IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "F", MUMBAI

BEFORE SHRI G.S.PANNU, ACCOUNTANT MEMBER
AND SHRI SANJAY GARG, JUDICIAL MEMBER

ITA No. 2947/MUM/2010,(A. Y : 2005-06)

Mahindra Engineering & Chemical
Products Ltd.,
Gateway Building, Appollo Bunder,
Mumbai 400001
PAN: AAACM 5764A ... Appellant

Vs.

The DCIT, Cir.2(2),
Aaykar Bhavan, M.K.Road,
Mumbai 400020 .... Respondent

Appellant by : Shri H.P.Mahajani
Respondent by : Shri K. Ravi Ramchandran

Date of hearing : 23/06/2016
Date of pronouncement : 30/06/2016

ORDER

PER G.S.PANNU, A.M:

The captioned appeal of the assessee is directed against the order passed by CIT(A)-5, Mumbai dated16/02/2010, pertaining to the assessment year 2005-06, which in turn has arisen from the order passed by the Assessing Officer dated 19/12/2007 under section 143(3) of the Income Tax Act, 1961 (in short 'the Act').

2. In this appeal assessee has raised the following Grounds of appeal:-

"Being aggrieved of the order passed by the Commissioner of Income-tax (Appeals)-5, Mumbai, (hereinafter referred to as "C.IT.(A)") Mahindra Engineering & Chemical Products Limited, Mumbai (hereinafter referred to as "Appellant") hereby submits the following grounds for your kind and sympathetic consideration:

1. *On the facts and in the circumstances of the case and in law the learned CIT(A) erred in confirming the order of the learned AO bringing to tax interest of Rs.15,73,952, on a hypothetical basis, in respect of deposit of Rs 435 lacs with Mahindra Construction Company Ltd. (MCCL), notwithstanding the fact that the principal amount of the said deposit was written off in the books as not recoverable. The addition made by the learned AO be deleted.*

2. *On the facts and in the circumstances of the case and in law the learned CIT(A) erred in confirming the order of the learned AO not allowing deduction for interest of Rs.1,35,35,072 in respect of the aforesaid deposit which interest was brought to tax in AY 2002-03, 2003-04 , AND 2004-05.*

   The learned CJT(A) ought to have allowed the claim of the appellant in the year under appeal since the principal amount of the said deposit was written off in the books as not recoverable. The appellant be allowed deduction for Rs.1,35,35,072 as claimed by it
3. *On the facts and in the circumstances of the case and in law the learned CIT(A) erred in confirming the order of the learned AO not allowing deduction for the principal amount of the aforesaid deposit was written off in the books as not recoverable.*
   The appellant be allowed deduction for Rs.4,35,00,000 as claimed by it
4. *On the facts and in the circumstances of the case and in law the learned CIT(A) erred in confirming the order of the learned AO holding expenditure of Rs.3,13,446 on repairs to plant and machinery as being capital in nature*
   The appellant be allowed deduction for Rs.3,13,446 as claimed by it.
5. *On the facts and in the circumstances of the case and in law the learned CIT(A) erred in confirming the order of the learned AO holding expenditure of Rs.1,14,000/- on software expenses as being capital in nature.*
   The appellant be allowed deduction for Rs.1,14,000 as claimed by it.
6. *On the facts and in the circumstances of the case and in law the learned CIT(A) erred in confirming the order of the learned AO allowing expenditure of Rs.3,53,760/- u/s. 35D rejecting the contention of the appellant that the expenditure was allowable as a revenue expenditure.*
   The appellant be allowed deduction for Rs.3,53,760 as claimed by it."

2. At the time of hearing Ld. Representative for the assessee submitted that in so far as the Grounds of appeal No.2,4,5 & 6 are concerned, the same are not pressed and accordingly they are dismissed as not pressed.

3. The substantive dispute remaining in this appeal revolves around the deposit of Rs.4,35,00,000/- made by the assesse with Mahindra Construction Company Ltd (in short MCCL) in an earlier financial year of 2000-01 corresponding to assessment year 2001-02. Firstly, the appellant is aggrieved that the lower authorities have brought to tax interest income of Rs.15,73,952/- on such deposit on a hypothetical basis, notwithstanding that assessee had written off the principal amount of deposit itself as irrecoverable. Secondly, assessee company is aggrieved with the action of lower authorities in not allowing the write off of Rs.4,35,00,000/- while computing the total income.

4. Briefly put, the facts relevant to adjudicate the aforesaid controversy can be summarized as follows. The appellant company placed total deposits of Rs.4,35,00,000/- in assessment year 2001-02 with MCCL and for the assessment year 2001-02, it declared interest income thereon of Rs.15,73,952/-, which has been taxed. Subsequently, from assessment year 2002-03 onwards assessee did not account for any interest income on the ground that the deposit/advance itself had become doubtful of recovery and, therefore, there was no accrual of interest income. The material on record reveals that in assessment year 2002-03 and upto assessment year 2004-05, the aforesaid stand of the assessee was not accepted by the income-tax authorities and instead for each of the three years, it was held that

interest income duly accrued on such deposits and the same was brought to tax. It appears that the issue for assessment years 2002-03 to 2004-05 reached the Tribunal, which vide a common order in ITA NO.1259 to1261/Mum/2010 dated 27/04/2011, restored the issue of assessment of notional interest income back to the file of Assessing Officer for re-examination. In particular, the Tribunal directed the Assessing Officer to examine the evidences regarding poor financial health of MCCL and, thereafter decide the matter afresh.

5. Before us, Ld. Representative for the assessee has furnished copies of the orders passed by the Assessing Officer in pursuance to the directions of the Tribunal for assessment years 2002-03 to 2004-05, wherein assessee's plea that no addition on account of notional interest merited has been accepted. In such orders, passed by the Assessing Officer under section 143(3) r.w.s 254 of the Act dated 28/03/2013, it has been accepted that the evidences produced by the assessee adequately prove the poor financial health of the borrower MCCL and, therefore, he has deleted the addition on account of interest income for such assessment years.

6. In this background, the grievance of the assessee in Ground of appeal No.1 above arising from the action of the Assessing Officer in bringing to tax interest income of Rs.15,17,952/- on accrual basis with respect to the year under consideration is quite potent and deserves to succeed. The Assessing Officer in assessment years 2002-3 to 2004-05 has accepted the plea of the assessee that no interest income accrues with respect to the impugned deposits made with MCCL on account of

its poor financial health and, therefore, in the absence of change in facts and circumstances in the instant year, the addition of Rs.15,73,952/- in this year does not survive. On this aspect of the matter, Ld. Departmental Representative has not made any argument considering the order of the Assessing Officer for assessment years 2002-03 to 2004-05. Accordingly, the appellant succeeds on this issue.

7. The second dispute is with regard to the claim of the assessee that the amount of Rs.4,35,00,000/-written off in the books of account as not recoverable be allowed as deduction as a bad debt. On this aspect of the controversy, Ld. Representative for the assessee pointed out that the assessee company fulfils the requirements of section 36(1)(vii) r.w.s 36(2)(i) of the Act. Firstly, the amount has been written off as irrecoverable in the books of account. Secondly, it is pointed out that the interest income for assessment year 2001-02 of Rs.15,73,952/- was offered and assessed to tax as part of business income and, therefore, it was to be understood that the impugned deposits/advances made to MCCL were in the ordinary course of business.

8. On this plea, the Ld. Departmental Representative has primarily justified the action of the lower authorities by pointing out that the assessee could not be said to be in the business of banking or money lending and, therefore, the principal amount of deposits/advances to MCCL could not be claimed as deduction under section 36(1)(vii) of the Act, on account of the condition placed in section 36(2) of the Act. It was also pointed out that the deposit was more in the nature of

investments, therefore, its non-recovery, at best, can be treated as a capital loss.

9. We have carefully considered the rival stands. Factually speaking, it is not in dispute that assessee had made deposits/advances with MCCL in the previous year 2000-01, corresponding to assessment year 2001-02 amounting to Rs.4,35,00,000/-. The interest accruing on such deposits for assessment year 2001-02 amounted to Rs.15,73,952/-, which was duly offered to tax in the said assessment year. Subsequently, assessee has not accounted for any interest income on the ground that the aggregate of the principal amount as well as interest accrued to assessment year 2001-02 was doubtful of recovery. Upto assessment year 2004-05, the Assessing Officer has accepted that the financial position of MCCL was poor and, therefore, no interest income can be said have accrued for the purposes of taxation. In the current year, the assessee company claims that the principal amount of deposits/advances be considered as bad debt, which has been rejected by the income-tax authorities. Primarily, the arguments advanced by the Revenue is that assessee is not engaged in any systematic business of money lending and that the non-recovery was a capital loss.

10. Before us, the Ld. Representative for the assessee has relied upon the judgment of the Hon'ble Bombay High Court in the case of Pudumjee Pulp & Paper Mills Ltd., in ITA No.1590 of 2013 dated 05/08/2015. According to the Ld. Representative for the assessee, in the case of Pudumjee Pulp & Paper Mills Ltd. (supra), a somewhat similar fact-situation prevailed. In the case before Hon’ble High Court, assessee had made an inter-corporate deposit with another concern

and in some of the years interest thereof was offered for tax. Subsequently, a part of the debt was sought to be written off and claimed as bad debt within the meaning of section 36(1)(vii) r.w.s. 36(2) of the Act. The said claim was resisted by the income tax authorities primarily on the ground that the conditions of section 36(1)(vii) r.w.s. 36(2) of the Act are applicable, inasmuch as, the assessee company was not carrying on business of money lending and that the principal amount claimed as 'bad debt' was not in fact offered to tax either in the relevant assessment year or in the earlier assessment years. The Hon'ble High Court considered the provisions of section 36(1)(vii) and section 36(2)(i) of the Act and made the following discussion:-

"*11. It is noticed that Section 36(2)(i) of the Act allows deduction on account of satisfaction of any of one of the two conditions as under:-*

(a) bad debts or part thereof taken into account in computing the income of the assessee for an earlier Assessment Year before such debt or part thereof is written off; or
(b) the debt represents money lent in the ordinary course of business of banking or money –lending which is carried on by the assessee.

Therefore, even if one of the two conditions of Section 36(2)(i) of the Act is satisfied, then bad debts claimed under Section 36(1)(vii) of the Act has to be allowed.

12. So far as first part of Section 36 (2)(i) of the Act is concerned, i.e. (a) above, we find that the Respondent-Assessee had during the earlier Assessment Years offered to tax an amount of Rs. 42.65 lakhs received as interest on the deposit made with M/s. GSB Capital Market Ltd. The Appellant had since Assessment Year 1998-99 claimed an amount of Rs. 49.82 lakhs as doubtful debts from M/s. GSB Capital Market Ltd. This consisted of the aggregate of principal and interest payable by M/s. GSB Capital Market Ltd. It was in the subject Assessment Year that a settlement was arrived at between the parties and the Respondent-Assessee received Rs. 15 lakhs from M/s. GSB Capital Market Ltd. and the balance amount of Rs. 34.82 lakhs being non-recoverable was being claimed as bad debts by writing off the same in its books of account. It would thus be noticed the amount of Rs. 34.82 lakhs which constitutes partly the principal amount of the inter-corporate deposits and partly the interest which is unpaid on the principal debt. The Assessing Officer's contention that amount of Rs. 34.82 lakhs was not offered to tax earlier and, therefore, deduction under Section 36(2)(i) of the Act is not

available, is no longer res+-integra. This very issue camp up for consideration before this court in Shreyas S. Morakhia (supra) wherein the assessee was a stock broker and engaged in the business of sale and purchase of shares. The brokerage payable by the client was offered for tax. Subsequently, it was found that the principal amount which was to be received from its clients would not be received. The assessee sought to claim as bad debts not only the brokerage amounts not received but the aggregate of principal and brokerage amounts not received in respect of the shares transacted. This Court held that the debt comprises not only the brokerage which was offered to tax but also principal value of shares which was not received. Therefore, even if a part of debt is offered to tax, Section 36(2)(i) of the Act, stands satisfied. The test under the first part of Section 36 (2)(i) of the Act is that where the debt or a part thereof has been taken into account for computing the profits for earlier Assessment Year, it would satisfy a claim to deduction under section 36(1)(viii) read with Section 36(2)(i) of the Act. In fact, the Revenue also does not dispute the above provisions as no submission in that regard were made during the course of hearing before us."

10.1 In the present case, as per the Revenue, the amount of principal deposits/advances was not offered to tax in an earlier or the current year and, therefore, condition prescribed under section 36(2)(i) is not fulfilled. The Hon'ble Bombay High Court referred to its earlier judgment in the case of CIT vs. Shreyas S. Morakhia, 342 ITR 285(Bom), wherein assessee was a stock broker and engaged in the business of sale and purchase of shares. Brokerage earned from the clients was offered for tax; and the principal amount due from the clients also remained outstanding. The claim of the assessee was to treat not only the unrecoverable brokerage, but also the unrecoverable amount of principal as a bad debt. The Hon'ble Bombay High Court held that the debt referred to in section 36(2)(i) of the Act comprises not only of the brokerage which was offered to tax but also the principal value of shares not received. Therefore, according to the Hon'ble High Court, even if a part of the debt was offered to tax, the condition contained in section 36(2)(i) of the Act stood satisfied. In the present case too, it is

not disputed that interest income accruing for assessment year 2001-02 has been offered to tax and the debt is to be understood as comprising of not only interest, but also the principal amount of deposit/advances. In this manner, following the ratio of the judgment of the Hon'ble Bombay High Court in the case of Pudumjee Pulp & Paper Mills Ltd.,(supra) the test contained in section 36(2)(i) of the Act stands satisfied, inasmuch as, debt or part thereof has been taken into consideration for computing the profit for an earlier year. In this view of the matter, the other aspect as to whether the assessee was engaged in the business of money lending and/banking is not relevant to adjudicate the controversy.

10.2 Apart from the aforesaid, there is also nothing to repudiate the position canvassed by the assessee that the interest income in assessment year 2001-02 relating to such deposits has indeed been taxed as business income, and thus advancing of deposit is to be understood as having been done in the ordinary course of business. Moreover, we find from the discussion in order passed by the Assessing Officer dated 28/3/2013 for assessment years 2002-03 to 2004-05 that the plea of the assessee has been that the amount of deposits made to MCCL was a trading investment and it was made with the aim to improve the business health of the company and that it was not an investment of any surplus funds. This aspect of the matter has not been disputed by the Assessing Officer. Be that as it may, in our view, the claim of the assessee for write-off of the principal amount of the aforesaid deposit as irrecoverable is on all fours, in view of the judgments of the Hon'ble Bombay High Court in the case of Pudumjee

Pulp & Paper Mills Ltd. and Shreyas S. Morakhia(supra). As a consequence, we set-aside the order of CIT(A) and direct the Assessing Officer to allow appropriate relief.

11. In the result, appeal of the assessee is partly allowed.

Order pronounced in the open court on 30/06/2016.

Sd/-	Sd/-
(SANJAY GARG)	(G.S.PANNU)
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Mumbai, Dated 30/06/2016

Vm, Sr. PS

Copy of the Order forwarded to :

1. The Appellant ,
2. The Respondent.
3. The CIT(A)-
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

BY ORDER,

//True Copy//

(Dy./Asstt. Registrar)
ITAT, Mumbai