IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCHES **“B”** BENCH: HYDERABAD

BEFORE SMT. P.MADHAVI DEVI, JUDICIAL MEMBER AND
SHRI D.S. SUNDER SINGH, ACCOUNTANT MEMBER

ITA. No.1651/Hyd/2017
Assessment Year: 2013-2014

DCIT, Circle-16(2), Hyderabad.	vs.	Maruti Securities Limited, Secunderabad. PAN: AABCM 3651 M
(Appellant)		(Respondent)

For Assessee:	Shri K. Sai Prasad
For Revenue :	Smt. N. Swapna, DR

Date of Hearing :	22.03.2018
Date of Pronouncement :	23.03.2018

ORDER

PER D.S. SUNDER SINGH, AM.

This appeal filed by the Revenue is directed against the order passed by Ld. CIT(A)-4, Hyderabad and it pertains to A.Y. 2013-2014. In this appeal, assessee raised the following grounds which read as under:-

> *“1. The Ld. CIT(A) erred in deleting the addition of Rs. 1,26,86,509/- made on account of interest accrued on the loans advanced by the assessee.*
> *2. The Ld. CIT(A) erred in ignoring the fact that Revenue’s appeal on identical issue in assessee’s own case for A.Ys 2005-06 to 2007-08 are pending before the Hon’ble High Court.”*

2. Briefly stated relevant facts of the case are that the assessee-company is engaged in the business of investment in capital markets. Assessee filed the return of income for the A.Y. 2013-14 on 27.09.2013 declaring a loss of Rs. 5,35,493/-. During the assessment proceedings, Assessing Officer observed that there were unsecured loans to the

extent of Rs. 19.25 Crs under 'advances recoverable in cash or kind'. The A.O. verified the advances recoverable in cash or credit and found that the assessee did not charge interest on three parties as per the details given below:

Sl No.	Name of the Party	Amount as on 31.03.2013
1.	Goldstone Trading Co. Pvt Limited	10,40,75,151/-
2.	Realstone Trading Co. Pvt Limited	1,03,52,909/-
3.	ACME Craft Pvt Limited	4,92,264/-

3. Further, assessee-company has not entered into agreements for charging interest @ 8% on the following outstanding loans.

Sl No.	Name of the Party	Amount as on 31.03.2013
1.	Ask Holdings P. Ltd	1,20,00,000
2.	DPK Stock & Securities	66,50,000
3.	Sunrich Investments	1,45,50,000
4.	Platonium Com Ltd	48,00,00

4. The Assessing Officer was of the view that the company has entered into an agreement for receipt of interest from the above companies @ 8% per annum during the previous year relevant to the A.Y. 2009-10. At the end of the years, the assessee-company has again entered into agreements for not charging interest or waiver of the interest stating that all the three parties suffered losses. The practice of entering and cancellation of agreements, is not acceptable according to the AO, since the assessee-company is following mercantile system of accounting. Therefore, A.O. was of the view that since the assessee-company is consistently following the mercantile system of accounting, according to which the interest accrues and subsequent relinquishment of interest after expiry of the accounting year is of no consequence. Accordingly, the A.O. held that the interest is not a notional interest and it constitutes interest income not offered to tax and hence computed the rate of interest @ 8% on amounts advanced by the assessee-company

during the FY under consideration and brought to tax the same which amounts to Rs.1,26,86,509/-.

5. Aggrieved by the order of the Assessing Officer, the assessee went on appeal before the first appellate authority.

6. Ld. CIT(A) following the order of the ITAT, Hyderabad Benches in the assessee's own case for the AYs 2005-06 to 2006-07 and 2008-09 to 2011-12 held that the interest is a notional interest and no notional income can be brought to tax on loans and advances. Accordingly, Ld. CIT(A) deleted the addition and directed the A.O. to verify whether the interest has been actually received by the assessee and tax the same on receipt basis. Aggrieved by the order of the Ld. CIT(A), Revenue is in appeal before the Tribunal.

7. During the appeal hearing, Learned Counsel for the Assessee argued that the issue of notional interest is squarely covered by the order of this Tribunal in the assessee's own case for the AYs 2005-06 & 2006-07 (ITA Nos. 468/H/2009 and others, dated 05.09.2014) and for the A.Y. 2007-08 (ITA Nos. 841 & 1176/Hyd/2012, dated 03.12.2014). For the sake of ready reference, the relevant portions from the said Tribunal's order (dated 03.12.2014) (supra) is extracted as under:-

> *"21. We have considered the rival submissions and perused the impugned orders of the Revenue authorities and other material on record. We have also gone through the written submissions filed and the decisions relied upon by the parties before us. We are of the opinion that to arrive at a real income, accrual basis cannot be a justifying factor and the commercial and business realties of the assessee, should be considered. The interest income has been recognized in the books of accounts only to ITA No.468/Hyd/2009 & 3 others M/s. Maruti Securities Limited, Secunderabad . to the extent of actual collection, which is the recommended/ recognized method as per Accounting Standard 9 of ICAI which lays down that when uncertainties exist regarding the determination of the amount or its collectability, the revenue shall not be treated as accrued and hence shall not be recognized until collection. The recognition of revenue on accrual basis presupposes the satisfaction of two conditions-*
>
> *(a) The revenue is measurable*
>
> *(b) The revenue is collectable with certainty.*
>
> *The interest income has been admittedly recognised only on receipt basis. The contention of the revenue that the loan agreements have interest clause*

permitting the assessee to charge interest at the rate of 14% is not tenable. The terms of the agreements, which enabled the assessee company to demand interest were only enabling provisions and those enabling provisions did not guarantee the collection of overdue interest. They only gave a cause of action to the applicant.

22. The method of accounting, as followed by the assessee, does not create any income; but the method of accounting only recognizes income. There is some merit in the submission of the assessee that when the principal itself is overdue and not collected, there is no basis for making out a case that interest income would be collectable with certainty. Even where an assessee is following the mercantile system of accounting, it is only accrual of real income which is chargeable to tax, that accrual is a matter to be decided on commercial belief having regard to the nature of business of the assessee and character of the transaction. Accordingly, for the purpose of determining whether there has been accrual of real income or not, recourse is to be made to ascertain the nature of business and character of the transaction and the realities and peculiarities of the situations. The decision very heavily relied upon by the first appellate authority in the case of State Bank of Travancore Vs CIT (1986) 158 ITR 102 was subsequently overruled in its land mark decision in the case of UCO Bank Vs CIT 237 ITR 889. In this regard, we place reliance on the ratio laid down by various judicial authorities on the proposition that the income cannot be taxed on hypothetical basis, and it is only the real income that is to be brought to tax. In this behalf, we also rely, giving below summary of the ratio laid down, on the following decisions

a) CIT vs. Godhra Electricity Co. 225 ITR 746 (SC),

The view expressed was that if income does not result at all, there cannot be any tax and that if an income has not materialized, then merely an entry made about a hypothetical income by following book keeping methods, the liability to tax cannot be attracted.

b) Andhra bank(225 ITR 447)(SC):

It was held, that there cannot be a tax if no income resulted, despite the entry in the book keeping. The case deals with s. 148. Assessee changed method of accounting from AY 1960 onwards. But during AY 1963-64, the AO objected the change and reopened assessments for AY 1960 onwards. Apex court held that this amounts to change of opinion and re-assessment is not valid.

23. Further, the learned counsel for the assessee relied on the decision of the Hon'ble Supreme Court CIT vs. Excel Industries Ltd. & Ors. (358 ITR 295) and submitted that going by the accounting standard though the revenue is collectible by certainty, the assessee in the present case, in fact, had not received any interest and hence, interest in question remained only notional interest. As canvassed by the learned counsel for the assessee, some of the parties did not repay even the principal amount and some of the parties settled the accounts by paying some interest and hence, we agree that computation of notional interest at 14% on all the ITA No.468/Hyd/2009 & 3 others M/s. Maruti Securities Limited, Secunderabad . 14 advances and making additions on that basis to the income of the assessee, is not justified.

24. We may, at this juncture, refer to the Ahmedabad Bench decision of the Tribunal in the case of ITO vs. CJ Rathod (11 ITR (Trib.) 252), relied upon by the learned counsel for the assessee. In this case the assessee had given interest free loans to some persons. The Assessing Officer added certain sums as deemed interest on such loans. It was held that there was no agreement between the assessee and the persons to whom the money had been advanced regarding charges of interest and the assessee had actually not charged any interest and these loans were interest free loans. As there was no charge of interest it was

held that the assessee was not entitled to any income and the deemed addition made by the Assessing Officer is to be deleted.

25. We may further refer to the decision of this Tribunal in CCI Finance V/s. ACIT (91 ITD 573), also relied upon by the learned counsel for the assessee, wherein it was held that accrual of interest income on non-performing assets account has to be judged from realistic point of view. Non recognition of interest income on the ground that the interest had not really accrued as the realisability of principal outstanding itself was doubtful was held to be legally correct under the mercantile system of accounting.

26. We may further refer to the decision of this Tribunal in the case of NSL Power Infrastructure Ltd. V/s. CIT in ITA No. 1219/Hyd/2011 dated 24.1.2013, relied upon by the learned counsel for the assessee before us, duly pointing that the High Court in ITTA No. 607 of 2013, has dismissed the appeal by the Department, by holding that non-offering of interest income is distinguished when there is no certainty and the company has not derived any interest. As for the decision of State Bank of ITA No.468/Hyd/2009 & 3 others M/s. Maruti Securities Limited, Secunderabad . 15 Travancore V/s. CIT (158 ITR 102), relied upon by the learned CIT(A) in the impugned order, as pointed out by the learned counsel for the assessee the Hon'ble Supreme Court has reversed the view taken in that case, vide its decision in UCO Bank (237 ITR 889) wherein it has been held as follows:

"……The question whether interest earned, on what have come to be known as "sticky" loans, can be considered as income or not until actual realisation, is a question which may arise before several Income-tax Officers exercising jurisdiction in different parts of the country. Under the accounting practice, interest which is transferred to the suspense account and not brought to the profit and loss account of the company is not treated as income. The question whether in a given case such "accrual" of interest is doubtful or not, may also be problematic. If, therefore, the Board has considered it necessary to lay down a general test for deciding what is a doubtful debt, and directed that all Income-tax Officers should treat such amounts as not forming part of the income of the assessee until realised, this direction by way of a circular cannot be considered as travelling beyond the powers of the Board under section 119 of the Income-tax Act. Such a circular is binding under section 119. The circular of October 9, 1984, therefore, provides a test for recognising whether a claim for interest can be treated as a doubtful claim unlikely to be recovered or not. The test provided by the said circular is to see whether, at the end of three years, the amount of interest has, in fact, been recovered by the bank or not. If it is not recovered for a period of three years, then in the fourth year and onwards the claim for interest has to be treated as a doubtful claim which need not be included in the income of the assessee until it is actually recovered.

In the case of Navnit Lal (C.) Javeri v. K.K. Sen, AAC [1965] 56 ITR 198, the legal effect of such circular is, inter alia, considered by a Bench of five judges of this court. Section 2(6A)(e) and section 12(1B) were introduced in the Income-tax Act by the Finance Act 15 of 1955, which came into force on April 1, 1955. The Government, however, realised that the operation of section 12(1B) would lead to extreme hardship because it would have covered the aggregate of all outstanding loans of past years and would impose an unreasonably high liability on the shareholders to whom the loans might have been advanced. The Minister, therefore, gave an assurance in Parliament that outstanding loans and advances which are otherwise liable to be taxed as dividends in the assessment years 1955-56 will not be subjected to tax if it is shown that they had been genuinely refunded to the respective companies before June 30, 1955. Accordingly, a circular was issued by the Central Board of Revenue on May 10, 1955, pointing out to all Income-tax Officers that it was likely that some of the companies might have advanced loans to their shareholders as a result of genuine transactions of

loans, and the idea was not to affect such transactions and not to bring them within the mischief of the new provision. The officers, therefore, were asked to intimate to all the companies that if the loans were repaid before June 30, 1955, in a genuine manner, they would not be taken into account in determining the tax liability of the shareholders to whom they may have been advanced despite the new section. This circular was held by this court as binding on the Revenue, though limiting the operation of section 12(1B) or excluding certain transactions from the ambit of section 12(1B). It was so held because the circular was considered as issued for the purpose of proper administration of the provisions of section 12(1B) and the court did not look upon this circular as being in conflict with section 12(1B).

A similar view of the Central Board of Direct Taxes circulars has been taken in the case of K.P. Varghese v. ITO [1981] 131 ITR 597, by a Bench of two judges consisting of P.N. Bhagwati and E.S. Venkataramiah, JJ. The Bench has held that circulars of the Central Board of Direct Taxes are legally binding on the Revenue and this binding character attaches to the circulars even if they be found not in accordance with the correct interpretation of the section and they depart or deviate from such construction. Citing the decision of Navnit Lal (C.) Javeri v. K.K. Sen, AAC [1965] 56 ITR 198 (SC), this court observed that circulars issued by the Central Board of Direct Taxes under section 119 of the Act are binding on all officers and persons employed in the execution of the Act even if they deviate from the provisions of the Act. In Keshavji Ravji and Co. v. CIT [1990] 183 ITR 1, a Bench of three judges of this court has also taken the view that circulars beneficial to the assessee which tone down the rigiour of the law and are issued in exercise of the statutory powers under section 119 are binding on the authorities in the administration of the Act. The benefit of such circulars is admissible to the assessee even though the circulars might have departed from the strict tenor of the statutory provision and mitigated the rigour of the law. This court, however, clarified that the Board cannot preempt a judicial interpretation of the scope and ambit of a provision of the Act. Also a circular cannot impose on the taxpayer a burden higher than what the Act itself, on a true interpretation, envisages. The task of interpretation of the laws is the exclusive domain of the courts. However, the Board has the statutory power under section 119 to tone down the rigour of the law for the benefit of the assessee by issuing circulars to ensure a proper administration of the fiscal statute and such circulars would be binding on the authorities administering the Act.

In the case of C.B. Gautam v. Union of India [1993] 199 ITR 530 at page 546, a Bench of five judges of this court considered as enforceable, Instruction No. 1A-88 issued by the Central Board of Direct Taxes relating to the enforcement of the provisions of Chapter XX-C of the Income-tax Act. The Central Board pointed out in the said instruction that in administering the provisions of the said Chapter, it has to be ensured that no harassment is caused to bona fide and honest purchasers or sellers of immovable property and that the power of pre-emptive purchase has to be exercised by the appropriate authority only when it has good reason to believe that the property has been sold at an undervalue and there is payment of black money in the transaction. The instruction that when the property is put up for sale by the appropriate authority, the reserve price should be fixed at a minimum of 15 per cent. above the purchase price shown as the apparent consideration under the agreement between the parties, was held to be binding on the authority. The Constitution Bench in the above case also approved of the decision of this court in K.P. Varghese v. ITO [1981] 131 ITR 597.

There are, however, two decisions of this court which have been strongly relied upon by the respondents in the present case. The first decision is the majority judgment in State Bank of Travancore v. CIT [1986] 158 ITR 102, decided by a Bench of three judges of this court by a majority of two to one. This judgment directly deals with interest on "sticky advances" which have been debited to the customer but taken to the interest suspense account by a banking company. The

majority judgment has referred to the circular of October 6, 1952, and its withdrawal by the second circular of June 20, 1978. The majority appears to have proceeded on the basis that by the second circular of June 20, 1978, the Central Board had directed that interest in the suspense account on "sticky" advances should be includible in the taxable income of the assessee and all pending cases should be disposed of keeping these instructions in view. The subsequent circular of October 9, 1984, by which, from the assessment year 1979-80 the banking companies were given the benefit of the circular of October 9, 1984, does not appear to have been pointed out to the court. What was submitted before the court was, that since such interest had been allowed to be exempted for more than half a century, the practice had transformed itself into law and this position should not have been deviated from. Negativing this contention, the court said that the question of how far the concept of real income enters into the question of taxability in the facts and circumstances of the case, and how far and to what extent the concept of real income should intermingle with the accrual of income, will have to be judged "in the light of the provisions of the Act, the principles of accountancy recognised and followed, and feasibility". The court said that the earlier circulars being executive in character cannot alter the provisions of the Act. These were in the nature of concessions which could always be prospectively withdrawn. The court also observed that the circulars cannot detract from the Act. The decision of the Constitution Bench of this court in Navnit Lal (C.) Javeri v. K.K. Sen, AAC [1965] 56 ITR 198, or the subsequent decision in K.P. Varghese v. ITO [1981] 131 ITR 597 (SC), also do not appear to have been pointed out to the court. ITA No.468/Hyd/2009 & 3 others M/s. Maruti Securities Limited, Secunderabad . 18 Since the later circular of October 9, 1984, was not pointed out to the court, the court naturally proceeded on the assumption that the benefit granted under the earlier circular was no longer available to the assessee and those circulars could not be resorted to for the purpose of overcoming the provisions of the Act. Interestingly, the concurring judgment of the second judge has not dealt with this question at all but has decided the matter on the basis of other provisions of law.

The said circulars under section 119 of the Income-tax Act were not placed before the court in the correct perspective because the later circular continuing certain benefits to the assessees was overlooked and the withdrawn circular was looked upon as in conflict with law. Such circulars, however, are not meant for contradicting or nullifying any provision of the statute. They are meant for ensuring proper administration of the statute, they are designed to mitigate the rigours of the application of a particular provision of the statute in certain situations by applying a beneficial interpretation to the provision in question so as to benefit the assessee and make the application of the fiscal provision, in the present case, in consonance with the concept of income and in particular, notional income as also the treatment of such notional income under accounting practice.

In the premises the majority decision in the State Bank of Travancore v. CIT [1986] 158 ITR 102 (SC), cannot be looked upon as laying down that a circular which is properly issued under section 119 of the Income-tax Act for proper administration of the Act and for relieving the rigour of too literal a construction of the law for the benefit of the assessee in certain situations would not be binding on the departmental authorities. This would be contrary to the ratio laid down by the Bench of five judges in Navnit Lal (C.) Javeri v. K.K. Sen [1965] 56 ITR 198 (SC). In fact State Bank of Tranvancore v. CIT [1986] 158 ITR 102 (SC), has already been distinguished in the case of Keshavji Ravji and Co. v. CIT [1990] 183 ITR 1 (SC), by a Bench of three judges in a similar fashion. It is held only as laying down that a circular cannot alter the provisions of the Act. It being in the nature of a concession, could always be prospectively withdrawn. In the present case, the circulars which have been in force are meant to ensure that while assessing the income accrued by way of interest on a "sticky" loan, the notional interest which is transferred to a suspense account pertaining to

doubtful loans would not be included in the income of the assessee, if for three years such interest is not actually received. The very fact that the assessee, although generally using a mercantile system of accounting, keeps such interest amounts in a suspense account and does not bring these amounts to the profit and loss account, goes to show that the assessee is following a mixed system of accounting by which such interest is included in its income only when it is actually received. Looking to the method of accounting so adopted by the assessee in such cases, the circulars which have been issued are consistent with the provisions of section 145 and are meant to ensure that assessees of the kind specified who have to account for all such amounts of interest on doubtful loans are uniformly given the benefit under the circular and such interest amounts are not included in the income of the assessee until actually received if the conditions of the circular are satisfied. The circular of October 9, 1984, also serves another practical purpose of laying down a uniform test for the assessing authority to decide whether the interest income which is transferred to the suspense account is, in fact, arising in respect of a doubtful or "sticky" loan. This is done by providing that non-receipt of interest for the first three years will not be treated as interest on a doubtful loan. But if after three years the payment of interest is not received, from the fourth year onwards it will be treated as interest on a doubtful loan and will be added to the income only when it is actually received.

We do not see any inconsistency or contradiction between the circular so issued and section 145 of the Income-tax Act. In fact, the circular clarifies the way in which these amounts are to be treated under the accounting practice followed by the lender. The circular, therefore, cannot be treated as contrary to section 145 of the Income-tax Act or illegal in any form. It is meant for a uniform administration of law by all the income-tax authorities in a specific situation and, therefore, validly issued under section 119 of the Income-tax Act. As such, the circular would be binding on the Department.

The other judgment on which reliance was placed by the Department was a judgment of a Bench of two judges of this court in Kerala Financial Corporation v. CIT [1994] 210 ITR 129, where this court, following the majority view in State Bank of Travancore v. CIT [1986] 158 ITR 102 (SC), held that interest which had accrued on a "sticky" advance has to be treated as income of the assessee and taxable as such. It is said that ultimately, if the advance takes the shape of a bad debt, refund of the tax paid on the interest would become due and the same can be claimed by the assessee in accordance with law. For reasons set out above, we are not in agreement with the said judgment. The relevant circulars of the Central Board of Direct Taxes cannot be ignored. The question is not whether a circular can override or detract from the provisions of the Act; the question is whether the circular seeks to mitigate the rigour of a particular section for the benefit of the assessee in certain specified circumstances. So long as such a circular is in force it would be binding on the departmental authorities in view of the provisions of section 119 to ensure a uniform and proper administration and application of the Income-tax Act.

27. In the light of the foregoing discussion and the case-law on the point, we delete the addition of Rs.2,76,38,140 made by the assessing officer and sustained by the CIT(A), allowing the grounds of the assessee on this issue.

8. Learned Counsel for the Assessee also brought our attention to the Ld. CIT(A)'s order for the AYs 2008-09 to 2011-12 and relevant para 4.1 which reads as under:

"4.1 I have perused the ITAT's orders in ITA No.468 for A.Y. 2005-06, ITA No.1111 for A.Y. 2006-07 and 841 for A.Y. 2007-2008. The Hon'ble ITAT decided the issue in favour of the appellant for the AYs 2005-06, 2006-07 in ITA No.468/Hyd/2009, dated 05/09/2014 at para "53" by relying on several case laws as discussed in the order vice paras 21 to 27 and for the AYs 2007-08 in ITA No.841 & 1176/Hyd/2012 vide its order dated 03.12.2014 vide paras 5 to 7 deleted the addition made by the Assessing Officer in this regard. Since the facts are similar for these four years also, i.e., A.Y. 2008-09, 2009-10, 2010-11 and 2011-12, respectfully following the above orders, all the appeals for all the four years are allowed."

9. Since the facts are identical and the Ld. CIT(A) has rightly allowed the appeal of the assessee following the order of this Tribunal for the earlier years (supra), respectfully following the view taken by this Tribunal in the assessee's own case (supra), we hold that the notional interest on above advances cannot be charged on accrual basis and the Assessing Officer is directed to verify the interest actually received and assess the same on actual receipt basis. Accordingly, the appeal filed by the Revenue is allowed for statistical purposes.

10. In the result, appeal filed by the Revenue is allowed for statistical purposes.

Order pronounced in the open court on 23rd March, 2018

Sd/-	Sd/-
(Smt. P. MADHAVI DEVI)	**(D.S. SUNDER SINGH)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Hyderabad, Dated: 23rd March, 2018.

OKK, Sr.PS
Copy to

1.	M/s. Maruti Securities Limited, Plot No.66, Ground Floor, Park View Enclave, Manovikas Nagar, Secunderabad.
2.	DCIT, circle-16(2), 2nd Floor, "B" Block, I.T. Towers, A.C. Guards, Masab Tank, Hyderabad.
3.	CIT (A)-4, Hyderabad.
4.	Pr. CIT-4, Hyderabad.
5.	DR, ITAT, Hyderabad.
6.	Guard File