



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

+ **ITA No.578 of 2009**

% Decision Delivered On: 13th May, 2011.

COMMISSIONER OF INCOME TAX . . . APPELLANT

through : Mr. Sanjeev Sabharwal, Sr.
Standing Counsel.

VERSUS

GOYAL M.G. GASES P. LTD. . . .RESPONDENT

through: Mr. Ajay Vohra, Adocate 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?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J. (ORAL)

1. The sole issue involved in the present case is as to whether the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') has rightly held that the assessee has presented its accounts on mercantile system and not followed the cash basis of accounting in respect of interest income for the purpose of preparing its accounts under the Income Tax Act ('the Act' for



- brevity) and deleted additions made by the Assessing Officer (AO) on account of undisclosed income from interest.
2. The AO had made additions of ₹5,68,80,364/- on account of undisclosed income from interest. We may note in this behalf that the assessee is engaged in the business of financing other enterprises by way of loans/Inter Corporate Deposits (ICDs), bill discounting, etc. For the Assessment Year 2000-01, the assessee maintained its account, for the purpose of Companies Act, 1956 on the basis of Calendar Year January to December. However, for the purpose of Income Tax Act 1961, the assessee prepared its account on the Financial Year basis from April to March. The assessee had given various loans/ICDs to other parties. In its account prepared for the purpose of Companies Act, the assessee followed the accrual basis of accounting in respect of the interest income of the loans/ICDs given to the parties except that the interest income in respect of loans doubtful of recovery is not accounted for as shown in income. This was the practice followed by the assessee for number of years and had been accepted by the respective AO in the past. However, in the Assessment Year 1998-99, addition was made on the ground that in mercantile system of accounting, which was followed by the assessee and relevant for income tax



- purpose, interest on such loans/ICDs should also be treated as accrued income.
3. The additions were deleted by the CIT (A). However, no appeal was preferred by the Revenue thereagainst.
 4. For the Assessments Year 2000-01 and 2001-02 with which we are concerned, the AO again made the addition in respect of aforesaid interest on sticky loans in the sum of ₹5,68,80,364/- on the same premise. The interest income which was offered by the assessee was in the sum of ₹12,00,10,940/-. The AO, however, added the aforesaid amount of ₹5,68,80,364/- also as interest income chargeable to tax.
 5. The assessee preferred appeal thereagainst before the CIT (A) and submitted that it had consistently followed a particular system of accounting not showing interest on sticky loans which was accepted by the AO all through. It was submitted that the interest on loans/advances which itself were doubtful of recovery had not been accounted for in the accounts prepared under the Act, since such interest income cannot be said to have been accrued even under the mercantile system of account and did not, in any case, represent real income of the assessee, some additional evidence was furnished before the



CIT (A) in the form of copy of ledger accounts in respect of interest income for the relevant period i.e. 01.01.1999 to 31.12.1999 and 01.01.2000 to 31.12.2000. The CIT (A) forwarded these ledgers along with the detailed submissions of the assessee before the AO for his comment and after considering the same as detailed in his remand report, the AO *inter alia* pointed out discrepancies to the extent of ₹14,092/-. After considering the submissions and the remand report, the CIT (A) deleted the addition of ₹5,68,66,272/- sustaining the amount of ₹14,092/- only, which was on account of discrepancy noted in the ledger accounts by the AO.

6. The Revenue preferred appeal against the order of the CIT (A), which has been dismissed by the Tribunal in the following terms:

“10. In the instant case the assessee has prepared its accounts on mercantile system and has not followed the cash basis of accounting in respect of interest income for the purposes of preparing its accounts under the Act. The basis followed for recording of interest income in such accounts is the same as that followed for the purposes of preparing accounts under the Companies Act, 1956. The only difference is that the interest in respect of loans and advances which itself are doubtful of recovery has not been accounted for in the accounts prepared under the Act, since such interest income cannot be said to have been accrued even under the mercantile system of accounting and not, in any case, represent real income of the appellant. Although the notes to accounts prepared for the purposes of the Act state that interest income has been accounted for on cash basis, the intention of the note was only to indicate that interest income which is not received in respect of doubtful loan and advances has not been accounted for. Since after excluding the interest on



loans doubtful of recovery, only the interest income actually received was left, the note was worded in the stated manner. It was not, in any manner, intended to mean that mercantile basis has not been followed in respect of interest income in the relevant tax period.

11. The ledger accounts of the assessee simply indicated that the only material adjustment made by the assessee in the interest income account was reversal of interest of ₹1,18,50,577/- in the month of March, 2000 and this interest was represented by interest relating to loans given to the parties, the principle amount of which itself was of doubtful recovery. The interest credited to the interest income account by the assessee in December, 1999 while preparing its accounts for the purpose of Companies Act, 1956 which was reversed in the months of March, 2000 while preparing the accounts for the purposes of the Act and no further adjustment had been made in the interest income account while preparing the accounts for the purposes of the Act. It means the interest income reflected in the account prepared for the purposes of the Act is on the same basis as adopted for the purpose of preparing the accounts under the Companies Act, 1956. The only deviation was that the interest incomes on sticky loans which had been accounted for in the account prepared for the purposes of Companies Act, 1956 by reversing the amount of ₹1,18,50,577/- in the interest account.

12. Before us the Id. DR of the Revenue has not been able to find any fault with the system of accounting followed by the assessee. It has also not been controverted that the additions made by the AO on account of interest income on sticky loans had been deleted by the CIT (A) in assessment year 1998-99. Further, it is also not disputed that in the instant case the AO after conducting independent verifications from parties, to whom the assessee advanced loans during the year for the period 1-1-99 to 31-12-99, on the basis of photocopies of ledgers of those 13 parties selected at random, submitted that except the discrepancy mentioned against Ranbaxy Laboratories Ltd. to the extent of ₹14,092/- no other discrepancy was found in the interest ledger submitted by the assessee, hence CIT (A) was fully justified in sustaining the addition to the extent of ₹14,092/- and in allowing relief of ₹56,86,62,72/- to the assessee in a well-reasoned and well-discussed order as in the existing facts and circumstances of the case of the assessee or on the basis of detailed Remand Report of the AO. No other addition could be made on account of interest income except to the extent of the discrepancy.



Accordingly, the order of CIT(A) in this regard is upheld and ground no.1 of the Revenue's appeal is rejected."

7. The following aspects become discernible from the aforesaid factual matrix:

- a) The system of accounting followed by the assessee has been accepted by the successive AO in the past.
- b) The assessee has been showing the interest income on accrual/mercantile basis except in case of sticky loans/ICDs. These are the loans or advances, the recovery whereof itself was doubtful.
- c) Thus, when the recovery of loans/advances is doubtful, interest thereupon cannot be treated as accrued even under the mercantile system of accounting.
- d) Moreover, as per real income theory, it would not represent income of the assessee.
- e) In certain cases, even the principal amount of loans/ICDs was fully written off as the same had become bad and doubtful.

8. It would also be relevant to state that in the case of this very assessee, this Court has affirmed the similar view of the Tribunal in the case entitled **Commissioner of Income Tax Vs. Goyal M.G. Gases Pvt. Ltd.** [163 Taxman 541 (Delhi)] in the following terms:



“9. The Tribunal relied upon the decision of the Supreme Court in Godhra Electricity Co. Ltd. v. Commissioner of Income-tax . We have gone through this decision. The Supreme Court quoted a passage from an earlier decision rendered in Commissioner of Income-tax v. Shoorji Vallabhdas and Co. where it had been stated as follows:-
Income-tax is a levy on income. No doubt, the Income-tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a hypothetical income, which does not materialise.

10. The principle that the Supreme Court applied was that even if the accounts are maintained in the mercantile system, what has to be seen is whether income can be said to have really accrued to the assessed. In support of this principle, reliance was placed upon Commissioner of Income-tax v. Birla Gwalior (P) Ltd. [1973] 89 ITR 255 which approved the view taken by the Bombay High Court in H.M. Kashiparekh and Co. Ltd. v. Commissioner of Income-tax , Morvi Industries Ltd. v. Commissioner of Income-tax as well as Poona Electric Supply Co. Ltd. v. Commissioner of Income-tax . In the penultimate paragraph of the judgment, the Supreme Court held as follows:-

The question whether there was real accrual of income to the assessed-company in respect of the enhanced charges for supply of electricity has to be considered by taking the probability or improbability of realisation in a realistic manner. If the matter is considered in this light, it is not possible to hold that there was real accrual of income to the assessed-company in respect of the enhanced charges for supply of electricity which were added by the Income-tax Officer while passing the assessment orders in respect of the assessment years under consideration.

11. Applying the law laid down by the Supreme Court, what has to be seen in the present case is whether there was any real accrual of interest to the assessed. Both the CIT (A) as well as the Tribunal came to the conclusion that there was no real accrual of interest. It has been noted that the interest had not even been recorded by the assessed in its books of accounts. The assessed had also issued a notice to the parties under Section 138 of the Negotiable Instruments Act for dishonour of cheques issued by all (except one of the debtors) followed by initiation of appropriate



proceedings. The debts were written off as bad debts and were also allowed by the Assessing Officer in subsequent years. These facts lead to the inescapable conclusion that realization of even the principal amount was in jeopardy and, therefore, there cannot be said to be any real accrual of income by way of interest. We find no fault in this view taken by the Tribunal and are of the opinion that no substantial question of law arises for our consideration.”

9. We also find that identical view is taken in the case of ***Commissioner of Income Tax Vs. Goyal M.G. Gases P. Ltd.*** [303 ITR 159] and ***Commissioner of Income Tax Vs. Eicher Ltd.*** [320 ITR 410]. We are, thus, of the view that no substantial question of law arises, this appeal is accordingly dismissed.

(A.K. SIKRI)
JUDGE

(M.L. MEHTA)
JUDGE

MAY 13, 2011
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