IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "D" MUMBAI

BEFORE SHRI M. BALAGANESH (ACCOUNTANT MEMBER) AND
SHRI PAVAN KUMAR GADALE (JUDICIAL MEMBER)

ITA No. 802/MUM/2020
Assessment Year: 2014-15

DCIT, Circle-3(3)(1), Room No. 609, 6th floor, Aayakar Bhavan, M.K. Road, Mumbai-400020. **Appellant**	**Vs.**	M/s Ravi Dyeware Company P. Ltd., 121, Atlanta, V.S. Marg, Nariman Point, Mumbai-400021. **PAN No. AAACR4665 F** **Respondent**

Revenue by	:	Mr. Prabhat Kumar Gupta, DR
Assessee by	:	Mr. Prateek Jain, AR
Date of Hearing	:	17/05/2022
Date of pronouncement	:	13/06/2022

ORDER

Per PavanKumarGadale JM;

The Revenue has filed an appeal against the order of Commissioner of Income Tax (Appeals)-8, Mumbai [in short 'the Ld. CIT(A)'] passed u/s 143(3) and 250 of the Income Tax Act, 1961 (in short 'the Act'). The Revenue has raised following grounds:

i. *Whether on the facts and circumstances of the case and in law, the Ld. CIT(A) was right in deleting the addition of Rs.1,92,96,068/- holding that the assessee company has not received the interest income for the year under consideration when as per Form 26AS the parties have deducted tax on the interest accrued to the assessee.*

ii. *Whether on the facts and circumstances of the case and in law, the Ld. CIT(A) was right in deleting the addition of Rs1,92,96,068/- holding that the parties have not paid even a single penny to the assessee on account of either interest or principal without appreciating that the assessee has neither demonstrated to have made any sincere effort to collect the demand nor initiated any legal action against the parties who have defaulted the payment of interest as well as principal and additionally when the assessee has not passed any resolution to waive the interest/principal due from the parties?*

iii. *Whether on the facts and circumstances of the case and in law, the Ld. CIT(A) was right in deleting the addition of Rs.1,92,96,068/- by placing reliance on the decision of the Hon'ble Bombay High Court in the case of M/s. Neo Solution Pot. Lid. (387 ITR 667) without appreciating that the facts and the circumstances of the case of the assessce different from the fact of the case of M/s. Neo Solution Pot. Ltd.?*

2. The brief facts of the case are that, the assessee company is engaged in the business of manufacturing, trading and export of dyes & dyes intermediate & other goods. The assessee has filed the return of income electronically for the A.Y. 2014-15 with a total income of Rs.12,50,76,010/- and book profits u/s 115JB of the Act is computed. Subsequently, the case was selected for scrutiny and notice u/s 143(2) and 142(1) of the Act along with questionnaire was issued. In compliance, the Ld. AR of the assessee appeared from time to time and submitted the details and the case was discussed. The Assessing Officer on perusal of the financial statements found that the assessee has given donation for scientific Research and claimed deduction u/s 35(1)(ii)of the Act in the computation of the income. The Assessing Officer was not convinced with the nature of the donation for scientific research and disallowed the claim. The Assessing Officer(A.O.) on perusal of Form no 26AS found that the assessee-company has received Rs.53,93,668/- from M/s Kamla Corporate Park and Rs.1,39,76,380/- from M/s Kamla Shanti

Landmark Property Pvt. Ltd as interest on Loan and both the parties have deducted TDS.

3. The assessee has not recorded income in the books of account and the A.O. has issued notice u/s 142(1) of the Act. In response to the notice, the assessee has filed a letter dated 24.11.2016 explaining that the assessee-company has provided loans and advances of Rs.2,50,00,000/- to M/s Kamla Corporate Park and Rs.6,05,00,000/- to M/s Kamla Shanti Landmark Properties Pvt. Ltd. in the financial year 2007-08 relevant to assessment year 2008-09. Whereas the assessee has neither received any interest or repayment of principal till date. The assessee tried to collect dues from borrowers after making several efforts and the amounts are still outstanding receivable. Whereas the assessee in the earlier years has considered the interest income in the books of account and paid taxes. But no actual income has been received or realized. The recipient has deposited only TDS on interest with the Government and there is no actual realization of interest and the

said income is not the real income and there is no certainty of receipt of income/interest but has to taxed only as notional income. Therefore the assessee company has not considered the interest income in the books of account and filed the return of income. Whereas the Assessing Officer was not satisfied with the explanations and made addition as under :

> *"6.3. The above explanation of the assessee has been considered, however, the same is not acceptable because of the following reasons;*
>
> i. *The assessee is following mercantile system of accounting and it has admitted that it has given loans & advances to above two parties and interest is due from the parties, however, the same is not being paid by the parties. Therefore, once the interest is accrued, same should be first credited to the Profit & Loss Account and offered to tax, irrespective of the status of receipt.*
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> ii. *Assessee has not produced even a single piece of paper to demonstrate that it had tried to recover the debt and interest and the party is not paying.*
>
> iii. *No legal proceedings have been initiated by the assessee to recover the dues from from both the parties, even a on today i.e., 09.12.2016.*
>
> iv. *Assessee has not made any provision in the books of accounts for doubtful advances or interest. Assessee is merely saying that it is doubtful, however, even after completion of two*

years from the end of F,Y.2013-14, no provision has been made, as confirmed by the AR of the assessee and evidenced from the ITR and balance sheet filed with the Department along with ITR.

v. Till last year, the assessee was recognizing income from interest on these loans and advances and as mentioned above no provision has been made, assessee arbitrarily and suo moto decided and not shown interest income in the current year.

6.4 Hence, assessee's action in not recording said interest, accrued to it, from above two parties, for the reason that the same is not collectible from the party, is not acceptable under the mercantile system of accounting followed by it. Therefore, the amount of Rs.1,92,96,068 (Rs. 53,19,688 from M/s.Kamla Corporate Park and Rs.1,39,76,380 M/s.Kamla Shanti Landmark Property Pvt. Ltd.) is hereby added to the total income of the assessee company. Penalty proceedings u/s.271(1)(c) of the Income Tax Act, 1961 are initiated separately for furnishing inaccurate particulars of income and/or concealment of particulars of income."

4. The Assessing Officer find that the assessee has received dividend income of Rs.6,36,452/- and claimed exempt u/s 10(34) of the Act and no disallowance of expenses attributable to earning the exempt income was made by the assessee. Therefore the A.O. has worked out the disallowance u/s 14A r.w.r 8D of I T Rules of Rs.1,91,915/- and assessed the total income of Rs.14,46,18,990/- and passed u/s 143(3) of the Act dated 19.12.2016.

5. Aggrieved by the order, the assessee has filed an appeal before the Ld. CIT(A). On the disputed issue in respect of the Assessing Officer treating the addition of interest as real income based on the Form 26AS. The Ld. CIT(A) has considered the grounds of appeal, findings of the scrutiny assessment and submissions of the assessee and relied on the facts and judicial decisions and allowed the grounds of appeal of the assessee.

6. Aggrieved by the order of the Ld. CIT(A), the Revenue has filed an appeal before the Hon'ble Tribunal. At the time of hearing, the Ld. DR submitted that the Ld. CIT(A) has erred in deleting the addition holding that the assessee has not received the real income though it was reflected in the Form no. 26AS. Further the Ld. DR submitted that the assessee has not offered the income in the books of account and referred to Para 6.1. to 6.2 of the assessment order and prayed for allowing the Revenue's appeal.

7. Contra, the Ld. AR submitted that the asesssee company has been offering the interest income on accrual basis from the assessment year 2009-10 and there is no actual realization of interest The assessee considering the facts of non recovery of the interest and principal, has not offered the interest income in the books of account. The TDS was deducted in the current year after filing the return of income and the Ld.AR supported the order of the CIT(A) and prayed for dismissal of the appeal.

8. We have heard the rival submissions and perused the material on record. The sole crux of the disputed issue as envisaged Ld. DR, that the Ld. CIT(A) has erred in deleting the addition of interest income, which has accrued on mercantile accounting system and is reflected in Form 26AS. We find that the assessee has provided loans referred in assessment order at page 4 Para 6.2, in the financial year 2007-08 and the Ld.AR submitted that the assessee has been offering the income in the earlier years on accrual basis though no real income has realized and it was accumulated along

with the principal loan amount. In the current assessment year, no interest has been received for earlier years or current year and dispute arise between the parties and the recovery of the principle and interest became doubtful and bad. Hence the assessee has not accounted the interest income on accural in the books of account. The Ld. AR submitted that the parties have deducted TDS after filing the return of income for the assessment year 2014-15 and the same was not reflected at the time of filing return of income u/s 139(1) of the Act. At this juncture, we considered it appropriate to refer to the observations of the CIT(A) deleting the addition of interest at page 8 Para3.1.2 to 3.1.6 of the order read as under :

> *"3.1.2 This ground of appeal pertains to adeltion of Rs.1,92,96,008/- (Rs.53,19,688/. from M/s Kama Corporate Park and Re. 1,39,76,380/- from M/s kamla Shanti Landmark Property Put Lid) as accrued interest on loans advanced to the parties mentioned above. The AO observed from the Form No 26AS that the assessee company had received Rs.53.19.688/- and Rs.1,39,76,380/- from M/s Kamla Corporate Park and M/s kamla Shanti Landmarc Property Pt Ltd respectively during the year under consideration and TDS was also deducted by the above parties. However, the assessee had not offered the said income to tax in its return of income. In response, the assessee stated that it had given loans and advances of Rs.2.5 crores to M/s Kamla*

Corporate Park and Rs.6.05 crores to M/s kamla Shanti Landmark Property Pvt in F.Y.2007-08. But, it had neither received any interest nor any repayment of principal till date.

3.1.3 In fact, it was further stated by the assessee that it had indeed offered the interest income in the previous years and paid taxes on the same. However, there was no actual amount received from those parties. So much so that the gross amount of outstanding interest till 31-03-13 was Rs.2,22,79,881/- and Rs 6,49,77,591/- respectively from M/s Kamla Corporate Park and M/s Kamla Shanti Landmark Property Pvt. Ltd. Despite various efforts, it has not been able to recover any interest or principal actually at all from the aforesaid parties so far. So much so that the same are now absolutely doubtful to recover. Hence, it has not booked the income in this A.Y. The AO, however, rejected the explanation and stated that the assessee is following the mercantile method of accounts and the income should be offered even if it is not actually received by the assessee. Accordingly, he made addition of Rs.1,92,96,068/-(Rs.53,19,688/- from M/s Kamla Corporate Park and Rs.1,39,76,380/- from M/s kamla Shanti Landmarc Property Pvt Ltd) as interest accrued.

3.1.4 During the appellate proceedings, the appellant reiterated the submissions and contentions made before the AO. The appellant also stated that in F.Y.2016-17, it had also filed the police complaint against Jitendra Ramesh Jain and Ketan Shah who were into construction business in the name of Kamla Landmark Group. The said report has been filed on record. It has also written off the interest receivable in A. Y.2018-19 and principal amount in A.Y:2019-20. The loans had become stagnant and no interest was shown as accrued having regard to principle of providence as recognized under the accounting standard prescribed u/s 145A.

3.1.5 I find that the case of the appellant company is covered by the jurisdictional Hon'ble Bombay High Court decision in the case of Neo Solution Put Ltd 387 IT 667 Bombay dated 05.04.2016 in which it is held that notional interest could not be taxed in assessee's hands even if it was following mercantile system of accounting if the interest was not recoverable on account of financial difficulties. The relevant extract of the same is reproduced here as follows;-

"4. In the two assessment years under consideration, the Assessing Officer made addition of Rs. 84 lakhs each being 2% interest on Rs. 42 crores of debentures by Assessment Orders passed under Section 143(3) of the Act. This on the ground that waiver of interest for the six year period (2004 to 2010) by board resolution as produced is not believable.

5. In appeal the Commissioner of Income Tax (Appeals) upheld the orders of the Assessing Officer for both the subject assessment years.

6. On further appeal, the Tribunal by the impugned order takes into account the fact that even in mercantile system of accounting an item would be regarded as accrued income only if there is certainty of receiving it and not when it has been waived. The Tribunal has in the impugned order very succinctly set out the principles to be applied while recovering income in following the mercantile system of accounting:-

that merely because assessee was following mercantile system of accounting, it could not be held that income had accrued to it.

earning of the income, whether actual or notional, has to be seen from the viewpoint of a prudent assessee. If in given facts and circumstances the assessee decides not to charge interest in order to safeguard the principal amount and ensure its recovery, it cannot be said that he has acted in a manner in which no reasonable person can act.

The guidance note on accrual of income on accounting issued by the ICAl lays down that where the ultimate collection with reasonable certainty is lacking, the revenue recognition is to be postponed to the extent of uncertainty involved. In terms of the guidance note, it is appropriate to recognize revenue in such cases only when it becomes reasonably certain that ultimate collection will be made.

Non-recognition of income on the ground that the income had not really accrued as the realisability of the principal outstanding itself was doubtful, is legally correct under the mercantile system of accounting, when the same is in accordance with AS- notified by the Government.

It is one of the fundamental principles of accounting that, as a measure of prudence and following the principle of conservatism, the incomes are not taken into account till the point of time that there is a reasonable degree of certainty of its realization, while all anticipated losses are taken into account as soon as there is a possibility, howsoever uncertain, of such losses being incurred.

The provisions of Section 145(1) are subject to, inter alia, mandate of AS- which also prescribes that 'Accounting policies adopted by an assessee should be such so as to represent a true and fair view of the state of affairs of the business, profession or vocation in the financial statements prepared and presented on the basis of such accounting policies.' In the name of compliance with Section 145(1), it cannot be open to anyone to force adoption of accounting policies which result in a distorted view of the affairs of the business. Therefore, even under the mercantile method of accounting, and, on peculiar facts of instant case, the assessee was justified in following the policy of not recognizing these interest revenues till the point of time when the uncertainty to realize the revenues vanished."

The Tribunal further referred to the fact that the various resolutions which were passed by the company as well as the communication exchanged between the parties would establish on facts that interest has been waived. Further on facts it holds that there is no reason to disbelieve the resolution passed by the Respondent-Assessee waiving interest. The Tribunal further adverted to the fact that subsequently, M/s. Marketing & Brand Solutions (1) Pvt. Ltd. had amalgamated with the Respondent- Assessee which would also establish that the debentures issuing company was in serious financial difficulties which was incidentally a group company of the Respondent. The decision rendered by the Tribunal in the impugned order is a decision on facts by this Court on account or any finding being perverse arbiter.

7. We were informed at the hearing that for the Assessment years prior to A.Y. 2007-08 no addition was sought to be made by the Revenue on account of notional interest.

8. The view taken by the Tribunal in the impugned order is a possible view. In these circumstances, the questions raised for our consideration does not give rise to any substantial question of law.

3.1.6 find that the above decision of Hon'ble Bombay High Court is squarely applicable in the instant case. It is found that the said parties have not paid even a single penny to the appellant on account of either interest or principal. Still, for a long time, the appellant company kept on offering accrued interest. However, nothing actually really was received by way of interest all through the years. As a measure of last resort, it has now stopped offering accrued interest. It is also worth-while to mention over here that it is one thing to disallow from interest paid on account of interest-free advances given and completely another thing to add notional interest on accrual basis. There is no judicial support for such type of addition. Respectfully following the Hon'ble Bombay High Court, the addition of Rs.1,92,96,068/- Rs.53,19,688/- from M/s Kamla Corporate Park and Rs.1,39,76,380/- from M/s kamla Shanti Landmarc Property Pvt Ltd) as accrued interest is hereby deleted. This ground of appeal is hereby allowed."

9. We find the Ld. CIT(A) has relied on the submissions that the assessee has filed the Police complaint in the financial year 2016-17 against the borrowers M/s Kamla Landmarc group and in A.Y. 2018-19 the interest income was written off which was receivable/outstanding from the earlier years in the books of account of the assessee. Similarly principal amount was also written

off in A.Y. 2019-10 as per the Accounting Standards of ICAI. We find that the Ld. CIT(A) has considered the facts, circumstances provisions of law and relied on the ratio of the judicial decisions on the concept of notional income taxability and passed a logical and reason order. Further, the Ld. DR could not controvert observations/ findings of the CIT(A) with any new cogent material or information to take a different view. Accordingly, we do not find any infirmity in the order of Ld. CIT(A) and up hold the same and dismiss the grounds of appeal of the Revenue.

10. In the result, the appeal filed by Revenue is dismissed.

Order pronounced in the open Court on 13/06/2022.

Sd/-	Sd/-
(M. BALAGANESH)) **ACCOUNTANT MEMBER**	**(PAVAN KUMAR GADALE** **JUDICIAL MEMBER**

Mumbai;
Dated: 13/06/2022
Rahul Sharma, Sr. P.S.

Copy of the Order forwarded to :

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

6. Guard file.

BY ORDER,

//True Copy//

(Sr. Private Secretary)
ITAT, Mumbai