The IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "E", MUMBAI

Before Shri Mahavir Singh(JUDICIAL MEMBER)

AND
Shri G Manjunatha (ACCOUNTANT MEMBER)

I.T.A No.1490/Mum/2012
(Assessment year: 2000-01)
&
I.T.A No.3523/Mum/2013
(Assessment year: 2001-02)

Tata Motors Ltd (Successor to Tata Finance Ltd), Bombay House, 24, Homi Mody Street Fort, Mumbai- 400 001 PAN : AAACT1629F	vs	ACIT, Range-10(2) / Dy.CIT, Range(3), Mumbai
APPELLANT		**RESPONDENT**

I.T.A No.1721/Mum/2012
(Assessment year: 2000-01)
&
I.T.A No.4095/Mum/2013
(Assessment year: 2001-02)

ACIT-2(3) / Dy.CIT-8(3), Mumbai	vs	Tata Motors Ltd (Successor to Tata Finance Ltd), Bombay House, 24, Homi Mody Street Fort, Mumbai- 400 001 PAN : AAACT1629F
APPELLANT		**RESPONDENT**

Assessee by	Smt. Aarti Vissanji
Revenue by	Shri R Manjunatha Swamy

Date of hearing	02-08-2018
Date of pronouncement	21-08-2018

O R D E R

Per G Manjunatha, AM :

These cross appeals filed by the assessee as well as the revenue

are directed against separate, but identical orders of the CIT(A)-6, Mumbai dated 30-12-2011 and 14-03-2013 for the assessment years 2000-01 & 2001-02. Since facts are identical and issues are common, these appeals were heard together and are disposed of by this common order, for the sake of convenience.

AY 2000-01 – ITA No. 1490/Mum/2012 (Assessee's appeal)

2. The assessee has raised the following grounds of appeal:-

> "The grounds set out below are independent and without prejudice to one another:
> 1. The Learned Commissioner of Income-tax (Appeals) [hereinafter referred to as "the CIT (A)"] erred in law and on facts in upholding that the transactions of lease of various assets were mere financing transactions and the Appellant was therefore not entitled to depreciation allowance of Rs. 33,90,43,696 under section 32 of the Act.
> 2. The learned C1T(A) erred in law and on facts in confirming disallowance of Rs.33,333 in respect of amount paid for late payment of sales tax.
> 3. The Learned CIT (A) erred in confirming the disallowance under section 14A of the Act of Rs. 39,31,00,000 out of interest and further sum of Rs. 10,00,000 out of expenses made by the Assessing Officer under section 14A of the Act.
> 4. The learned CIT(A) has erred in law and on facts in confirming disallowance of software license fees."

2. The brief facts of the case are that the assessee company which is engaged in the business of finance company including hire purchase leasing, bill discounting, hypothecation finance, investment and credit card business, filed its return of income for AY 2000-01 on 30-11-2000 declaring total loss of Rs.45,49,23,020. The case was selected for scrutiny and assessment has been completed u/s 143(3) on 28-03-2003, determining total income at Rs.12,17,91,362 by making various additions

including disallowance of depreciation on leased assets, disallowance of penalty paid for late payment of sales-tax, disallowance of expenditure incurred in relation to exempt income u/s 14A of the Act, being interest disallowance of Rs.39,31,00,000 and further sum of Rs.10 lakhs towards administrative and other expenses, disallowance of bad debts written off being principal amount due in respect of bill discounting, disallowance of excess depreciation claimed on motor lorries, motor buses and motor taxis, disallowance of excess depreciation claimed on software licence and denial of exemption claimed u/s 54EA of the Income-tax Act, 1961.

3. Aggrieved by the assessment order, assessee preferred appeal before the CIT(A). Before the CIT(A), assessee has filed elaborate written submissions on each and every addition made by the AO which has been reproduced by the Ld. CIT(A) in his appellate order. The Ld.CIT(A), for the detailed discussion in his appellate order dated 30-12-2011 partly allowed appeal filed by the assessee, wherein he has deleted additions made by the AO towards bad debts written off on account of principal amount due in respect of bill discounting, disallowance of excess depreciation on motor lorries, motor buses and motor taxis and software licence and also addition made towards denial of exemption claimed u/s 54EA of the Act. The Ld.CIT(A), however, confirmed addition made by the AO towards disallowance of depreciation claimed on leased assets, disallowance of amount paid towards late

payment of sales-tax and disallowance of expenditure incurred in relation to exempt income u/s 14A being interest on borrowed funds and administrative expenses. Aggrieved by the order of Ld.CIT(A), the assessee as well as the revenue are in appeal before us.

4. The first issue that came up for our consideration from assessee's appeal is disallowance of depreciation claim on leased assets. The AO has disallowed depreciation claimed on leased assets of Rs.33,90,43,696, on the ground that sale and lease back transaction entered with different companies are in the nature of finance / loan transactions, therefore, the assessee is neither the owner of the assets nor such assets were used for the purpose of business and hence, depreciation cannot be allowed on leased assets. The Ld.AR for the assessee at the time of hearing submitted that the issue is covered in favour of the assessee by the decision of ITAT, Mumbai Bench in assessee's own case for AY 1999-2000 in ITA No.2997/Mum/2006 dated 24-01-2018 wherein the ITAT by following the order of ITAT for AY 1996-97 deleted addition made by the AO.

5. We have heard both the parties and perused the material available on record. The issue of depreciation on sale and lease back of assets is no longer res integra. The coordinate bench of ITAT in assessee's own case from AY 1997-98 onwards, by following the decision of Hon'ble Supreme Court in the case of ICDS vs CIT 350 ITR 527 (SC) and also

the decision of Hon'ble Bombay High Court in the case of CIT vs Apollo Finvest India Ltd in ITA 2298 of 2013 held that the assessee is eligible to claim depreciation on assets sold and leased back. The relevant portion of the order is extracted below:-

> 5. We have considered the rival .submission of the parties and perused the material
> available on record carefully. Besides the year under consideration, the Id. CIT(A) sustained the similar disallowance of depreciation of leased asset for AYs 1995-96, 1996-97, 1997-98 and 1998-99. The assessee has filed appeal before the ITAT vide ITA No. 62M/Mum/2f)03 for AY 1 997-98 and ITA No. 714S/MunV2004 for AY 1998-99 and the Tribunal passed the following order:
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> "1 8. 1 5. We have heard the rival jsubmissions and perused the material before us. We find that impugned assets underlying lease agreements were very much in existence, that purchase consideration of assets was discharged by the assessee through banking channels, that copies of ihe cheques were a/so produced, that the tease transactions were completed as per *all* legally prescribed procedures, that it was a righiful owner of 'eased assets that rhe lessees had confirmed lhc ownership of assets, that they had not claimed depreciation in their books of account for purchase and lease of assets, that lease rentals earned by the assessee was offered to tax and same \vas assets by the AO.s in the ysar under$_0$ consideration as well as in the subsequent AY.s. Here, we would like to discuss the matter of f.C.D.S Ltd.(supra).In that case the Hon'ble Apex Court has held as under:
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> *"The provision on depreciation in ihe Income-lax Act, 1961, reads that the asset must be "owned, wholly or partly, by the assessee and used for the purposes of the business ".*
> *Therefore, it imposes a $_f$ twin requirement of "ownership" and "usage for business" for a successful claim under section 32 of the Act. The section requires that the assessee must use the asset for the "purposes of business ". It does not mandate usage of the asset by the assessee itself. As long as the asset is utilized for the purpose of business of the assessee, the requirement of section 32 will stand satisfied, notwithstanding non-usage of the asset itself by the assessee. The definitions of "ownership" essentially make ownership a function of legal right or title against the rest of the world. However, it is "nomen generalissimum", and its meaning is to be gathered from the connection in • which it is used, and from the subject-matter to which it is applied. As long as the assessee has a right to retain the legal title against the rest of the world, it would be the owner of the asset in the eyes of law. "*
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> As the assessee was the owner of the assets leased out to different parties, so, *it* was *entitled* to claim depreciation. The FAA had gone through tj'ie lease agreements, confirmation letters and other relevant material. As the existence of assets and their use is in doubt, so, the AO, in our opinion was not justified in denying the claim of depreciation made by assessee. We also find that FAA had allowed depreciation @50%, as the assets were used for less then 180 days during the year under consideration- It is also a fact that two of the lessees are state electricity boards i.e. APSEB and RSEB. Both **of** them have confirmed t)'C lease transaction and installation of machinery/ assets. The FAA had observed that it could not be alleged that govt. undertakings had colluded with I e assessee to mislead and defraud the govt. of'its revenue by giving wrong confirmations. So, we do not see any infirmity in the order of the FAA. Confirming his order, we decide the Ground No. 11 against the AO."

> Thus, considering the decision of Tribunal in assessee's own case on identical grounds of appeal, which was decided on the identical fact, we find that this ground of appeal is covered in favour of assessee and against the revenue. The coordinate bench decided the identical ground of appeal on the basis of decision of Apex Court in case of ICDS Ltd (supra). Thus, respectfully following the decision of Tribunal the ground No.1 of appeal raised by assessee is allowed."

6. In this view of the matter and consistent with the view taken by the co-ordinate bench in assessee's own case for earlier years, we direct the AO to delete addition made towards disallowance of depreciation on leased assets.

7. The next issue that came up for our consideration from assessee's appeal is disallowance of late payment penalty paid for delayed payment of sales-tax liability of Rs.33,333. The Ld.AR for the assessee at the time of hearing submitted that considering the smallness of amount involved in dispute, she did not want to press the ground, but would keep open the issue be challenged at appropriate time, whenever required in the light of various judicial precedents including the decision of Hon'ble Supreme Court in the case of Lachmandas Mathuradas vs CIT 254 ITR 799 (SC). Therefore, the ground taken by the assessee challenging disallowance of penalty paid for late payment of sales-tax is dismissed, as not pressed.

8. The next issue that came up for our consideration from assessee's appeal is disallowance of expenditure incurred in relation to exempt income. The facts with regard to the impugned dispute are that during

the year under consideration, the assessee has earned dividend income of Rs.45,14,29,050 and claimed as exempt u/s 10(34) of the I.T. Act, 1961. The assessee has not made any disallowance of expenditure incurred in relation to exempt income. The AO has determined disallowance of Rs.39,31,00,000 towards proportionate interest paid on borrowed funds and also made adhoc disallowance of Rs.10 lakhs towards administrative expenses on the ground that the assessee has paid huge interest on borrowed funds and also claimed various expenditure in the P&L Account; however, failed to disallow any expenditure incurred in relation to exempt income. The Ld.AR for the assessee, at the time of hearing, submitted that the issue of disallowance of proportionate interest is covered in favour of the assessee by the decision of ITAT in assessee's own case for AY 2005-06 in ITA No.630/Mum/2012 wherein the Tribunal, by following its own order for AYs 1999-2000 to 2002-03, deleted addition made towards proportionate disallowance of interest paid on borrowed funds. The Ld.AR further submitted that insofar as administrative expenses is concerned, the assessee did not want to press the ground taken for challenging disallowance of administrative expenses incurred in relation to exempt income.

9. We have heard both the parties and perused the material available on record. The issue of disallowance of proportionate interest u/s 14A of

the Act, has been considered by the ITAT in assessee's own case for AY 2005-06 in ITA No.630/Mum/2012 and after considering relevant facts and also by following the decision of Hon'ble Bombay High Court in the case of HDFC Bank Ltd vs CIT 383 ITR 529 (Bom) and Reliance Utilities & Power Ltd vs CIT 318 ITR 340 (Bom) held that when own funds in the form of share capital and reserves is in excess of amount invested in shares and securities which yielded exempt income, then no disallowance can be made towards interest expenditure u/s 14A of the Act. The relevant portion of the order is extracted below:-

> "16. We have considered the rival submission of the parties and have gone through the orders of authorities below. We have noted that similar ground of appeal was raised by the assessee in earlier assessment year as submitted by learned AR of the assessee and the Tribunal in assessee's own case vide order dated 31 August 2017 passed the following order:-
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> *"6. We. have considered (he rival submissions of the parties and have gone through the orders of authorities below. We have seen that during the relevant financial year the assessee has earned dividend income of' Rs.15.82 Crore. The AO while giving effect to the order of Ld CIT(A) disallowed 5% of dividend income ids I4A of the Act. We have perused the financial statement of assessee as on 31.03.2002. The assessee was having Capital of Rs319.82 Crore and Reserve & Surplus of Rs. 2145.24 Crore. Thus, the assessee has total Capital, and Reserve & Surplus fund of Rs. 2465.06 Crore. The during the relevant financial year has made the investment of Rs. Crore. From the perusal of financial statement, we have noted that the interest free funds available with the assesses- are more than the investment made during the year. The Hon'ble Bombay High Cowl in Reliance Utility and Power Ltd (supra) held that where both the interest free funds and interest hearing funds are available and the interest free funds arc more than the investment made the presumption **is** that the investment is made out of interest free funds available with the assessee. The High Court further held that for the years for which Rule 8D is not applicable and in the event the AO is not satisfied with the working given by the assesses, the disallowance under section 14A has to be made on reasonable basis. The Hon'ble jurisdictional High Court in HDFC Bank Lid. (supra) held that while considering disallowance under Section 36(l)(iii) the application of Section I4A of the Act would apply Considering the fact that no interest hearing funds utilized in earning the exempt income. Thus, no interest disallowance can he made while disallowance u/s 14A of the Act.*
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> *7. We have further noticed that the AO has not recorded his dissatisfaction about the claim of assesses, further the lower authority has not disputed that (he majority investments are in group companies. We have noted that the co-ordinate Bench of*

Kolkata Tribunal in Ashoka Trading Co. Pvt. Ltd.. Sagrika Goods & Service Pvt. Ltd , Diamond Company Ltd and S.R. Batliboi & Co (supra), the Tribunal has taken a consistent view to allow reasonable wanes and restricted the disallowance u/s I4A of the Act to 1% of the id income. Thus, respectfully following the decision of Co-ordinate we restrict the disallowance n/s 14A to 1% of the exempt income and the AO to work out the disallowance accordingly."

17. Considering the decision of Tribunal in assessee's own case as referred as referred above, wherein the identical ground above, wherein the identical ground of appeal was dismissed in appeal for assessment years 1999-2000 to 2002-03. We direct the assessing officer to restrict the disallowance under section 14 A to 1% of the dividend income. In the result the ground of appeal raised by the assessee is allowed."

10. Insofar as disallowance of administrative expenses, the ITAT has directed the AO to restrict disallowance @1% of dividend income. In this year, the AO has adopted different method to quantify disallowance of administrative expenses and made adhoc disallowance of Rs.10 lakhs. Since, the assessee has not pressed the ground taken to challenge disallowance of administrative expenses, we direct the AO to sustain addition made towards adhoc disallowance of administrative expenses of Rs.10 lakhs u/s 14A of I.T. Act, 1961.

11. The next issue that came up for our consideration from assessee's appeal is disallowance of software licence fees claimed as revenue expenditure. The assessee has claimed EDP charges being software licence fees of Rs.45,90,000 in the P&L Account. The AO has disallowed a sum of Rs.13,34,492 on the ground that expenditure debited under the head 'EDP charges' are in the nature of capital expenditure; but allowed depreciation as per the I.T. Act, 1961. During

the course of hearing, the Ld.AR for the assessee submitted that she did not want to presss the ground taken challenging disallowance made by the AO for the reason that the AO has already allowed depreciation on such capital expenditure as per law. Therefore, the ground taken by the assessee is dismissed.

12. In the result, the appeal filed by the assessee is partly allowed.

Revenue's appeal I.T.A No.1721/Mum/2012 – AY : 2000-01

13. The first issue that came up for our consideration from revenue's appeal is disallowance of bad debts written off being principal amount due in respect of bill discounting. The assessee has claimed bad debt written off amounting to Rs.14,80,73,023 which includes principal as well as interest. The AO has allowed bad debt written off in respect of interest expenses; however, disallowed principal amount on the ground that the assessee cannot claim any sum which is never credited to P&L account. The AO further held that principal amount being asset in nature and not offered to tax in the earlier years, bad debt written off by the assessee does not fulfil the conditions prescribed u/s 36(1)(vii) and 36(2) of the Income-tax Act, 1961 and hence, not allowable as deduction. It is the claim of the assessee that the assessee is in the business of bill discounting and, therefore, the non recovery of debts incurred on account of discounted bills are in the nature of trading loss which is

allowable as deduction u/s 36(1)(vii) of the Income-tax Act, 1961. The assessee relied upon the decision of Hon'ble Bombay High Court in the case of Shreyas M Morakia vs CIT 342 ITR 285 to argue that even principal amount outstanding is deductible, if the same is not recoverable.

14. We have heard both the parties and perused the materials available on record. It is an undisputed fact that the assessee is in the business of financing and in the process, it has carried out bill discounting business. The amount outstanding in bill discounting became non recoverable and the same has been written off as bad debt. The transaction of bill discounting is particularly an advance against the security of the bill and the discount represents interest on the advance from the date of purchase of the bill only when it is due for payment. The assessee recognised interest received on bill discounting as its income. Any amount of loan outstanding in respect of bill discounting represents money lent in the ordinary course of business of banking or money lending and if the same is written off as bad debt, which fulfils the conditions prescribed u/s 36(1)(iii) and 36(2) of the Income-tax Act, 1961. The Hon'ble Bombay High Court in the case of Shreyas M Morakia vs CIT (supra) has considered similar issue in the light of provisions of section 36(1)(vii) r.w.s. 36(2) and held that in a case of share broker, unrealised value of shares from clients are deductible u/s 36(1)(vii) if

brokerage is taken into P&L account. In this case, the assessee is in the business of finance and money lending, in the process, engaged in the business of bill discounting. In bill discounting business, the assessee recognised discounting charges as its income and hence, any part of the amount outstanding on account of bill discounting business is deductible u/s 36(1)(vii), if such amount is written off as bad debts in books of account. The CIT(A), after considering relevant submissions of the assessee has rightly deleted addition made by the AO. We do not find any error in the order of the Ld.CIT(A); hence, we are inclined to uphold the findings of Ld.CIT(A) and reject ground taken by the revenue.

15. The next issue that came up for our consideration is disallowance of excess depreciation claimed on motor lorries, motor buses and motor taxis. The AO has disallowed depreciation claimed on assets being motor lorries, motor buses and motor taxis @40% on the ground that higher rate of depreciation is allowable only in cases where the assessee uses motor lorries, motor buses and motor taxis in the business of hiring. In this case, the assessee has used the assets in its own business, therefore, not eligible for higher depreciation and accordingly, allowed depreciation at normal rate of 25% being eligible for plant & machinery and excess depreciation has been disallowed.

16. The Ld.AR for the assessee, at the time of hearing submitted that the issue is covered in favour of the assessee by the decision of ITAT,

Mumbai in assessee's own case for earlier years in ITA No.5365/Mum/2001, wherein under similar set of facts, ITAT deleted addition made by the AO towards disallowance of excess depreciation.

17. Having heard both the sides and considered material on record, we find that the ITAT has considered similar issue in assessee's own case for earlier years in ITA 5365/Mum/2001 for AY 1996-97 and by following the decision of Hon'ble Madras High Court in the case of CIT vs Madan & Co reported in 254 ITR 445 held that leasing out of the trucks by the assessee to others for consideration amounts to running the same on hire and will entitle to claim for higher depreciation. The relevant portion of the order is extracted below:-

> "4. We find that the above issue is squarely covered in favour of the assessee, by Tribunal's Mumbai Bench order in assessee's own case for the assessment year 1992-93 in ITA No.413/Mum/96 dated 26th December, 2002, wherein in out esteemed colleages, following Hon'ble Madras High Court's judgment in the case of CIT vs Madan & Co. Reported in (254 ITR 445). The Hon'ble Court held that leasing of the trucks by the assessee to others for consideration amounts to running the same on hire and will entitle the assessee to claim higher depreciation."

18. In this view of the matter and consistent with the view taken by the co-ordinate bench, we direct the AO to allow depreciation as claimed by the assessee.

19. The next issue that came up for our consideration is denial of exemption claimed u/s 54EA of the Income-tax Act, 1961, before setting

off of long term capital loss. The facts with regard to the impugned dispute are that during the year under consideration, the assessee has claimed exemption u/s 54EA before setting off long term capital loss of Rs.3,26,16,950. The AO has denied the benefit of carry forward of set off of long term capital loss of Rs.3,26,16,950 on the ground that before claiming exemption u/s 54EA of the Act, the assessee shall first set off short term capital loss against long term capital gain. It is the claim of the assessee that the benefit of exemption claimed u/s 54EA shall be allowed first against long term capital gain derived from transfer of any asset before allowing set off of short term capital loss. The assessee further claimed that the method of computation of long term capital gain has been prescribed u/s 45 and as per which the assessee can claim the benefit of exemption, if any, provided under the statute. Accordingly it has claimed exemption u/s 54EA from long term capital gain derived from sale of asset. The assessee has relied upon the decision of Hon'ble Madras High Court in the case of CIT vs Vijay M Mahatani (2013) 35 Taxman.com 228 and also circular issued by CBDT vide circular No.26 of 1955.

20. We have heard both the parties and considered material available on record. The issue is squarely covered in favour of the assessee by the decision of Hon'ble Madras High Court the case of CIT vs Vijay M Mahatani (supra), wherein the Hon'ble High Court has held that the

assessee can claim exemption u/s 54EC and then set off capital loss, if any. Even the board has clarified the issue in its circular No.26 of 1995 dated 07-07-1955 wherein it has been explained the manner of computation of set off of loss under one head and how it can be set off against income under another head, particularly when total income includes items of tax free income, as per which the board clarified that the department should adopt the method which will give the assessee maximum benefit. In this case, the assessee has first claimed benefit of exemption u/s 54EA against long term capital gain before setting off of long term capital loss. The claim made by the assessee is in accordance with the clarification issued by the board vide its circular No.26 of 1955 and it is further supported by the decision of Hon'ble Madras High Court in the case of CIT vs Vijay M Mahatani (supra). Therefore, we direct the AO to allow exemption claimed u/s 54EA before setting off of long term capital loss.

21. In the result, the appeal filed by the revenue is partly allowed.

I.T.A No.3523/Mum/2013 (Assessee) & **I.T.A No.4095/Mum/2013 (Revenue)**

22. The first issue that came up for our consideration from assessee's appeal is disallowance of depreciation on sale cum lease back of assets. We have considered similar issue in ITA No.1490/Mum/2012 for AY 2000-01. The reasons given by us shall mutatis mutandis apply to this

appeal also. Therefore, for the detailed discussion in the foregoing paragraphs in ITA No.1490/Mum/2012, we direct the AO to delete addition made towards disallowance of depreciation on leased assets.

23. The next issue that came up for our consideration is disallowance of expenditure incurred in relation to exempt income being proportionate interest disallowance and adhoc disallowance of administrative expenses. The AO has disallowed proportionate interest of Rs.41.26 crores and for administrative expenses 2% of dividend income. The Ld.CIT(A) restricted total disallowance worked out by the AO to 5% of exempt income.

24. We have considered similar issue in ITA No.1490/Mum/2012 for AY 2000-01 and held that no disallowance can be made towards proportionate interest disallowance; however, sustained addition made by the AO towards adhoc disallowance of administrative expenses. In this case, the facts in respect of disallowance of proportionate interest is similar to the facts already considered by us in ITA No.1490/Mum/2012; however, in respect of administrative expenses, the AO has adopted different method to compute disallowance and accordingly made 2% disallowance on dividend income. The reasons given by us in ITA No.1490/Mum/2012 in respect of interest disallowance shall mutatis mutandis apply to this appeal also. Therefore, for the detailed discussion in the foregoing paragraphs in ITA No.1490/Mum/2012, we direct the AO

to delete addition made towards proportionate interest. Insofar as administrative expenses, the AO has disallowed 2% of dividend income. The assessee claims that the disallowance worked out by the AO @2% on dividend income is higher side, therefore, it may be restricted to 1% of dividend income. The assessee also filed calculation of such disallowance. We find that the disallowance quantified by the AO @2% of dividend income is on higher side and hence, we direct the AO to restrict the disallowance of administrative expenses to 1% of dividend income which works out to Rs.23,96,493.

25. The next issue that came up for our consideration is disallowance of depreciation on computer software @25% instead of 60%. The Ld.AR for the assessee submitted that she did not want to press the ground taken to challenge disallowance of depreciation. Therefore, the same is dismissed, as not pressed.

26. The next issue that came up for our consideration from assessee's appeal is addition of late payment compensation charges on non performing assets. The AO has made addition of Rs.5,64,44,000 towards compensation charges provided in the books of account on mercantile basis towards NPA on the ground that the assessee is following mercantile system of accounting and accordingly interest including any charges levied on loans and advances to be accounted on accrual basis whether the same has been received or not. It is the

contention of the assessee that interest including any charges levied on NPAs is assessable on receipt basis, but not on accrual basis whether the accounts has been prepared on mercantile system or not. It is well settled principle that interest on NPAs cannot be taxed on accrual basis by following method of accounting and what needs to be taxed is income which is accrued to the assessee, based on real income theory. The assessee further submitted that it is following this method of accounting of interest and other charges including compensation for late payment of principal on receipt basis and whenever the assessee has received such charges, the same has been offered to tax. In this regard relied upon the decision of Hon'ble Supreme Court in the case of CIT vs Vasisht Chay Vyapar reported in 90 taxmann.com 365.

27. We have heard both the parties and perused the material on record. There is no dispute with regard to the fact that the assessee is following method of accounting whereby it is accounting interest and late payment charges on NPAs on accrual basis; however, for the purpose of taxation, the same is considered on receipt basis. The AO has made addition towards late payment compensation charges only on the ground that the assessee is following mercantile system of accounting and hence, whatever charges levied on loans and advances including interest, needs to be accounted for on accrual basis whether the same has been received or not. We do not find any merit in the findings of AO for the

reason that it is a well settled principle that once the recovery of principal amount itself is in doubt, the question of accounting interest accrued on such NPAs is against the principles of real income theory. This legal proposition is supported by the decision of Hon'ble Supreme Court in the case of CIT vs Vasisht Chay Vyapar (supra) wherein the Hon'ble Apex Court held tht income from NPAs should be assessed on cash basis and not on mercantile basis despite the assessee following the mercantile system of accounting. Since late payment compensation charges are akin to interest, the same principle would be applicable and the said charges should also be taxable in the year of receipt. Therefore, we are of the considered view that the AO was erred in making addition towards late payment compensation charges on NPAs on accrual basis. We further notice that the assessee's claim that it is considering interest and late compensation charges on NPAs in the year of receipt for AY 2002-03. Since the AO has made addition on said receipts on accrual basis for impugned assessment year, further addition towards the same in the subsequent year on receipt basis amounts to double addition, which cannot be done. We find that the AO has made addition towards late payment compensation charges on accrual basis and also made similar addition on said charges on receipt basis in the subsequent financial years. Since we have already directed the AO to make addition towards late payment compensation charges on receipt basis in the year of

receipt of such charges, addition made on accrual basis in the impugned assessment year is directed to be deleted. However, the fact with regard to the claim of the assessee that it has offered to tax such charges on receipt basis in AY 2002-03 are not clear from the orders of the lower authorities. Therefore, we set aside the issue to the file of the AO for the limited purpose of verification of facts that the assessee has offered to tax late payment compensation charges on receipt basis in AY 2002-03. If, the AO finds that the assessee has offered to tax the said receipt on receipt basis in AY 2002-03, then he is directed to delete addition made towards said charges on accrual basis in the current year. In case the AO finds that the assessee has not offered to tax said receipt for AY 2002-03, then also, the same may be considered for taxation on receipt basis in the year of receipt.

28. The next issue that came up for our consideration from revenue's appeal is depreciation on motor lorries, motor buses and motor taxis @40%. We have considered similar issue in ITA No.1721/Mum/2012 for AY 2000-01. Since facts being identical for this year, the reasons given by us in the preceding paragraphs shall mutatis mutandis apply to this appeal also. Therefore, for similar reasons, we direct the AO to allow depreciation @40% on motor lorries, motor buses and motor taxis.

29. The next issue that came up for our consideration from revenue's appeal is disallowance of advertisement expenditure u/s 37(1) of the

Income-tax Act, 1961. The AO has disallowed a sum of Rs.2 lakhs debited under the head 'advertisement expenditure' being amount paid to Sarvajanik Ganesh Mandal, Marol on the ground that expenditure incurred towards contribution for hosting Ganesh Festival has no relevance to the business promotion of the assessee and it does not have any advertisement value. It is the contention of the asseswsee that installation of banners and posters bearing the name of the company is a mode of advertisement and is an allowable expenditure u/s 37(1) being wholly and exclusively incurred for the purpose of business.

30. Having heard both the sides, we do not fine any merit in the argument of the assessee for the reason that expenditure incurred for payment to an organisation for celebrating Ganesh Festival is having a nexus with business activity of the assessee. The assessee has paid an amount of Rs.2 lakhs to Sarvajanik Ganesh Mandal, Marol for celebration of festival. There is no nexus between expenditure incurred by the assessee and business activity. Therefore, we are of the considered view that the AO was right in disallowing expenditure incurred under the head 'advertisement' u/s 37(1) of the Act. The Ld.CIT(A) without appreciating the facts simply deleted addition made by the AO. Therefore, we reverse the findings of the Ld.CIT(A) and uphold disallowance made by the AO.

31. The next issue that came up for our consideration is disallowance of

interest expenditure u/s 37(1) for contravention of law. The AO disallowed interest @12% on loans and advances given to subsidiary companies of assessee for contravention of RBI guidelines in respect of Non Banking Financial Companies on prudential norms. According to the AO, the assessee has given loans and advances of more than 25% of assessee's own funds to a single entity, viz. M/s Nischal Investment & Trading Company, a subsidiary company in contravention of Regulation 12 of NBFCs and non banking company's acceptance of public deposits Rules. The AO has taken clue from Notes of Accounts provided in financial statements which clearly states that the company has given more than 25% of its own funds to a single entity which is prohibited as per the guidelines issued by RBI to NBFC companies. It is the contention of the assessee that though the assessee has given loans and advances over and above prescribed limit provided, still, the Explanation to section 37(1) applies only to any expenditure which is not an expenditure covered under sections 30 to 36 and which is in the nature of expenditure incurred for any purpose which is an offence or which is prohibited by law. The assessee has paid interest on borrowings which is eligible for deduction u/s 36(1)(iii) and hence, there is no reason to disallow such expenditure by invoking Proviso to section 37(1) of I.T. Act, 1961.

33. We have heard both the parties and perused the material on record.

The facts with regard to the impugned dispute are that the assessee being an NBFC, given loans and advances of more than 25% of its own funds to a single entity, M/s Nischal Investment & Trading Company, a subsidiary company, in contravention of Regulation 12 of NBFCs Prudential Norms (Reserve Bank) Acceptance of Public Deposit Rules. The AO made disallowance of interest @12% on total loans and advances given to a subsidiary company on the ground that the assessee has contravened provisions of RBI guidelines and any expenditure incurred on such loans and advances is in the nature of expenditure incurred for any purpose which is an offence or which is prohibited by law and hence, not allowable as deduction. The AO made disallowance of Rs.57,79,00,000 being interest @12% p.a. on the amount of Rs.48,159.54 crores of loans and advances given to subsidiary company. The AO has calculated notional interest on said loans and advances and disallowed u/s 37(1) of the Act. It is not a case of AO that the assessee has paid any fine or penalty for contravention of RBI guidelines issued to NBFCs for not following prudential norms. The AO also not brought out any facts with regard to the violation of any law and the RBI has passed any order imposing penalty or fine on the assessee. The AO has taken a clue from the Notes to Accounts given by the assessee in its financial statements, which states that the assessee has given loans and advances to a single entity in

contravention of RBI guidelines issued to NBFCs. Except this, nothing has been brought on record to indicate that the assessee has incurred an expenditure of Rs.57.79 crores in contravention of RBI guidelines which comes within the ambit of Proviso to section 37(1) of the Act. The AO has not brought any materials against the assessee to prove that the RBI has passed any orders imposing fine or penalty. On the other hand, the assessee has filed enough evidence before the AO to prove that the guidelines issued by the RBI is only advisory in nature and any contravention of such guidelines can be cured by making an application before RBI for condonation of such violations using its powers. Therefore, we are of the considered view that disallowing notional interest on borrowings for the simple reason that the assessee has violated directives issued by RBI without any contrary materials to prove that the assessee has incurred such expenditure for contravention of the provisions of the Act is incorrect. Therefore, we are of the considered view that the AO was erred in disallowing interest expenditure of Rs.57.79 crores u/s 37(1) of the Act. The Ld.CIT(A), after considering relevant submissions, has rightly deleted addition made by the AO. We do not find any error in the order of Ld.CIT(A). Hence, we are inclined to uphold the finding of Ld.CIT(A) and reject ground taken by the revenue.

33. In the result, appeals filed by the assessee are partly allowed, for statistical purpose and the appeals filed by the revenue are partly

allowed.

Order pronounced in the open court on 21st August, 2018.

Sd/-	sd/-
(Mahavir Singh)	(G Manjunatha)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Mumbai, Dt : 21st August, 2018
Pk/-
Copy to :

1. Appellant
2. Respondent
3. CIT(A)
4. CIT
5. DR

/True copy/ By order

Sr.PS, ITAT, Mumbai