsel for the Revenue that it is covered by the judgment of this Court in the case of this very assessee for the Assessment Year 1995-96, which was reported as 185 Taxman 296. As a result thereof, we dismiss these appeals.

20. In other appeals filed by the Department, apart from the aforesaid issue relating to provision of bad and doubtful debts, one more issue is raised which pertains to expenditure incurred by the assessee on issue of bonds, viz., whether such expenditure is covered by the provisions of Section 35D of the Act. This issue has already been decided in favour of this very assessee and against the Revenue in earlier Assessment Years and therefore, no question of law arises.

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21. One additional issue is raised which is as under:

> Whether the ITAT was correct in law in deleting addition of ₹1,44,85,30,000/- made by the Assessing Officer on account of reversal of interest income?

22. During the Assessment Year 2000-01, in which the issue arises, the assessee had returned ₹144 Crores receivable from Non-Performing Assets in accordance with the guidelines by reversing its income accounted for and offered for tax in earlier years. Such reversal of income resulted in reduction of total income which was not accepted by the AO on the ground that provisions of Section 43D of the Act, nowhere permits for reversal of income which has already been recognized on accrual basis and has been offered for tax in the earlier years. The AO further found that since the company was not following the RBI norms, the interest income on certain NPAs was rightly declared by the assessee in those years.

23. CIT(A) upheld this order, which has been reversed by the Tribunal in the following manner:

> "7. We have considered the rival contentions and gone through the records. The RBI guidelines in relation to income recognition, clearly provides that financial institutions should not charge and take to income account interest on any NPA. NPA is defined as a credit or loan facility in respect of which interest has remained 'past due' for a period of four quarters during the year ending 31st March 1994; three quarters during the year ending 31-3-1995; and two quarters during the year ending 31-3-1996 and onwards. In respect of all NPAs, interest accrued and other charges like fees and commission credited to income account during the previous accounting year but which have not been actually realized, should be reversed or provided for in the current accounting period. That means, if any interest which has not been actually realized and which was offered to tax, requires to be reversed in the

current accounting period. The assessee in this case being a financial institution, is governed by these guidelines issued by the RBI and has therefore correctly reversed the interest from NPA and it is not the case of revenue that the assessee has realized any part of the interest which it has credited to the P & L A/c in the earlier years to the extent the interest remains unrealized the same is really in the nature of bad debt and could have been claimed u/s 36(1)(vii) of the Act. As held by the Hon'ble Supreme Court in the case of Arunachalam Vs. CIT 4 ITR 173, the loss of stock in trade is always a trading loss irrespective of the method of accounting followed by an assessee. The assessee being a financial institution, is duty bound to follow the guidelines of the RBI. This position has been subject matter of detailed discussion by the Tribunal in the case of Tedco Investment and Financial Services (P) Ltd. (supra). The functioning of the financial institution is monitored by the RBI, an apex bank. Overriding of mandate of those guidelines cannot be accepted. It cannot be seen that the assessee on one hand in its functioning violates that mandates of the accounting norms prescribed by the regulatory authority, like RBI. In these circumstances, the reversal of the income which is strictly in accordance with the guidelines cannot be ignored. The consequence of the same is a reduction of income. After all, the income of the financial institution has to be determined in accordance with the norms of accounting guidelines which are applicable to it. In the light of these decisions, the claim of the assessee deserves to be accepted and we direct accordingly."

24. It may not be necessary to go into the validity of the reasons given by the Tribunal as in any case, the assessee was entitled to this deduction. If the income which is earlier recognized is not to be allowed to be reversed in the subsequent assessment years, in any case it is permissible for the assessee to write off such an income in the concerned assessment years when it was found that the amount was not recoverable. Reference in this connection can be made to the judgments of the Supreme

Court in the case of ***Vijaya Bank Vs. Commissioner of Income Tax and Another [323 ITR 166]*** and ***T.R.F. Ltd. Vs. Commissioner of Income Tax [323 ITR 397]***.

25. Counsel for the Revenue could not provide any satisfactory answer to the aforesaid submission of the learned counsel for the assessee.

26. Accordingly, we are of the opinion that no question of law arises. This appeal is dismissed.

(A.K. SIKRI)
JUDGE

(M.L. MEHTA)
JUDGE

JULY 11, 2011
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