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% 05.08.2011

Present: Ms. Rashmi Chopra, Sr. Standing Counsel for the Revenue/appellant.
Mr. Somnath Shukla, Advocate for the assessee/respondent.

+ITA No.1737/2010

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In the income tax return filed by the respondent/assessee for the Assessment Year 1998-99, the Assessing Officer made two additions, which are as follows:

- (1) The assessee had claimed prior period expenses of ₹2,32,68,493/- debited under the head "interest".
- (2) Addition of ₹14,58,677/- under the head "miscellaneous expenses".

Insofar as the first addition on account of payment of interest is concerned, the AO found that M/s DCM Ltd. had given interest free deposit to the assessee herein in the sum of ₹9.50 Crores in January, 1996 against the proposed right to issue. Since there was considerable delay in the right issue, M/s. DCM Ltd. vide its letter dated 19.08.1997 required the assessee herein to pay interest from the date of giving of the advance. Ultimately, it was agreed by the assessee to pay the amount @ 20% interest per annum from the date of receiving the advance.

The AO rejected the aforesaid deduction in this year on the ground that the AO was following mercantile system of accounting and



any expenditure related to the previous years could not be allowed to the assessee in this year.

Insofar as second addition is concerned, the AO held that the assessee was following mercantile system of accounting and in mercantile system of accounting, expenses were to be booked in the respective years and the expenses should have been accounted for in the earlier year.

The CIT (A) confirmed the aforesaid order of the AO thereby dismissing the appeal preferred by the assessee.

On further challenge by the assessee before the Income Tax Appellate Tribunal ('ITAT' for brevity), the ITAT has allowed the appeal resulting into the deletion of the aforesaid additions made by the AO.

From the facts narrated above, it is clear that the AO as well as CIT (A) did not dispute the genuineness of agreement entered into between M/s. DCM Ltd. and the assessee herein whereby the assessee had agreed to pay the interest @ 20% per annum from the date when the amount was advanced, i.e., January, 1996. The only ground on which the disallowance made was that the interest paid by the assessee for the period January, 1996 onwards did not pertain to the year in question.

The ITAT held that, in fact, the liability to pay the interest even for earlier period was crystallized during this year in view of the aforesaid agreement arrived at between the parties. Earlier, there was



no such liability, since no interest was payable against the proposed right to issue and there was no occasion for debiting any interest expenditure in that year. Since liability was crystallized in the year in question when the aforesaid agreement to pay interest @20% was entered into between the assessee and M/s. DCM Ltd. treating the aforesaid amount as advance, the ITAT rightly held that the assessee was entitled to seek deduction of the aforesaid amount as expenditure on account of interest paid on loan. While coming to this conclusion, the ITAT has relied upon the judgment of the Gujarat High Court in the case of **Saurashtra Cement and Chemical Industries Ltd. v. Commissioner of Income-tax** [213 ITR 523], wherein the High Court opined as under:

“Merely because an expense relates to a transaction of an earlier year it does not become a liability payable in the earlier year unless it can be said that the liability was determined and crystallized in the year in question on the basis of maintaining accounts on the mercantile basis. In each case where the accounts are maintained on the mercantile basis it has to be found in respect of any claim, whether such liability was crystallized and quantified during there previous year so as to be required to be adjusted in the books of account of that previous year. If any liability, though relating to the earlier year, depends upon making a demand and its acceptance by the assessee and such liability has been actually claimed and paid in the later previous years it cannot be disallowed as deduction merely on the basis the accounts are maintained on mercantile basis and that it relates to a transaction of the previous year. The true profits and gains of a previous year are required to be computed for the purpose of determining tax liability. The basis of taxing income is accrual of income as well as actual receipt. If for want of necessary material crystallizing the expenditure is not in existence in respect of which such income or expenses relate, the mercantile system does not



call for adjustment in the books of account on estimate basis. It is actually known income or expenses, the right to receive or the liability to pay which has come to be crystallized, which is to be taken into account under the mercantile system of maintaining books of account."

Thus, the interest of ₹2.32 Crores deduction whereof sought was paid during the year under consideration in the aforesaid circumstances and was, thus, rightly allowed.

Insofar as addition pertaining to expenses of ₹14,58,677/- is concerned, as noted above, the AO had disallowed the same on the ground that these expenses relate to the prior period. However, the ITAT has recorded a categorical finding that the bills relating to this expenditure were submitted by the employees of the assessee during the year under consideration and for this year, the amount was debited to Profit and Loss Account and actual payment was made.

No question of law arises. This appeal is accordingly dismissed.

A.K. SIKRI, J.

J.R. MIDHA, J.

AUGUST 05, 2011

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