IN THE HIGH COURT OF HIMACHAL PRADESH SHIMLA

I.T.R. No.26 of 1995.

Judgment reserved on: 29.12.2007.

Date of Judgment: 10-01-2008

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M/s.H.P.Mineral & Ind. Development Corpn., Shimla ....Petitioner

-Versus-

The Commissioner of Income-tax, Patiala ….Respondent

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Coram:

The Hon'ble Mr.Justice Deepak Gupta, Judge.

The Hon'ble Mr.Justice V.K.Ahuja, Judge.

Whether approved for reporting?

For the Petitioner: Mr.Vishal Mohan, Advocate

For Respondent: M/s.Vinay & Vandana Kuthiala, Advocates

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**Deepak Gupta, J.**

The following question of law has been referred for the opinion of this Court under Section 256(2) of the Income Tax Act:

> "Whether in the facts and in the circumstances of the case, the Tribunal was right in upholding the addition of interest of Rs.15 lacs on accrual basis".

The brief facts giving rise to this question are that the assessee M/s.H.P. Mineral & Ind.Development Corpn., Shimla is a Government owned Corporation. It had a number of subsidiary companies i.e. M/s.Fertilizers Ltd., Himachal Wool Processors Ltd. and Himachal Worsted Mills Ltd. It had advanced temporary loans to its subsidiary companies. The assessee was following mercantile

system of accounting. In the assessment year 1982-83, where the year closing was on 31.3.1982, no provision was made for such interest in the books of account of the assessee. According to the assessee the interest was waived off by a Resolution of its Board dated 26.6.1983.

The Assessing Officer did not accept the contention of the assessee and held that the assessee had not been able to show that the interest was waived due to commercial exigency. He also held that the proposal for waiver and decision for waiver was taken after the closing of the accounting period. The assessee filed an appeal and the CIT appeals rejected the claim of the assessee. The learned Appellate Tribunal held that the accounting period for the relevant assessment year 1982-83 ended on 31.3.1982. The loans advanced to the subsidiaries were outstanding and had not been written off on the said date. The Board's Resolution was passed much latter on 26.6.1983 after the closing of the accounting period and since the assessee was following the mercantile system of accounting the interest had accrued prior to 31.3.1982 and since the interest was not waived before the closing of the accounting period the same was assessable in the hands of the assessee.

We have heard Sh.Vishal Mohan, learned counsel for the assessee and Sh.Vinay Kuthiala learned counsel for the Revenue. A number of authorities have been cited before us.

In **Commissioner of Income Tax Bombay City vs. Messrs.Shoorji Vallabhdas and Co., (1962) 46 ITR 144,** the Apex Court held 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 materialize. Where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account."

The Punjab and Haryana High Court in **Commissioner of Income-tax, Amritsar-II vs. Ferozepur Finance (P.) Ltd. (1980)124 ITR 619,** following the judgment in **Shoorji's** case (supra) held that unless income accrues no tax can be levied whether mercantile or cash system of accounting is allotted. In that case the Punjab & Haryana High Court held that though a sum of Rs.10 lakhs was due to the assessee from one Shri B.K.Bedi but since it was not possible for the assessee to recover the same the assessee was justified in not charging interest thereon.

In **State Bank of Travancore vs. Commissioner of Income Tax, Kerala, (1986) 2 SCC 11,** the appellant Bank maintained its account on the basis of mercantile system. It was charging interest on the loans advanced by it. In some loans the recovery became extremely doubtful. The bank charged interest on these loans and debited the interest to the account of the parties. However, it did not

carry forward the interest amount to the profit and loss account and placed the same in Interest Suspense Account. The Apex Court by a majority judgment held as follows:

> "69.As a result of the aforesaid discussion following propositions emerge:
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> (1) It is the income which has really accrued or arisen to the assessee that is taxable. Whether the income has really accrued or arisen to the assessee must be judged in the light of the reality of the situation.
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> (2) The concept of real income would apply where there has been a surrender of income which in theory may have accrued but in the reality of the situation no income had resulted because the income did not really accrue.
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> (3) Where a debt has become bad deduction in compliance with the provisions of the Act should be claimed and allowed.
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> (4) Where the Act applies the concept of real income should not be so read as to defeat the provisions of the Act.
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> (5) If there is any diversion of income at source under any statute or by overriding title then there is no income to the assessee.
>
> (6) The conduct of the parties in treating the income in a particular manner is material evidence of the fact whether income has accrued or not.
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> (7) Mere improbability of recovery, where the conduct of the assessee is unequivocal, cannot be treated as evidence of the fact that income has not resulted or accrued to the assessee. After debiting the debtor's account and not reversing that entry- but taking the interest merely in suspense account cannot be such evidence to show that no real income has accrued to the assessee or treated as such by the assessee.
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> (8) The concept of real income is certainly applicable in judging whether there has been income or not but in

> every case it must be applied with care and within well recognized limits."

The Apex Court dealt with a similar point in **Commissioner of Income Tax, Amritsar vs. Shiv Prakash Janak Raj & Co. Pvt.Ltd. and others, (1996)11 SCC 530.** In that case the assessee Company had advanced loans to a firm. The partners of the said firm were the shareholders/directors in the assessee Company. The Assessee Company in its books of accounts charged interest from the Firm for the assessment years 1966-67, 1967-68. However, for the assessment years 1968-69, 1969-70, 1970-71 and 1971-72 the assessee Company decided not to charge interest from the firm in view of the difficult financial position of the firm. The Apex Court held that it would not be permissible for the Court to import the concept of real income so as to whittle down, qualify or defeat the provisions of the Act and the Rules. The Court held that the decision to waive off the interest must be taken prior to the accrual of the same.

Shri Vishal Mohan has placed reliance on the judgment of the Apex Court in **Godhra Electricity Co. Ltd. vs. Commissioner of Income Tax, (1997)225 ITR 746.** In our opinion the facts of the said case are not applicable to the present case since in that case the assessee had enhanced the rates of electricity and these rates were being shown in its books of accounts. However, due to litigation the assessee was prevented by Court orders from recovering these amounts and subsequently the assessee Company was taken over by the Government. It was in these circumstances that the Apex Court

held that the amount due on enhancement of the electricity rate had not accrued.

A three Judge Bench of the Apex Court in **UCO Bank vs. Commissioner of Income Tax, (1999) 237 ITR 889,** has held that the circular issued by the Department Board are binding on the revenue. However, after reading the entire judgment we are of the view that the same has no applicability in the present case since even if the second circular is taken into consideration the interest for the first 3 years of doubtful loan has to be treated as an income. This authority, in our view, does not help the assessee.

A Division Bench of the Delhi High Court in **Saraswati Insurance Co. Ltd. vs. Commissioner of Income-Tax, (2001) 252 ITR 430,** held as follows:

> "That the taxability is attracted not only when income was actually received but also when it accrued. Income accrues when it falls due, that is to say when it becomes legally recoverable, irrespective of whether it is actually received or not and accrued income is that income which the assessee has a legal right to receive. Therefore, the income by way of interest, waived by the assessee, was includible in its total income for the assessment years 1977-78 and 1978-79."

Keeping in view the aforesaid law especially the judgments of the Apex court in the cases of **State Bank of Travancore & Shiv Prakash Janak Raj & Co. Pvt.Ltd.** (supra) the decision to waive off loan or interest should be taken on the basis of commercial expediency and should be taken before the end of the accounting year.

Section 36 of the Income Tax Act deals with other deductions. Bad debts can be written off in terms of Section 36(1)(vii) which at the relevant time read as follows:

> "subject to the provisions of sub-section(2), the amount of any debt, or part thereof, which is established to have become a bad debt in the previous year."

It is obvious that the decision must be taken immediately after the previous year. In this case the decision to waive off the loan was taken at a much later stage. The Resolution to waive off the loan was passed after the income had already accrued. Once the income had accrued the passing of Resolution after the close of the accounting year would be of no consequence. The decision to waive off the interest should have been taken during the accounting year or prior thereto. The concept of real income would not apply in such a case. If the debt had become bad the deduction can be claimed only in compliance with the provisions of the Act and the Rules. Once the provisions of the Act were applicable and the income had already accrued the concept of real income cannot be brought into use to defeat the provisions of the Act.

In view of the above discussion, we are of the view that the case was rightly decided by the Tribunal. We accordingly answer the reference in favour of the Revenue and against the assessee. The Registrar General of this Court is directed to send a copy of this order to the Income Tax Appellate Tribunal.

**( Deepak Gupta ),**
**Judge**

January 10 , 2008.
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**( V.K. Ahuja ),**
**Judge**