

IN THE INCOME TAX APPELLATE TRIBUNAL, DELHI 'F' BENCH,
NEW DELHI (THROUGH VIDEO CONFERENCING)

BEFORE SHRI N.K. BILLAIYA, ACCOUNTANT MEMBER AND
MS. SUCHITRA KAMBLE, JUDICIAL MEMBER

ITA No. 742/DEL/2020
[A.Ys 2016-17]

Red Fort Shahjahan Properties Pvt. Ltd., N-226, LGF,
Greater Kailash-1,
New Delhi - 110048

Vs. ACIT,
Circle - 21(2),
New Delhi

PAN No: AADCR 6247 E

[Appellant]

[Respondent]

Date of Hearing : 17.08.2020
Date of Pronouncement : 20.08.2020

Assessee by : Shri Ajay Vohra, Sr. D.R
Shri Gaurav Jain, Adv.

Revenue by : Shri Jagdish Singh, Sr. D.R

ORDER

PER N.K. BILLAIYA, ACCOUNTANT MEMBER,

This appeal by the assessee is preferred against the order of the Commissioner of Income Tax (Appeals)-7, New Delhi dated 10.01.2020 pertaining to the Assessment Year 2016-17.

2. The solitary grievance of the assessee is that the CIT(A) erred in confirming the addition of Rs.3,84,13,000/-, being notional interest income, computed @17.95% on loan of Rs.21.40 crores advanced to group concern M/s. Red Fort Akbar Properties Pvt. Ltd.

3. The representative of both the sides were heard at length, the case records carefully perused and with the assistance of the Learned Counsel, we have considered the relevant documentary evidences brought on record in the light of Rule 18(6) of ITAT Rules. Judicial decisions duly considered.

4. Roots of the quarrel lie in the Financial Year 2012-13 relevant to Assessment Year 2013-14. In that year vide loan agreement dated 14.02.2013 appellant advanced a sum of Rs.21.40 crores to Red Fort Akbar, which was a Special Purpose Vehicle (SPV) promoted to acquire and construct a residential housing project on a land parcel at Hyderabad from one, Deccan Infrastructure and Land Holdings Ltd. jointly owned by the A.P Housing Board and the A.P Government. The tenure of the loan was agreed to be for 2 years with interest to be charged at the prevailing prime lending rate as on the date of payment of interest, increased by 3.5% to be charged annually by the appellant. In the financial year 2012-13 relevant to 2013-14, the appellant

recognized interest income of Rs.48.41 lakhs, which was computed @17.95% p.a., for the period of advance which was 46 days falling in that year.

5. Subsequently, it came to the knowledge of Red Fort Akbar that there was an ongoing civil suit filed by the original owners of the land disputing the title of A.P. Housing Board/ Deccan. As a consequence, since Red Fort Akbar could not enter into development agreement with Deccan, it put on hold further development of the land.

6. In view of the legal stalemate in the civil suit and failure of Deccan to provide un-encumbered rights in the land, Red Fort Akbar requested Deccan to refund the entire amount of advance alongwith interest thereon. Deccan proposed an option to settle the sum due to Red Fort Akbar through offer of an alternate plot of land of 10 acres under a public auction. Since Red Fort Akbar had already exhausted all its funds, moneys to the extent of Rs.21.40 crores were borrowed by Red Fort Akbar from the appellant.

7. However, once again Deccan did not effectuate the sale of the alternate land as a result, even the new project could not commence.

8. In view of the ongoing dispute between Deccan and Red Fort Akbar and there being remote chances of recovery of the principal amount of the advance as also interest thereon, the appellant and Red Fort Akbar mutually agreed from time to time to defer payment of interest on sum advanced to Red Fort Akbar. These agreements and the amended agreements and the agreement in respect of interest waiver are exhibited at Pages 55 to 81 of the paper book.

9. In terms of these agreements, the parties deferred the right to collect interest at the end of the revised tenure. However, finally during the F.Y 2018-19 relevant to A.Y 2019-20, taking into consideration the long drawn litigation between Red Fort Akbar and Deccan and the remote chances of recovery of the said amount, management of the appellant company vide Board resolution dated 29.09.2018 decided to write off the principal sum advanced as bad debt.

10. The lower authorities had failed to appreciate the factual matrix discussed hereinabove and made the additions of notional interest income on the ground that the same accrued to the appellant under the mercantile system of accounting. Moreover the CIT(A) upheld the order of AO relying upon the directions of DRP dated 06.09.2018 in

appellant's own case for A.Y. 2014-15. It would be pertinent to mention here that in the appeal for A.Y. 2014-15, the Tribunal vide order dated 14.06.2019 set aside the matter for fresh adjudication by the AO after taking complete note of facts.

11. Before us, the Counsel for the assessee drew our attention to Accounting Standard - 9 ("AS-9") on "Revenue Recognition" which is as under:

"9. Effect of Uncertainties on Revenue Recognition

9.1 Recognition of revenue requires that revenue is measurable and that at the time of sale or the rendering of the service it would not be unreasonable to expect ultimate collection.

9.2 Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g., for escalation of price, export incentives, interest, etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognize revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognized at the time of sale or rendering of service even though payments are made by installments.

.....

9.4 An essential criterion for the recognition of revenue is that the consideration receivable for the sale of goods, the rendering of services or from the use by others of enterprise resources is reasonably determinable. When such consideration is not determinable within reasonable limits, the recognition of revenue is postponed.

9.5 When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised.” (emphasis supplied).”

12. A perusal of the afore mentioned AS-9 showed that in a situation where there is uncertainty regarding realisation of any claim/ receipt including interest, the same is to be recognized only when there is reasonable certainty as regards its ultimate collection.

13. Since there was uncertainty with regard to ultimate collection of interest on the given factual matrix discussed elsewhere the appellant did not accounted for the same in its books of accounts for the relevant previous year, though it is following the mercantile system of accounting. In our considered opinion the addition of notional interest in the circumstances of the present case, not justified under the accrual concept of accounting, having regard to the mandate of the mandatory and binding AS-9.

14. On the earlier date of hearing i.e. 11.06.2020, the Bench asked the DR to call for a remand report from the Assessing Officer on the factual matrix mentioned elsewhere. The DR filed the reply of the AO which reads as under:

This appeal has been filed by the assessee against the Ld.CIT(A)'s order dated 10.01.2020 passed in appeal no.10353/CIT(A)-7/Del/18-19 wherein the Ld.CIT(A) has dismissed the assessee's appeal.

Facts of the Case:

Return of income was filed by assessee company on 17.10.2016 declaring income of Rs.2,92,98,070, and assessment u/s 143(3) of the Act was completed vide order dated 16.12.2018 at total income of Rs.6,77,11,070 after making addition of Rs.3,84,13,000, being notional interest income accrued at 17.95% p.a. on outstanding loan of Rs.21,40,00,000 advanced to group concern, viz., M/s. Red Fort Akbar Properties Pvt. Ltd. ('Red Fort Akbar') in the previous year relevant to AY 2013-14. Against the above, the appellant filed appeal before the Ld. CIT(A), which was dismissed vide order dated 10.01,2020. The assessee company is engaged in the business of development and construction of real estate projects in India.

2. The assessing officer, vide assessment order dated 16.12.2018 passed under section 143(3) of the Act, raised income tax demand of Rs,1,68,91,624. The assessee company paid Rs, 50,68,000/- i.e. 30% of outstanding demand and balance was stayed by Hon'ble ITAT vide order dated 14/02/2020 for a period of six months or disposal of appeal whichever earlier.

3. The case was last heard by Hon'ble ITAT on 11.06.2020, in e-hearing through video conferencing and the case was heard in detail. The Hon'ble ITAT directed to call for a report from the AO, providing comments/observations on the factual matrix of the case. In response, the AO has submitted his report which is reproduced as under:-

(i) With regard to the set aside assessment of A.Y. 2014-15, the AO vide his letter dated 21.07.2020 has submitted as under:

"GOVERNMENT OF INDIA
MINISTRY OF FINANCE
INCOME TAX DEPARTMENT
OFFICE OF THE DEPUTY COMMISSIONER OF INCOME TAX
CIRCLE 21(1), DELHI

To,

The Sr. Departmental Representative
F-Bench, ITAT, New Delhi, Delhi India

Dated: 21/07/2020	DIN & Letter No : ITBA/COM/F/17/2020-21/1027546701(1)
----------------------	--

Sir/ Madam/ M/s.

Subject: Appeal in the case of M/s Red Fort Shahjahan Properties Ltd. in ITA No. 742/Del/2020
for the A.Y. 2016-17-reg

Kindly refer to your office letter F. No. Sr. DR/F-Bench/ITAT/2020-21 dated 29.06.2020 on the above mentioned subject.

In this regards it is submitted that the order of Hon'ble ITAT for the above mentioned assessee company for A.Y. 2014-15 was received in July, 2019 vide which the issue of TPO and Issue in which addition made by the AO were Set-Aside by the Hon'ble ITAT. The said order has already been forwarded to the TPO for necessary order, the same is pending at the level of TPO. Accordingly, the said order is pending for completion of Set-Aside order. Once the Set-Aside process gets completed, the same will be informed to you for your kind perusal.

KAPIL KUMAR SINGH
CIRCLE 21(1), DELHI

(In case the document is digitally signed please refer
Digital Signature at the bottom of the page)

Note: If digitally signed, the date of digital signature may be taken as date of document.
C R BUILDING, TPO, 1P ESTATE, NEW DELHI, DELHI, Delhi, 110002
Email: DELHI.DCT21.I@INCOMETAX.GOV.IN,
* DIN-Document identification No.

This document is digitally signed

Signer: KAPIL KUMAR SINGH
Date: 21 July 2020 12:53
Location: DELHI, India

ii. comments on factual matrix as called for by Hon'ble ITAT has been furnished by the AO vide his letter dated 11.08.2020 as under:



OFFICE OF THE
DEPUTY COMMISSIONER OF INCOME TAX,
CIRCLE-21(1), ROOM No.202B, 2ND FLOOR, C.R.BUILDING,
I.P. ESTATE, NEW DELHI-110002.

PH: 011-23379551, Email Id: delhi.dclt21.1@incometax.gov.in
F. No.: DCIT/Circle 21(1)/ITAT/20120-21/ Dated: 11/08/2020

To

The Addl. Commissioner of Income Tax
Sr. DR, F-Bench, ITAT,
Income Tax Appellate Tribunal,
Lok Nayak Bhawan, Khan Market
New Delhi-110003.

Sir/Madam,

Sub:-Appeal in the case of Red Fort Shahjahan Properties Pvt.Ltd.
A.Y.2016-17-Submission of comments on supplementary synopsis -
Reg.

Ref: Mail from Addl.CIT,SR.DR, F-Bench, ITAT,dated:06/08/2020.

Kindly refer to the above subject.

In this connection, the submission of the comments on supplementary synopsis of the above mentioned case is as under:-

The reply of the assessee company has been duly considered but not found to be tenable as due to the principle of consistency the assessee company ought to charge the interest from the loan extended by it to Red Fort Akbar properties as it had been doing in the earlier years. Moreover, the 'business prudence' in this case stands questioned as no prudent company would leave its funds parked in a non-profitable company and that too without earning any interest income on the same. The assessee company would have rather used those funds in its own business or at least keep the funds in bank and earn some nominal interest on the same.

Moreover, the company's accounts are maintained on actual basis and thus, even when Red Fort Akbar was facing liquidity crisis, the assessee company could have charged the same from the same from them on accrual basis and could have realized the same once the liquidity position of the borrower company was restored. Thus, it could have deferred the collection of interest instead of waiving it off altogether.

In the assessee's own case for the A.Y.2014-15, the then AO disallowed the interest expenditure @9% incurred by it during the F.Y.2013-14 u/s 36(1)(iii) on the ground that it had diverted interest bearing funds to associate concern for non-business purposes on interest free basis. The same was

referred to the Hon'ble DRP by the assessee company. It is worth quoting here the observations made by the Hon'ble DRP vide its directions u/s 144C(5) of the Income Tax Act, 1961 dated 06.03.2018 which is highly relevant here:-

"vi. On one hand the assessee in the TP grounds is claiming that it is operating in a high risk sector, the real estate sector was in a slump during the assessment year, the borrowing rate was 17 to 18% p.a. On the other hand, the assessee decided not to charge interest from another AE (because of its financial position). Interest of Rs. 48 Lakhs was charged in the AY2013-14 from the same AE. It is not known as to what was the rate of interest charged. Even if the financial condition of the borrower AE was not strong, generally the interest accrues to the lender even if it is not paid during the year.... It would be fair to verify the rate at which interest was charged from Red fort Akbar 2013-14 and apply the same rate to make the disallowance for A.Y.2014-15."

Relying on the direction of the Hon'ble DRP for the earlier Assessment year in the assessee's own case and the stand taken by the then AO along with the independent analysis conducted for this A.Y., it is held that the assessee company was required to recognize interest income accrued to it in the F.Y. 2015-16 from the loan given to M/s Red Fort Akbar Properties Pvt. Ltd, since the assessee company has been following the 'Mercantile' method of accounting as per which income is recognized when it accrues irrespective of actual receipt of the same. Furthermore, perusal of audited accounts of the assessee company for the A.Y. 2013-14 reveals that the assessee company credited interest Income of Rs.4,41,090/- in Profit and Loss Account, which had been charged on loan extended to Red Fort Akbar Properties Pvt. Ltd. for the period of 46 days at the rate of 17.95% as mentioned above and the Note No.16-'Other Current assets' forming part of the audited balance sheet for the A.Y.2013-14 reflects that the said amount i.e. interest of Rs.48,41,090/- was accrued on advances given by the assessee. There has been no deviation in the method of accounting employed by the assessee in the F.Y. 2015-16 relevant to the A.Y. 2016-17. Therefore, the assessee company cannot treat the same income differently in two assessment years as it has to abide by the principle of consistency, thus, it has to recognize the interest accrued on the loan given to M/s Red Fort Akbar Properties Pvt. Ltd. in the A.Y.2016-17.

Submitted for your kind perusal.


Encl: As above

Yours faithfully,

(Kapil Kumar Singh)
Dy. Commissioner of Income Tax
Circle 21(1), New Delhi

Copy to:

1. The Addl. Commissioner of Income Tax, Range-21, New Delhi for kind information.


Dy. Commissioner of Income Tax
Circle 21(1), New Delhi

Findings of Ld. CIT(A)

The Ld.CIT(A) while dismissing the appeal of the assessee company has observed as under:-

“Following the directions of the Hon’ble DRP, the then AO had added the accrued interest at the rate of 17.95% of the loan amount i.e. Rs.21,40,00,000/- being the rate of interest earned by the assessee company on this loan from the borrower AE during the F.Y 2012-13. Therefore, under these facts and circumstances, the assessee company was required to recognized interest income accrued to it in the F.Y 2015-16 from the loan given to M/s. Red Fort Akbar properties Pvt. Ltd. since the assessee company has been following the ‘Mercantile method’ of accounting, as per which income is recognized when it accrues irrespective of actual receipt of the same. Since there has been no deviation in the method of accounting employed by the assessee in the F.Y 2015-16 relevant to the A.Y 2016-17. Therefore, the assessee company cannot treat the same income differently in two assessment years as it has to abide by the principle of consistency. Thus, it has to recognize the interest accrued on the loan given to M/s. Red Fort Akbar Properties Pvt. Ltd, in the A.Y 2016-17. The action of the appellant company is not found to be on arm’s length.

Therefore, considering the facts and circumstances of the case, I do not find any reason to interfere with the findings of the AO and accordingly, the rate of interest to be charged on loan of Rs.21,40,00,000/- given by the assessee company to M/s Red Fort Akbar properties Pvt. Ltd. is to be taken at 17.95% and the interest income accrued to the assessee for the assessment year under consideration is calculated at an amount of Rs.3,84,13,000/-. Accordingly, the action of the AO is hereby confirmed.”

Revenue’s point of view:

It is humbly submitted that the revenue (respondent) fully support the order of Ld CIT(A) as well as of AO on the issue taken in appeal. The AO's report on factual matrix as ruled for

by the Hon'ble ITAT on last hearing has been submitted forgoing paragraphs which may kindly be considered."

15. A perusal of the afore mentioned reply of the DR along with the report of the AO show that instead of examining factual matrix which we have discussed elsewhere, the AO has simply relied upon the findings given in A.Y. 2014-15 without realizing that the Tribunal has set aside the assessment to the files of the AO.

16. In our considered opinion where the principle amount of loan/ advance is doubtful of recovery interest thereon cannot be accrued and added to income even under the mercantile system of accounting. Our view is fortified from the decision of the Hon'ble Madras High Court in the case of **CIT v. Motor Credit Co. P. Ltd.: 127 ITR 572**, wherein the Hon'ble High Court observed as under:

".....

Where no income has resulted, it cannot be said that income has accrued merely on the ground that the assessee has been following the mercantile system of accounting. Even if the assessee makes a debit entry to that effect, still no income can be said to have accrued to the assessee. If no income has materialised there can be no liability to tax a hypothetical income. It is not the hypothetical accrual of income based on the mercantile system of accounting followed by the assessee that has to be taken into account but, what should be considered is, whether the income has really materialised or resulted to the assessee. The question whether real income has materialised to the assessee has to be considered with reference to commercial and business realities of the situation in which the assessee has been placed and not with reference to the system of accounting. In the present case, in the

routes in which the buses of the two firms, M/s P. N. Swamy Naidu & Co. and M/s Prakash Transports, were playing were taken over by the Cheran Transport Corporation Ltd. It is on account of the taking over the routes by the Cheran Transport Cooperation Ltd., that the two firms defaulted in making the payment of the hire-purchase instalments and this has led to the seizure of the buses by the assessee. The legal opinion taken by the assessee also indicated that there was no prospect of any recovery of the amount lent to these two firms by initiating legal proceeding against them. When the facts and the circumstances of the case clearly indicated that there is not even the remotest possibility of any interest income materialising in favour of the assessee in respect of the outstanding for the accounting year relevant to the assessment year in question, no liability to tax can be imposed on the ground that interest has accrued because of the mercantile system of accounting employed by the assessee. The mercantile system of accounting can be only relevant only to determine the point of time at which tax liability is attracted and it cannot be relied on to determine whether income has, in fact, resulted or materialised in favour of the assessee merely because the assessee has been maintaining his accounts on the basis of mercantile system of accounting, the interest income on the outstanding in the two firms cannot be held to have accrued at the end of the accounting year. Viewed against the background of commercial business realities of the situation in which the assessee was placed, the Tribunal came to the conclusion that it would be very unrealistic on the part of the assessee to take credit for a highly illusory interest.

.....(emphasis supplied)

17. The revenue's SLP was dismissed by the Hon'ble Supreme Court vide SLP (Civil) No. 2806 of 1981. A similar view was taken by the Hon'ble High Court of Punjab and Haryana in the case of CIT v. Ferozepur Finance (P) Ltd.: 124 ITR 619.

18. The Hon'ble High Court of Delhi in the case of **CIT v. Goyal M.G. Gases (P) Ltd.:** 303 ITR 159 has held that when the when the realization of even the principal amount of loan was in jeopardy, there could not be any real accrual of income by way of interest, even as per the mercantile system of accounting. The relevant findings of the Hon'ble High Court are as under:

"10. The principle that the Supreme Court applied was that even if the accounts are maintained in the mercantile system, what has to be seen is whether income can be said to have really accrued to the assessee. In support of this principle, reliance was placed upon *Commissioner of Income-tax v. Birla Gwalior (P) Ltd.*, [1973] 89 ITR 255 which approved the view taken by the Bombay High Court in *H.M. Kashiparekh and Co. Ltd. v. Commissioner of Income-tax*, [1960] 39 ITR 706, *Morvi Industries Ltd. v. Commissioner of Income-tax*, [1971] 82 ITR 835 as well as *Poona Electric Supply Co. Ltd. v. Commissioner of Income-tax*, [1965] 57 ITR 521. In the penultimate paragraph of the judgment, the Supreme Court held as follows:-

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

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

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

12. The appeal is dismissed.”

19. Considering the facts in totality in the light of the judicial decision discussed hereinabove, we are of the considered view that on given set of facts there is no accrual of interest even though the assessee's following the mercantile system of accounting and the charge of notional interest by the AO/ CIT(A) is bad on facts and deserves to be deleted. We direct accordingly.

20. In the result, appeal of the assessee is allowed.

The order is pronounced in the open court on 20.08.2020.

Sd/-
[SUCHITRA KAMBLE]
JUDICIAL MEMBER

Sd/-
[N.K. BILLAIYA]
ACCOUNTANT MEMBER

Dated: 20th August, 2020

*Priti Yadav, Sr. PS**

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT

4. CIT(A)
5. DR

Asst. Registrar,
ITAT, New Delhi