THE INCOME TAX APPELLATE TRIBUNAL
"B" Bench, Mumbai
Shri Justice (Retd.) C.V. Bhadang (President) & Shri B.R. Baskaran (AM)

I.T.A. No. 4006/Mum/2018 (A.Y. 2011-12)
I.T.A. No. 4007/Mum/2018 (A.Y. 2012-13)
I.T.A. No. 4008/Mum/2018 (A.Y. 2013-14)
I.T.A. No. 4009/Mum/2018 (A.Y. 2014-15)
I.T.A. No. 4010/Mum/2018 (A.Y. 2015-16)
I.T.A. No. 2037/Mum/2023 (A.Y. 2019-20)

DCIT 3(2)(2)/DCIT 3(2)(1) Room No. 674 6th Floor Aayakar Bhavan M.K. Road Mumbai-400 020.	Vs.	National Bank for Agriculture & Rural Development C-24, G-Block, Bandra Kurla Complex, Bandra Mumbai-400 051.
(Appellant)		(Respondent)

I.T.A. No. 4188/Mum/2018 (A.Y. 2011-12)
I.T.A. No. 4189/Mum/2018 (A.Y. 2012-13)
I.T.A. No. 4190/Mum/2018 (A.Y. 2013-14)
I.T.A. No. 1990/Mum/2023 (A.Y. 2019-20)

National Bank for Agriculture & Rural Development C-24, G-Block, Bandra Kurla Complex, Bandra Mumbai-400 051.	Vs.	DCIT 3(2)(2) Room No. 674 6th Floor Aayakar Bhavan M.K. Road Mumbai-400 020./ CIT-National Faceless Appeal Centre, Delhi
(Appellant)		(Respondent)

PAN : AAACT4020G

Assessee by	Shri Jehangir D. Mistry & Shri Niraj Shah
Department by	Shri S. Srinivasu & Shri Ashok Kumar Ambastha
Date of Hearing	06.02.2024
Date of Pronouncement	02.04.2024

O R D E R

Per B.R.Baskaran (AM) :-

The cross appeals filed by the parties relate to assessment years 2011-12 to 2013-14 and 2019-20. The revenue has filed appeals for assessment years 2014-15 and 2015-16 also. All of them are directed against the orders passed by Ld CIT(A)-10, Mumbai/NFAC, Delhi. Since some of the issues urged in these appeals are identical in nature, they were heard together and are being disposed of by this common order, for the sake of convenience.

2. The assessee is a Government of India undertaking formed as an autonomous body by an Act of Parliament in 1982. It is popularly called as "NABARD". The assessee is engaged in development of agricultural and rural activities throughout the Country. Its business consisted of providing and regulating credit to agricultural and rural areas, providing grants, subsidies and other facilities for the promotion and development of agriculture, small scale industries, cottage and village industries, rural infrastructure, handicrafts and other rural crafts and other allied economic activities in rural areas with a view to promote rural development in an integrated way. Besides the above, the Government of India also appoints the assessee as nodal agency to carry out many of its programs. The assessing officer completed the assessment of all the years under consideration by making certain additions. The appeals filed by the assessee before Ld CIT(A) were partly allowed. Aggrieved by the orders passed by Ld CIT(A), both the parties have filed these appeals on the issues decided against each of them in the years under consideration.

3. We shall first take up the appeals filed by the revenue. In all the six years, following common grounds of appeal are urged by the Revenue:-

a) Whether Ld CIT(A) was justified in allowing interest income attributable to the "Rural Infrastructure Development Fund" as deduction.

b) Whether Ld CIT(A) was justified in allowing interest income attributable to the 'short term cooperative rural credit fund' as deduction (except in AY 2019-20)

The AO noticed that the assessee has claimed "interest expenditure" on amounts held under the name 'Rural Infrastructure Development Fund' (RIDF) and 'Short term Co-operative Rule Credit Fund' (STCRCF) in the liability side of Balance Sheet. It was noticed that the above said interest amount was not actually paid to anyone, but was credited to "Watershed Development Fund" & other such type of funds. The AO noticed that the assessee is not required to pay interest expenditure to anyone in respect of these funds. Accordingly, the AO took the view that the said claim is not allowable as deduction. Accordingly, he disallowed the interest expenditure so claimed against the above said two funds in all the years under consideration, i.e., interest claimed on RIDF is disallowed in all the years and the interest claimed on STCRCF was disallowed in AY 2011-12 to 2015-16.

3.1 Before Ld CIT(A), the assessee explained that these funds like RIDF and STCRCF have been set up by the Government of India (GOI) and it is holding them in fiduciary capacity, on behalf of GOI. It was submitted that the assessee did not segregate these funds into separate account and hence these funds were also used for its business purposes. In this process, the assessee has also earned interest income by using these funds. Accordingly, it was contended that the interest income attributable to those funds cannot be treated as assessee's income. Accordingly, it was submitted that the interest income attributable to those funds have been claimed as interest expenditure. The Ld CIT(A) noticed that he has decided an identical issue in AY 2010-11 in favour of the assessee, wherein he had held that the income related to RIDF does not fall in the definition of income as per section 2(24) of the Act. He further held that taxing RIDF amount would tantamount to taxing the expenditure of GOI since the entire amount is dedicated fund meant for spending on certain priority sector development projects like WDF

etc. Accordingly, the Ld CIT(A) deleted the disallowance of interest expenditure so made by the AO in all the six years. The revenue is aggrieved.

3.2 We heard the parties on this issue and perused the record. It was brought to our notice that the co-ordinate bench of Tribunal has considered an identical issue in AY 2010-11 and the Tribunal, vide its order dated 24.08.2022 passed in ITA No. 3650/Mum/2016, has deleted the addition made by the AO. The observations made and the decision taken by the co-ordinate bench in AY 2010-11 are extracted below:-

> "4. The facts relating to both the issues are identical in nature and are being discussed in brief. The assessee claimed a sum of Rs.2872.36 crores as interest expenditure. The AO noticed that the above said amount included a sum of Rs.682.55 crores which has been credited to Tribal Development Fund (TDF) account in the liability side of the Balance Sheet, i.e., the AO noticed that the said sum of Rs.682.55 crores was not payable to any bank or any other person, but the same has been claimed as expenditure. The AO also noticed that the assessee has credited a sum of Rs.4.88 crores to another fund named "Watershed Development Fund".
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> 5. The contention of the assessee was that the above said amounts of Rs.682.55 crores and Rs.4.88 crores do not belong to it. The facts relating to the above said claim are stated in brief. The RBI/GOI had directed all scheduled commercial banks to lend at least 18% of net bank credit to agricultural and rural sector. In order to ensure that the banks earmark minimum amount prescribed by GOI/RBI for giving loans to agricultural and rural sector, a new scheme was announced by GOI, i.e., A fund called "Rural infrastructure development fund" (RIDF) was established by the Honourable Finance Minister of India in his Budget Speech given on 15th March, 1995 and it was announced that the same will be established with in NABARD for giving loans to the various State Governments and State owned corporations for quick completion of on-going process. If any of the banks does not reach the prescribed limit of 18%, then the short fall amount shall be deposited by them to RIDF announced by the Honourable Finance Minister. The maturity period of the deposit will be up to 5 years from the date of each deposit. These funds shall be used by the assessee to give advances to various State Governments and also to "National Rural Road Development Agency" (NRRDA) in order to enable them to carry out various activities in agriculture and rural development.
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> 5.1 The assessee shall grant interest to the banks on the deposits made by it at the rate prescribed by RBI in this behalf. In turn, the assessee would collect interest from State Governments and NRRDA @ 6.50%, which rate has also been fixed by RBI/GOI. It was submitted that, out of the difference between interest received/receivable from State

Governments/NRRDA and interest payable to commercial banks, the assessee is allowed to retain 0.50% as its fees for acting in this manner. The "surplus amount" in excess of the margin of 0.50% was also called as "Relative margin". It was submitted that the assessee has been directed to credit this surplus amount/relative margin to a separate fund called "Tribal Development Fund" (TDF). It was submitted that the above said amount of Rs.682.55 crores represents the surplus amount of relative margin. It is the contention of the assessee that it does not have right over the above said surplus amount or relative margin, as the RIDF amount itself is administered by it as per the directions given by GOI/RBI. Accordingly, the assessee has transferred the surplus amount/relative margin to TDF account by debiting "interest expenses" account. In support this submission, the assessee placed its reliance on various circulars issued by RBI from time to time, which has been tabulated by AO as under in the assessment order:-

Sr. No.	Particulars	Purposes
1	RPCD. No. Plan. 898/04.09.01/2000-01 dated 30 April 2001	The rate of interest payable to the commercial hanks were linked with their shortfall in priority sector lending. For excess/surplus funds remaining with NABARD directions were issued for crediting the same to Watershed Development Fund.
2	RPCD. C.O. Plan. 290/04.09.41/2003-04 dated 06 August 2003	The funding of corpus for RIDF contribution was specified alongwith the rates of interest payable on deposits from commercial hanks, the rates of interest receivable from various Slate Governments and the manner in which the excess/surplus fund lying with NABARD should be dealt with has been elaborated.
3	RPCD. CO. Plan. 159/04.09.42/2004-05 dated 02 August 2004	Similar lines as above.
4	RPCD. CO. Plan. 6068/04.09.45/2006-07 dated 28 December 2006.	Similar lines as above.

5	RPCD. CO .Plan. 7681/04.09.45/2006-07 doled 22 February 2007.	The opening of a separate window with a corpus of Rs. 4,000 crore under RIDF XII for rural roads component of Bharat Nirman Programme - Allocations were elaborated alongwith the interest rates receivable and payable and manner in which the excess funds remaining with NABARD should be dealt with.
6	RPCD. CO .Plan. 3345/04.09.48/2007-08 dated 17 June 2008.	The opening of a separate window under RIDF XIV for rural roads component of Bharat Nirman Programme with a corpus of Rs 4000 crore. Allocations were elaborated alongwith the interest rates receivable and payable and manner in which the excess funds remaining with NABARD should be dealt with.
7	RPCD .C.O. Plan. 1 441/04.09.48/2008-09 dated 25 September 2008	Subsequently, with reference lo 6 above, the interest rate payable lo commercial banks for deposits placed was fixed at flat rate of 6% instead of interest rate linked with the shortfall in the priority sector lending of commercial banks . Further, directions were issued to repay the interest rate differentials to the commercial banks who had placed deposits.
8	RPCD.C.O.PIan. 3113/04.09.49/2009-10 dated 18 September 2009	Similar lines as 5 above.

Accordingly, the assessee submitted that it has acted as a "nodal agency" or as banker to RBI for mobilizing deposits from commercial banks in respect of shortfall in priority sector lending and disbursing the same as loan to State Governments/NRRDA. It was further submitted as under:-

> *"Here we would also like to clarify that the amounts lying in the "Tribal Development Fund" is not NABARD's own money and is the money of RBI spent/require to be spent as per the directions of RBI. To substantiate the same, we invite your attention to the following:-*
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> *a. While computing the Net Worth/Net owned fund of NABARD, the funds lying in Tribal Development Fund are excluded.*
>
> *b. The RBI has at times issued directions to pay back the commercial banks the interest rate differentials on RIDF deposits (i.e.,*

interest payable to commercial banks at flat rate of 6% and not linked with the shortfall in the priority sector lending).

In view of the foregoing, it is submitted and it will be appreciated that—

- *We are merely acting as a Banker/agent of RBI/GOI for mobilization and disbursement of RIDF deposits;*
- *We are entitled to a margin of only 0.5% as fixed/regulated by the RBI/GOI.*
- *The interest rate differential/excess or surplus funds remaining with us is not NABARD's own money and is the money of RBI spent/required to be spent as per the directions of RBI in this regard and*
- *Hence, the excess/surplus funds lying with us credited to Tribal Development Fund (as per the directions of the RBI/GOI) represents funds belonging to the RBI/GOI and the same is not/cannot be treated as forming part of our income."*

With regard to the amount credited to Watershed Development Fund (WDF), it was submitted that the facts are identical in nature except that this fund is generated out of another scheme, viz., Short term Co-operative Rural Credit Funds (STCRC) announced by the Government of India. Under this scheme also, the assessee is entitled to a margin of o.50% only and the surplus amount is transferred to Watershed Development Fund.

6. The AO, however, did not accept the submissions made by the assessee. The AO took the view that the entire surplus amount is income of the assessee and the amount transferred to TDF is only a provision made for future expenses. The view taken by the AO is summarized as under by him in the assessment order:-

"7.23 On the basis of analysis in the para-7 above, the following conclusion emerges:

(a) A sum of Rs.628,55,00,785/- is neither paid nor payable to any commercial bank as interest payment, but this amount is wrongly debited to P&L account for calculation of profit from business.

(b) RBI's direction allowed NABARD to generate income with a precondition that certain part of the income would be utilized in a manner specified by RBI. Thus, RBI had specified conditions only for application of income by NABARD.

(c) This amount has been credited to "Tribal Development Fund", which is according to section 45 of NABARD Act. Tribal Development Fund has been established under section 45 of the NABARD Act which allows transfer of fund to the Tribal Development Fund out of annual profit of NABARD, Thus, any contribution to Tribal Development Fund from the NABARD can only be out of NABARD annual profit. Thus, contribution

amounting to Rs.628,55,00,785/- can only be out of NABARD annual profit not prior to determining the annual profit.

(d) At the time of establishing Tribal Development Fund, contribution from the NABARD was made out of its post-tax profit. Therefore, assessee's stand of debiting the P/L Account for contribution to Tribal Development Fund is incorrect.

(e) Thus, a fund of Rs 628,55,00,785/- have been transferred to Tribal Development Fund without having brought to the ambit of tax

(f) Tribal Development Fund is established & operated by NABARD, substantial portion of Tribal Development Fund was available to NABARD in its common pool of funds and these funds were utilized for NABARD for its own business purposes.

(g) As Tribal Development Fund continues to be treated as assessee's own funds; no income/interest/service-charges have been credited to Tribal Development Fund.

(h) As per the Tribal Development Fund' document, the ownership of Tribal Development Fund' is vested only with NABARD and not with RBI or GOL

(i) The assessee has failed to file any clarification from RBI despite of the repeated opportunities given to them. The assessee could not file any supporting documents which can substantiate assessee's contention that the funds transferred to Tribal Development Fund are actually the RBI's income/RBI's Funds and not the income of NABARD. Further, there has been no clarification from RBI or any supporting evidence from the RBI/assessee to prove that the Tribal Development Fund' is RBI's money which is being held by NABARD on behalf of the RBI.

j) In the absence of any clarification/confirmation from RBI, despite of the repetitive opportunities provided to the assessee; assessee's stand that this is not a real income of NABARD and NABARD is playing a mere a role of Trustee is considered as incorrect. The amount transferred to Tribal Development Fund' was the real income of NABARD, application of which has taken place as per the instructions of RBI.

(k) Tribal Development Fund' remained under effective control of NABARD and no interest has been credited on these funds. A very small amount has been utilized out of these funds for tribal development and most of the funds have been utilized for NABARD's own income generating activities. In effect, the sum transferred to Tribal Development Fund' is like a provision made for expenditure to be incurred for tribal development. Such provision

would not be an allowable expenditure while computing the income of the assessee.

(l) The funds were transferred to TDF only after the close of the F.Y. The funds meant for TDF were effectively available with NABARD for the entire financial year and were only transferred to the TDF A/c. after the close of F.Y. as application of funds. For the entire year NABARD continued to derive benefits from this amount as the same was in its effective operational control and therefore, it requires to be treated as income of NABARD.

m) In nutshell, RBI created a mechanism, by which NABARD is allowed to make certain income; a part of which was to be utilized for NABARD's developmental purposes related to Tribal development. However, NABARD only utilized small portion of this income for Tribal development and remaining was utilized for NABARD's own purposes for generating further income. In substance, the entire amount credited to Tribal development Fund is therefore income of NABARD."

Accordingly, the AO held that the amount transferred to RIDF is only application of income. Accordingly, he assessed the above said sum of Rs.682.55 crores as income of the assessee. The assessee also administered another scheme named "Short term Co-operative Rural Credit fund (STCRC). The excess amount to the tune of Rs.4.88 crores was transferred from this scheme to WDF. On almost identical reasoning, the AO assessed the amount of Rs.4.88 crores as income of the assessee.

7. The Ld CIT(A), however, accepted the submissions of the assessee and held that the impugned amount of Rs.682.55 crores does not fall under the definition of income as per section 2(24) of the Act. He held that the margin of 0.50% retained by the assessee alone shall constitute income of the assessee. Accordingly, he deleted the addition of Rs.682.55 crores made by the assessing officer. On similar reasons, he deleted the addition of Rs.4.88 crores also. The revenue is aggrieved by this decision.

8. The Ld D.R submitted that the assessee is placing reliance on the directions given by RBI with regard to transfer of surplus funds to TDF/WDF. However, the said RBI directions only suggest the manner of utilization of surplus/relative margin and hence it cannot be considered as diversion of income by overriding title. Hence these directions will not determine or bar the taxability of the surplus or relative margin under the Income tax Act. The Ld D.R submitted that the assessee has not kept the funds transferred to TDF account in separate bank account, i.e., it has put the funds in common hotchpots and was freely using them in its regular business activities. Accordingly, the Ld D.R submitted that

the assessee is the owner of the funds and is in actual control of it. Further, section 45 of NABARD Act permits the assessee to create Reserve Funds or any other fund by transferring funds from out of annual profits and also out of any other receipts like gifts, grants, donations or benefaction, which the assessee may receive. Accordingly, the Ld D.R submitted that the TDF & WDF belong to such kinds of reserve funds created by the assessee in terms of sec. 45 of NABARD Act. He submitted that the law is clear that, if there is diversion of funds by overriding title, then the same cannot be assessed as income of recipient, since the legal right over the income is diverted before it reaches the hands of the assessee. However, if the amount is given after acquiring legal right over the income, then it is a case of mere application of income and hence the said income is liable to be assessed in the hands of the assessee. He submitted that, in the present case, the assessee has merely applied or appropriated income for some future purposes and hence the AO as rightly rejected the claims of the assessee holding it as mere appropriation of income. Accordingly, the AO has rightly assessed the impugned amount of Rs.628.55 crores as income of the assessee. The Ld D.R relied upon following case laws in respect of the proposition on diversion of income by overriding title:-

(a) CIT vs. Sunil J Kinerivala (126 Taxman 161)(SC)

(b) CIT vs. Travancore Sugars & Chemicals Ltd. (88 ITR 1)(SC)

(c) CIT vs. Sithaldas Tirathdas (41 ITR 367)(SC)

(d) Provat Kumar Mitter vs. CIT (41 ITR 624)(SC)

9. The Ld A.R, however, submitted that the RIDF/STCRC are schemes framed by the Government of India and it has appointed the assessee as implementing agency. He submitted that, as per the scheme, the scheduled commercial banks would deposit money with the assessee equivalent to the short fall in the priority sector lending and the said money was credited to RIDF account. The assessee is directed to lend this amount to State Governments /NRRDA for carrying out various rural development schemes. The rate of interest to be given to the banks on the deposits made by them and the rate of interest to be collected on the loan given by the assessee are fixed by GOI/RBI. Out of the net surplus between interest collected and interest paid, the assessee is allowed to retain a margin of 0.50% only and the remaining amount has been directed by GOI/RBI to be credited to TDF/WDF account. The Ld A.R further submitted that the assessee is only a nodal agency for implementing the above said scheme of Government of India. As per the directions given by GOI/RBI, it has transferred the surplus fund/relative margin to TDF account and held the said funds as trustee of GOI.

Accordingly, the Ld A.R submitted that the surplus amount or relative margin cannot constitute income in the hands of the assessee. In support of these submissions, the Ld A.R invited our attention to the Budget Speech given by the Finance Minister on 15th March, 1995, wherein the Hon'ble Finance Minister has announced establishment of "Rural Infrastructure Development Fund" within NABARD (the assessee herein). He also invited our attention to the guideline issued by RBI with regard to establishment of TDF/WDF. He further submitted that the Department of Financial Services under Ministry of Finance, vide its letter dated 20th February, 2013 has clarified that the assessee is only a trustee of these funds and interest under these funds do not count as income of the assessee. The Ld A.R accordingly submitted that it is a clear case of diversion of income by overriding title. The Ld A.R placed his reliance on the following case laws:-

(a) CIT vs. New Horizon Sugar Mills (P) Ltd (2000)(244 ITR 738)(Mad), wherein the amount set apart for construction of molasses storage tank as required by Molasses Control Order, which is required to be spent as per the directions of Government was held to be excluded as there is diversion of income at source.

(b) DCIT vs. M/s National Commodity & Derivatives Exchange Ltd (ITA No.1423/Mum/2011 & others dated 09-08-2017, wherein amount transferred to "Investors Protection Fund" as per the guidelines issued by Forward Market Commission was held not to constitute income of the assessee.

(c) CIT vs. Sitaldas Tirathdas (1961)(41 ITR 367)(SC) on the principle of Diversion of income by overriding title.

The Ld A.R also invited our attention to the circular issued by RBI for crediting the surplus amount to TDF and also the directions issued on manner of utilization of amounts so credited to WDF.

10. In the rejoinder, the Ld D.R submitted that the opinion expressed an Under Secretary in Department of Financial services cannot override the provisions of the Act. Hence, his opinion that the assessee is only trustee of funds cannot bind the revenue. The Ld D.R reiterated his earlier contentions.

11. We have heard rival contentions and perused the record. We notice that the Finance Minister, in pursuance of policy of the Government of India to promote investment in agricultural sector/rural infrastructure

has announced the scheme in his Speech. The relevant portion of announcement is extracted below:-

> "12. Inadequacy of public investment in agriculture is today a matter of general concern. This is an area which is the responsibility of the States, but many States have neglected investment in infrastructure for agriculture. There are many rural infrastructure projects, which have started but are lying incomplete for want of resources. They represent a major loss of potential income and employment to rural population. To encourage quicker completion of projects in rural infrastructure, I propose to establish a new Rural Infrastructural Development Fund within the National Bank for Agriculture and Rural Development (NABARD) from April, 1995. The fund will provide loans to State Governments and State owned Corporations for completing ongoing projects relating to medium and minor irrigation, soil conservation, watershed management and other forms of rural infrastructure. The loans will be on a project specific basis with repayment interest guaranteed by concerned State Government. Priority will be assigned to projects which can be completed within the least time period. Resources for the Fund will come from commercial banks which will be required by Reserve Bank of India (RBI) to contribute an amount equivalent to a bank's shortfall in achieving the priority sector target for agricultural lending, subject to a maximum of 1.5 per cent of the bank's net credit. This is expected to create a corpus of about Rs.2,000 crore for completion of rural infrastructure projects."

We notice that the Government of India has devised a scheme for increasing investment in Agricultural and rural infrastructure projects and accordingly, proposed to establish a new "Rural Infrastructural Development Fund" within NABARD, the assessee herein. It is also stated that the commercial banks shall contribute funds as per the directions given by RBI.

12. The Ld A.R submitted that the RBI has issued circulars in this regard from time to time. In this regard, he invited our attention to Circular No. RPCD. CO. Plan 3113/04.09.49/2009-10 dated September 18, 2009. This circular lists out the rate of interest payable to banks on the deposits contributed by them and also prescribes the rate of interest payable by the State Governments/NRRDA on the loans taken by them out of this fund. Following portions of the circular are relevant here:-

> "7. Further, **the relative margin available to NABARD in excess of 0.5 per cent** in respect of deposits placed by banks in RIDF XV and the separate window under RIDF XV for rural roads component under Bharat Nirman **will be credited to the Tribal Development Fund**."

As per circular dated 30th April, 2021, following instructions was given by RBI:-

"2. As per the announcement made by the Finance Minister in the Budget, the State Governments will be charged interest at 10.50 percent on loans from RIDF – VII. Keeping in view the above interest rate structure, the margin available to NABARD will be in excess of the usual margin of 0.5 percent. It is suggested that the margin in excess of 0.5 percent in this case may be credited to the Watershed Development Fund."

In Circular dated August 6, 2003, it was instructed as under:-

"6. As in the case of RIDF VIII, the relative margin available to NABARD in excess of 0.5 per cent in respect of RIDF IX deposits will be credited to the Watershed Development Fund."

13. We also notice that the assessee has issued guidelines in respect of Watershed Development Fund. In our view, following discussions made in the guidelines are relevant here:-

"II PROGRAM PERSPECTIVES AND APPROACH

1. Genesis

1.1 The Union Finance Minister, in his budget speech for 1999-2000 had announced the creation of a Watershed Development Fund (WDF) with the National Bank for Agriculture and Rural Development (NABARD) with broad objectives of utilization of multiplicity of watershed development programmes into a single national initiative through involvement of village level institutions and PFAs.

1.2 In pursuance thereof WDF has been created in NABARD with a contribution of Rs.100 crore each by MoA, Government of India (GOI) and NABARD."

The Guidelines further lists out the manner of utilization of WDF. The Ld A.R submitted that similar guidelines should be available for TDF also.

14. We notice that the Government of India has devised schemes for promotion of investments in agriculture and rural development. As per the scheme the banks were directed to deposit "shortfall amounts in giving priority sector lending by banks" with the assessee herein, which in turn, would lend the said money to State Governments to carry out various schemes of agriculture and rural development. The net surplus between the interest income and interest expenditure under this scheme was directed to be appropriated as under:-

(a) The assessee herein should take 0.50% as its income.
(b) The excess amount of surplus over and above 0.50% referred above shall be transferred to TDF/WDF.

(c) The funds credited to TDF/WDF should also be used for specified purposes only.

We noticed earlier that WDF was established with the assessee and the initial corpus has been contributed by the MOA, GOI and the assessee. The objective of the schemes is promotion of investment in agriculture and rural development.

15. The AO has taken the view that, since the assessee did not keep the funds pertaining to TDF/WDF in separate bank accounts and used it for its own business purposes, the amount so transferred to these funds would constitute income of the assessee. We notice that the manner of keeping funds is not the criteria for determining whether there is diversion of funds by overriding title. The criteria stated by Hon'ble Supreme Court in the case of CIT vs. Sitaldas Tirathdas (supra) is extracted below:-

> "……. In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as his income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Where by the obligation income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's own income, which has been received and is since applied. **The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable**……"

16. Before us, the Ld A.R placed his reliance on certain case laws in support of his submissions that the assessee cannot be considered to be owner of the income transferred to TDF/WDF. The first case law relied upon the Ld A.R is the decision rendered by Hon'ble Madras High Court in the case of New Horizon Sugar Mills (P) Ltd. In this case, the assessee was carrying on the business of manufacture and sale of sugar. The assessee set apart certain amount for the construction of molasses storage tank. As required by Molasses Control Order, the assessee had no power to spend the amount as per its wishes, but was to be spent as per the directions of Government. Accordingly, the assessee claimed that the amount so set apart should not be treated as income. The Hon'ble Madras High Court noticed that an identical issue was adjudicated by it earlier in the case of CIT vs. Salem Co-operative Sugar Mills Ltd (1998)(229 ITR 285). The relevant discussions made by Hon'ble Madras High court are extracted below:-

> "11. The Tribunal allowed the appeal. On a reference, a Division bench of this Court held that even before collection of the amount as directed by Central Government under the Molasses Control (Amendment) Order, the assessee was directed to keep this amount under a separate account under the head "Molasses storage fund". Though the assessee collected this amount under the statutory obligation, it did not belong to the assessee, but to the molasses storage fund. The assessee could not utilize the amount in the said fund for any other purpose. The fund had to be utilized for the purpose of constructing a storage tank in accordance with the specifications given by the Central Government. If the assessee failed to collect such amount as directed by the Molasses Control (Amendment) Order, the Central Government would construct a molasses storage tank and recoup the construction charges from the assessee. Therefore, there was diversion of title at the source of the income collected under the directions given under the Molasses Control (Amendment) Order. The sum in question was not includible in the assessee's total income.
>
> 12. In the face of the decision in the case of Salem Cooperative Sugar Mills Ltd (supra), it goes without saying that the Tribunal was right in holding that the amount set apart towards molasses storage reserve fund should be excluded from its total income as revenue expenditure. This question is, therefore, answered against the Revenue and in favour of the assessee."

It was brought to our notice that the revenue challenged above said decision rendered by Hon'ble Madras High Court by filing appeal before Hon'ble Supreme Court. However, the appeal of the revenue has been dismissed by the Hon'ble Apex Court following the decision rendered by it in the case of CIT vs. Ambur Co-op Sugar Mills Ltd (2004)(269 ITR 398)(SC). The decision of Hon'ble Supreme Court rendered in the case of New Horizon Sugar Mills (P) Ltd has been reported in (2004)(141 taxman 254)(SC).

17. The Mumbai bench of Tribunal has examined an identical issue in the case of M/s National Commodity Derivatives Exchange Ltd (supra). The assessee herein has collected penalty amounts from its members as per the direction given by Forward Market Commission. The amount so collected as transferred to "Investors Protection Fund". It was held by the Tribunal that the amount so collected and transferred to investor protection fund got diverted at source and consequently it cannot be assessed as the common of the above said assessee.

18. In our view, the above said cases support the claim of the assessee that the amounts transferred to these funds do not belong to it. The assessee has also submitted that the amounts available in TDF/WDF are excluded while computing Net worth/Net owned fund of the assessee.

Hence, the assessee is conscious of the fact that the amounts credited to TDF/WDF do not belong to it.

20. From the facts and circumstances of the case, we notice that

(i) the Government of India has framed the scheme for promotion of investment in Agricultural and Rural sector.

(ii) The scheme has been set up within the assessee herein.

(iii) Initial corpus fund for WDF has been contributed by the assessee, MoA and GOI. The details of contribution made for TDF is not available. Contribution by MoA and GoI by way of corpus to the WDF should mean that the WDF is considered as a separate fund by the GOI within the assessee.

(iv) The GOI/RBI has devised schemes for getting funds for the WDF/TDF. The RBI has given guidelines on receipt of deposit amount from banks, interest to be given thereon, manner of advancing loans to State Governments, the interest to be collected thereon, the manner of utilization of gains arising on such activities.

(v) Most pertinent point to be noted is that the assessee is not allowed to take entire surplus as its income, i.e., the assessee was allowed to take only 0.50% as its income. The excess amount has been directed to be credited to TDF/WDF.

(vi) Guidelines have been issued on the manner of utilization of the funds so credited.

From the foregoing discussions, we are of the view that the assessee has acted as nodal or implementing agency for the schemes framed by GOI. **Hence the amounts transferred to TDF/WDF are diverted at source itself and hence, the same does not belong to the assessee.** Accordingly, the amounts so diverted to TDF/WDF cannot be brought to tax in the hands of the assessee. Accordingly, we affirm the order passed by Ld CIT(A) in respect of amount of Rs.628.55 crores transferred to TDF/WDF. For identical reasons, we uphold the order passed by Ld CIT(A) in respect of amount of Rs.4.88 crores transferred to WDF/STCRC fund."

3.3 It was submitted that there is no change in facts with regard to the two funds mentioned above. In AY 2010-11, it has been held that the amounts transferred to TDF/WDF are diverted at source itself and hence the same does not belong to the assessee. Since the assessee has used those funds also for its business purposes, the income attributable to RIDF/STCRCF,

which is credited to TDF/WDF, does not belong to the assessee. We notice that interest expenditure claimed by the assessee, in reality, is in the nature of claim for exclusion of interest income diverted at source and such a claim made in AY 2010-11 has been allowed by the Tribunal. Accordingly, following the decision rendered in AY 2010-11, we hold that the assessee's claim for deduction of interest expenditure, which is in the nature of interest income attributable to RIDF/STCRCF and diverted at source, is allowable as deduction. Accordingly, we are of the view that there is no infirmity in the order passed by Ld CIT(A) on this issue. Accordingly, we dismiss the grounds raised by the Revenue on this issue in all the years under consideration.

4. The next issue raised by the revenue in assessment years 2014-15 and 2015-16 relates to the disallowance of interest expense claimed in respect of ST RRB Credit Refinance Fund. The AO had disallowed the claim of the assessee on identical reasoning given for disallowing interest relatable to RIDF & STCRCF (funds). The Ld A.R submitted that the facts relating to ST RRB Credit Refinance Fund is identical with the facts relating to RIDF & STCRCF funds, i.e., the assessee is acting as nodal agency only in respect of this fund and holding the same in fiduciary capacity on behalf of Government of India. Accordingly, he submitted that the interest income attributable to the said fund gets diverted at source. Accordingly, the decision rendered in respect of RIDF & STCRCF funds will equally apply to ST RRB Credit Refinance Fund.

4.1 We heard Ld D.R on this issue. It is submitted that the facts relating to ST RRB Credit Refinance Fund are identical with RIDF & STCRCF Funds. We notice from the assessment order passed for AY 2014-15, the assessing officer has also clubbed the RIDF, STCRCF and ST RRB Credit Refinance Fund for making disallowance of interest expenditure claimed by the assessee, i.e., the AO has given identical reasoning for making disallowance for all the three funds. We notice that the Ld CIT(A) has also deleted the

disallowance on the very same reasoning followed by him for giving relief in respect of RIDF & STCRCF.

4.2 In the earlier paragraphs, we have held that the interest income attributable to RIDF and STCRCF funds would get diverted at the source itself. In our view, since the facts are identical, the said reasoning would equally apply to ST RRB Credit Refinance Fund also. Accordingly, following the decision rendered on RIDF & STCRCF, we uphold the order passed by Ld CIT(A) on this issue in AY 2014-15 and 2015-16.

5. The next issue raised by the revenue in A.Y. 2014-15, 2015-16 and 2019-10 relates to the disallowance of expenditure incurred on promotional activities claimed under section 36(1)(xii) of the Act. The assessee has also raised this issue in 2011-12, 2012-13 and 2019-20. We notice that the assessee has raised an alternative contention in AY 2011-12 and 2012-13 that, if the expenditure incurred on promotional activities are not allowed as deduction u/s 36(1)(xii), then the same should be allowed u/s 37(1) of the Act.

5.1 The facts relating to this issue are discussed in brief. The assessee has incurred certain expenditure on promotional activities and claimed the same as deduction u/s 36(1)(xii) of the Act. As per the provisions of sec.36(1)(xii), the deduction under that section is allowable only to *"notified entities"*. The assessee herein was notified from assessment year 2013-14 onwards. The claim of the assessee is that the notification issued by the CBDT u/s 36(1)(xii) would apply retrospectively to earlier years also, even though it was granted with effect from 2013-14 onwards only. Accordingly, the assessee claimed deduction u/s 36(1)(xii) of the Act for AY 2011-12 and 2012-13 also.

5.2 The AO rejected the claim of the assessee on different reasoning in different years.

(a) The AO rejected the above said claim of the assessee in AY 2011-12 and 2012-13 on the reasoning that the assessee herein is not a "notified entity".

(b) In AY 2014-15, the AO disallowed the expenditure on multiple reasons viz.,

(i) the assessee is not a notified entity

(ii) the assessee has incurred promotional expenses out of various funds, viz., Co-operative Development fund, Farm Innovation and Promotion Fund, Producers Organisation Development Fund, Rural Infrastructure Promotion Fund and also incurred on non-farm section measures. The AO noticed that various funds mentioned above have been created by appropriating part of profits from Profit and Loss Appropriation Account. Accordingly, he took the view that the expenditure incurred on promotional activities should have been debited to the respective funds and not to the P & L account.

(iii) these expenses are developmental in nature and hence they are not made wholly and exclusively for the purposes of business.

(c) In 2015-16 and 2019-20, the AO disallowed the expenses for reason no. (ii) mentioned above.

5.3 In the appellate proceedings before Ld CIT(A),

(a) the Ld CIT(A) confirmed the disallowance of promotional expenses made in AY 2011-12 and 2012-13. Hence the assessee is in appeal on this issue in AY 2011-12 and 2012-13.

(b) the Ld CIT(A) directed the AO in AY 2014-15 and 2015-16 to verify the fact relating to notification issued by CBDT notifying the assessee as an eligible assessee for the purposes of sec.36(1)(xii) of the Act and then allow the expenditure. Hence the revenue is in appeal.

(c) In 2019-20, the Ld CIT(A) confirmed disallowance to the extent of Rs.1,69,03,000/- on the reasoning that the amounts transferred to

> "Producers Organisation Development Fund" (PODF) is a case of diversion of income by overriding title and hence the amount of Rs.1,69,03,000/- spent out of the said fund is not allowable as deduction. The Ld CIT(A) deleted the disallowance of remaining amount of Rs.59,72,32,648/-. The assessee is aggrieved by the decision of Ld CIT(A) in partially confirming the disallowance in AY 2019-20 and the revenue is aggrieved by the relief granted by him. Hence, both the parties are in appeal.

We noticed earlier that the assessee has raised an alternative contention before us that the expenditure should be allowed u/s 37(1) of the Act in AY 2011-12 and 2012-13, if the same is not allowed u/s 36(1)(xii) of the Act.

5.4 We heard the parties on this issue. We notice earlier that the assessee was notified as an eligible entity u/s 36(1)(xii) of the Act from AY 2013-14 onwards. Hence, we are of the view that this issue has to be addressed differently for pre-notification years (i.e., assessment years 2011-12 and 2012-13) and "Post-notification" years (i.e., from AY 2013-14 onwards).

5.5 We notice that an identical issue of claim for deduction of expenditure incurred on Promotional activities was examined by the co-ordinate bench of Tribunal in AY 2010-11, i.e, "Pre-notification" period. The claim of the assessee was rejected on the reasoning that the assessee became notified entity with effect from AY 2013-14 only. However, the alternative contention of the assessee that the relevant expenses should be allowed u/s 37(1) of the Act was accepted by the Tribunal and the matter was restored to the file of the AO for examining the alternative contention. The initial order was passed by the Tribunal for AY 2010-11 on 24.8.2022 in ITA No.3344/Mum/2016 and in that order, identical issue was adjudicated. Subsequently, the assessee filed a miscellaneous application pointing out that there are mistakes apparent from record in the order passed on the issue of disallowance of expenses incurred on promotional activities u/s 36(1)(xii) of the Act. It was also pointed out that the Tribunal did not adjudicate the alternative ground raised by the assessee for allowing the claim u/s 37(1) of

the Act. The above said miscellaneous application was numbered as M A No.292/Mum/2022 and the same was disposed of by the Tribunal on 15.6.2023. Hence the decision taken by the Tribunal in AY 2010-11 on this issue, as modified by the M A order, referred above, are extracted below:-

> "27. We heard rival contentions and perused the record. We have also gone through the decision rendered in the above said two cases, which have been in the context of sec.35(2AB) of the Act. Under the provisions of sec.35(2AB), the expenditure incurred in an "in house research and development facility" as approved by the prescribed authority is granted weighted deduction. Under sec.36(1)(xii), the corporation itself should be notified for the purposes of sec.36(1)(xii) of the Act. Hence, while interpreting the provisions of sec.35(2AB) of the Act, the Honourable High Courts have held that the date of approval of scientific research facility is not relevant. On the contrary, for availing deduction u/s 36(1)(xii) of the Act, **the assessee itself should have been notified by the Central Government**. Hence it is a question as to whether the assessee is a notified entity or not. In our view, there is vast difference between approval of a facility and notification of the assessee itself.
>
> 28. The assessee has been notified only subsequently in April, 2014, the copy of which is placed at page 204 of the paper book. Paragraph 2 of the said notification is relevant here:-
>
> > *"2. This notification shall be applicable with effect from Assessment year 2013-14 onwards, relevant to F Y 2012-13 in which the application seeking notification u/s 36(1)(xii) of the Income tax Act, 1961 was filed."*
>
> It can be noticed that the Central Government has notified the assessee from AY 2013-14 onwards, meaning thereby, the assessee was not notified for the year under consideration. It is the contention of the assessee that the above said not notification should be read as applicable to the years prior to AY 2013-14 also. However, the CBDT, being the authority issuing notification, has itself stated that the assessee is recognized u/s 36(1)(xii) of the Act from AY 2013-14 onwards.
>
> 29. In the decisions relied on by the assessee, it was the assessing officer, who had disallowed the claim for non-approval of scientific research facility. Hence it was a question of interpretation of the provisions of sec.35(2AB) of the Act. That is the not the case here. When the notifying authority itself has mentioned that the assessee is being notified from AY 2013-14 onwards, we are of the view that the assessee cannot be deemed to have been notified in the year under consideration, being AY 2010-11. Accordingly, we confirm the disallowance made by the AO.

The order passed in the miscellaneous application is extracted below:-

"8. We heard rival submissions and perused the record. With regard to various submissions made by the assessee, we hold as under:-

(a) With regard to the paragraph 30 of the order passed by the Tribunal, we notice that the Tribunal has made the observation out of context without correctly appreciating the facts, as submitted by the Ld A.R. As contended by him, it is nobody's case that the promotional expenditure claimed by the assessee u/s 36(1)(xii) is attributable to Government's contribution. Accordingly, the observations made in paragraph 30 constitutes mistake apparent from record. Accordingly, we omit paragraph 30 of the order.

(c) With regard to the contention of the Ld A.R that the notification issued u/s 36(1)(xii) shall have retrospective application, we notice that the Tribunal has passed a detailed order and has expressed a view on this issue. Hence the plea of the assessee would result in review of the order so passed by the Tribunal, which is not permitted u/s 254(2) of the Act. Accordingly, we reject this contention of the assessee.

(d) With regard to the alternative contention raised that the said expenditure is allowable u/s 37(1) of the Act, we notice that the Tribunal has not adjudicated the same. Accordingly, following paragraph shall be inserted as paragraph no.30 in the impugned order:-

"30. The assessee has raised an alternative contention that the expenditure claimed u/s 36(1)(xii) of the Act is allowable u/s 37(1) of the Act. Since the AO has not examined this issue under the provisions of sec. 37(1) of the Act, we restore this issue to the file of AO for examining the same."

5.6 Since the facts are identical, following the decision rendered by the Tribunal in AY 2010-11, we reject the contentions of the assessee to allow deduction u/s 36(1)(xii) of the Act in AY 2011-12 and 2012-13, since it was held by the Tribunal in AY 2010-11 that the notification issued by the CBDT recognizing the assessee from AY 2013-14 cannot be applied retrospectively. However, we admit the alternative contentions of the assessee for these two years that the expenditure incurred on promotional activities may be allowed as deduction u/s 37(1) of the Act and restore the same to the file of AO for examining the alternative claim in AY 2011-12 and 2012-13.

5.7 In respect of AY 2014-15 is concerned, we noticed earlier that the AO had disallowed the claim on multiple reasons. The first reasoning is that the assessee is not a notified entity, which was factually incorrect, since the assessee has been notified from AY 2013-14 onwards. This has been addressed by Ld CIT(A) accordingly. However, other reasonings given by the AO were not addressed by Ld CIT(A). The AO has stated that the expenses incurred are developmental in nature and hence they cannot be considered as having been incurred wholly and exclusively for the purposes of business. We notice that the AO has not given any reason or basis for arriving at such a conclusion. We notice that the assessee exists for so many years and the very object of establishing the assessee is for promotion of rural and agricultural development. Further, the provisions of sec.36(1)(xii) specifically allow the promotional expenses. Hence, we are of the view that the promotional expenses should be considered to have been incurred wholly and exclusive for the purposes of its business only. Hence this reasoning also fails.

5.8 The last reasoning given in AY 2014-15 is also given in AY 2015-16 and 2019-20. It is that the promotional expenses are related to various funds created by the assessee and the said funds were created by appropriating profits from the Profit and Loss account of earlier years and hence the promotional expenses should have been debited to the relevant funds and not to the Profit and Loss account. We noticed earlier that, in AY 2019-20, the Ld CIT(A) has confirmed part of disallowance, i.e., the expenditure relatable to "Producers Organisation Development Fund" (PODF) on the reasoning that the assessee is not the owner of PODF and hence the expenditure relating to the same cannot be claimed as deduction by the assessee.

5.9 We heard the parties on this issue. Earlier, we have held that the income attributable to the funds held by the assessee in fiduciary capacity

would get diverted at source. Hence, we are of the view that the said principle should be applied in respect of expenditure also. However, it is possible that various funds might have been set up by combining contributions from assessee and Government. Hence, this issue needs to be examined by following certain principles. In our view, following principles may be followed in examining the claim for deduction of promotional expenses u/s 36(1)(xii) of the Act:-

(a) if a fund has been created entirely out of the funds given by/belonging to the Government and it is held in fiduciary capacity by the assessee, then if the promotional expenditure has been incurred by the assessee out of the said fund *as per the requirement of/direction given by the Government*, then the same cannot be considered as business expenditure of the assessee and accordingly, the same cannot be claimed as deduction by the assessee. This is for the reason that the expenditure has been incurred by the assessee on behalf of the real owner of funds, i.e., GOI. On the contrary, if there is no such requirement/direction, then, in our view, the promotional expenses and the fund cannot be linked together and hence the entire expenses is allowable as deduction u/s 36(1)(xii) of the Act.

(b) if the fund has been created exclusively out of the funds appropriated from the Profit and Loss account of the assessee, then the entire promotional expenses claimed by the assessee is allowable as deduction u/s 36(1)(xii) of the Act. This is for the reason that the entire funds belong to the assessee, even though different names might have been given to various funds, since those funds might have been created for the convenience of the assessee or as per statutory requirements. The question of diversion of funds at source will not arise to these types of funds created by appropriating part of profits of the assessee. In any case, the fact would remain that those funds are used for the purposes of business of the assessee only. Hence, under these set of facts, entire promotional expenses is allowable as deduction u/s 36(1)(xii) of the Act.

(c) if the fund has been created both out of the contributions made by the Government and assessee (either by way of contribution or appropriation of profits), then the promotional expenses attributable to the assessee's contribution is allowable as deduction u/s 36(1)(xii) of the Act. In respect of contribution by Government, the discussion made in clause (a) would apply.

We notice that the facts relating to the relevant funds have not been brought on record. Hence, in our view, this issue requires fresh examination at the end of the AO in the light of principles discussed above. The AO may also examine the claim for deduction u/s 37(1) of the Act, if required. Accordingly, we set aside the order passed by Ld CIT(A) on this issue in AY 2014-15, 2015-16 and 2019-20 and restore the same to the file of AO for examining it afresh in the light of principles discussed above.

6. The last issue urged by the revenue in A.Y. 2012-13, 2013-14 & 2015-16 relates to the disallowance of prior period expenses. The AO noticed in these years that the assessee has claimed in the Profit and Loss account certain expenses categorized as "Prior Period Expenses". Since these expenses, but the name itself, is related to earlier years and do not pertain to the respective current years, the AO disallowed the same on the reasoning that they are not allowable as deduction under Mercantile System of Accounting. The Ld CIT(A) allowed the expenses in AY 2012-13 and 2015-16 following the decision rendered by Mumbai bench of Tribunal in the case of Toyo Engg India Ltd vs. JCIT (2006)(5 SOT 616), wherein it was held that the where the payment of routine expenses gets delayed due to procedural delays and administrative reasons, then the said expense is allowable in the year of payment. In AY 2013-14, the Ld CIT(A) noticed that the Prior period expenses claimed by the assessee included certain expenses that were booked under the head 'work in progress' in the earlier years. The Ld CIT(A) took the view that the deduction is allowable only in respect of revenue expenses, even it is claimed under the head 'Prior period expenses'. Hence the Ld CIT(A) restored the issue to the file of AO with the direction to examine the claim of the assessee and allow those expenses, which are revenue in nature. Accordingly, this ground was partly allowed by Ld CIT(A) in AY 2013-14. The revenue is agitating the decision of Ld CIT(A) in AY 2012-13, 2013-14 and 2015-16. The assessee is aggrieved by the decision of Ld CIT(A) in restoring the issue to the file of AO in AY 2013-14.

6.1 We heard the parties on this issue and perused the record. We notice that the settled proposition is that an expenditure shall be allowable in the year of crystallization of its liability, even though the said expenditure was related to an earlier period. The said expenditure is treated as current year's expenditure in the year of crystallisation and accordingly allowable as deduction in that year. This principle has been recognized by Hon'ble jurisdictional Bombay High Court in the case of CIT vs. Mahanagar Gas Ltd (2014)(42 taxmann.com 40)(Bom), wherein it was observed as under:-

> "(e) We find that the liability in respect of work/services rendered in earlier years was crystallized only on receipt of the bill in the current assessment year. Moreover, the method adopted by the respondent assessees has been accepted by the revenue for the earlier assessment year and also while accounting for the income earned in respect of the work done in earlier years. In the circumstances, the Revenue is required to adopt consistent approach and allow the expenditure which was crystallized during the assessment year under consideration as done in the earlier years. This finding of fact has not been shown to be perverse.
>
> In view of the above, we see no reason to entertain Question B as the does not raise any substantial question of law as it is essentially a finding of fact arrived at by two authorities concurrently."

In the instant case, it is the submission of the assessee that all the relevant expenses, even though titled as "prior period expenses" in the books of account, actually got crystallized during the relevant years under consideration. We notice that the AO has disallowed the expenses only the reasoning that the assessee itself has categorized the expenses as 'Prior period expenses".

6.2 In AY 2013-14, there is one more aspect. The Ld CIT(A) noticed that the assessee has claimed Rs.8,48,31,282/- as revenue expenses under the head "Prior period expenses". The said expenditure pertained to "Non-construction fee" paid to Punjab Development Authority from 2005 to 2013

and it related to construction of staff quarters. The Ld CIT(A) further noticed that the above said amount was booked as "Capital work in progress" in the earlier years and the same has been transferred to "Prior period expense" account during the year relevant to AY 2013-14. The Ld CIT(A) further noticed that the assessee has claimed a sum of Rs.92,29,411/- in respect of expenditure under "UPNRM Fund" as deduction, even though the same was not debited to Profit and Loss account. He also observed that the assessee did not furnish break-up details of Prior Period expenses before him. Hence, the Ld CIT(A) restored the issue to the file of AO in AY 2013-14.

6.3 In our view, the AO was not right in disallowing expenses merely on the reasoning that the same has been booked as "Prior period expense" in the books of account. He should have examined the details of prior period expenses claimed by the assessee in order to find out the year of crystallisation and then should have taken a decision in accordance with the principles discussed above. We also notice that the details of prior period expense were not examined by both the tax authorities and the year of crystallization was also not examined. In the absence of relevant details, it would not be possible for us to adjudicate the matter by applying above said principle. We noticed that, in AY 2013-14, the Ld CIT(A) has pointed out certain other points also and restored the said issue to the file of AO for examination. Accordingly, we are of the view that this issue requires examination in all the three years in accordance with the principles discussed above. Accordingly, we set aside the order passed by Ld CIT(A) on this issue and restore the same to the file of AO in AY 2012-13, 2013-14 and 2015-16 and direct him to determine the allowability of expenses by applying principles discussed above. In addition to the above, the AO shall also examine the claim for deduction of expenses claimed as "Non-construction fee" and "UPNRM Fund" in AY 2013-14. The assessee is also directed to furnish relevant details before the AO. After affording adequate opportunity of

being heard to the assessee, the AO may take appropriate decision in accordance with law.

7. We shall now take up the appeals of the assessee. Following issues urged by the assessee are common to the grounds urged by the revenue. Both these issues have been adjudicated in the earlier paragraphs, while dealing with the grounds of the revenue:-

(a) Disallowance of expenditure incurred on promotional activities u/s 36(1)(xii) of the Act (AY 2011-12, 2012-13 and 2019-20)

(b) Disallowance of Prior year expenses (AY 2013-14)

Hence these issues do not require separate adjudication. Accordingly, we shall adjudicate other issues agitated by the assessee.

8. In AY 2011-12, the assessee is aggrieved by the decision of Ld CIT(A) in confirming the addition relating to service charges, even though it has not accrued to the assessee.

8.1 The AO noticed that the assessee has been accounting for the service charges on receipt basis. While the service charges accrued to the assessee for the period from 1.4.2010 to 31.3.2011 was Rs.5,98,34,164/-, the assessee had declared a sum of Rs.5,87,70,786/- only as its income from service charges 'on receipt' basis. Since the assessee is following mercantile system of accounting, the AO held that the assessee should have declared entire amount accrued to it as its income. Accordingly, the AO added the difference of Rs.10,63,378/- to the total income of the assessee. The Ld CIT(A) also confirmed the addition following the decision rendered by him on an identical issue in AY 2010-11.

8.2 We heard the parties on this issue and perused the record. We notice that the co-ordinate bench has adjudicated an identical issue in AY 2010-11, wherein the Tribunal has accepted the contentions of the assessee that there was no certainty of receipt of service charges income and hence it is required to be accounted for on receipt basis. The co-ordinate bench has also noted the fact that the assessee is following the cash system of accounting for service charges for the past many years. For the sake of convenience, we extract below the decision rendered by the co-ordinate bench in AY 2010-11:-

> "32. We heard the parties on this issue. The ld A.R submitted that the total income declared by the assessee for this year was Rs.1817.68 crores. Further, **the assessee has been following the accounting policy of offering service charges on receipt basis. He submitted that this accounting policy is being followed on the basis of past experiences on account of uncertainty of recovery of service charges**. Considering the amount of total income offered by the assessee and consistent accounting policy followed by the assessee, the Ld A.R prayed for the deletion of this addition. The Ld D.R, on the contrary, supported the order passed by Ld CIT(A).
>
> 33. There is no dispute with regard to the fact that the assessee has been following consistent accounting policy to recognize income by way of Service charges on receipt basis. The assessee submitted that there was uncertainty in recovering service charges. There should not be any dispute that an income can be recognized under mercantile system of accounting also, only if there is certainty of its recovery. Considering the past consistent practice followed by the assessee, we are of the view that this addition is not justified. Accordingly, we set aside the order passed by Ld CIT(A) on this issue and direct the AO to delete this addition."

Since, there is no change in facts on this issue in this year also, consistent with the view taken by the co-ordinate bench in AY 2010-11, we set aside the order passed by Ld CIT(A) on this issue and direct the AO to delete the addition relating to Service charges in AY 2011-12.

9. The next issue urged by the assessee in AY 2011-12, 2012-13 and 2013-14 relates to the rejection its claim for deduction of Education cess, secondary and higher education cess as deduction while computing total income. This claim has been raised for the first time before the Tribunal.

9.1 We notice that the assessee had urged identical claim in AY 2010-11 also before the Tribunal. However, the Tribunal noticed that the Parliament has brought in an amendment through Finance Act, 2022 stating that the Education cess, Secondary and higher education cess is not allowable as deduction and it is specifically stated that the said amendment is retrospective in nature. Accordingly, the co-ordinate bench had rejected the identical claim made in AY 2010-11. Following the same, we reject this ground of the assessee in AY 2011-12, 2012-13 and 2013-14.

10. The last issue urged by the assessee in AY 2011-12, 2012-13 and 2013-14 relates to the disallowance of expenditure incurred out of interest income pertaining to various funds held by the assessee on behalf of GOI.

10.1 The facts relating to this issue are set out in brief. We noticed earlier that the assessee had claimed interest expenditure attributable to funds, such as RIDF, STCRC, ST RRB Credit Refinance Fund etc. The reason given by the assessee is that these funds actually belong to Government of India and it is holding them in fiduciary capacity on behalf of GOI. The interest expenditure so claimed was credited to Watershed Development Fund (WDF), Tribal Development Fund (TDF) etc. In the earlier paragraphs, we had accepted the contentions of the assessee and accordingly held that the interest expenditure claimed by the assessee is actually diversion of interest income attributable to the above said funds at source. Hence the deduction claimed by the assessee was held to be allowable. The assessee has been crediting the interest income attributable to RIDF, STCRC etc., to separate funds like WDF/TDF. It is the submission of the assessee that the GOI will direct the assessee to spend out of WDF/TDF for specific purposes and the assessee shall act according to the said direction. The assessee has also stated that these funds are kept invested in Government Securities.

10.2 For the book purposes, the assessee has followed a particular system of accounting. However, for income tax purposes, it has followed different methodology. The same is explained below:-

(a) In the books of accounts, interest is calculated on these funds following particular methodology (on the basis of mid-month average outstanding balance) and the same is debited to Profit and loss account as expense and credited to these funds. Thus above said interest expenditure was claimed as deduction for book purposes.

(b) However, for computing total income under Income tax Act, the above said interest expenditure was disallowed voluntarily by the assessee.

(c) However, actual expenditure incurred out of these funds as per the direction of GOI is claimed as deduction, which is restricted to the amount of credit available in the interest accrued account, i.e., i.e., opening balance of unutilized interest (+) interest credited during the year. Under this methodology, the deduction towards expenditure claimed will not exceed the actual amount of interest provision credited to these funds.

10.3 The stand taken by the AO in AY 2011-12 is discussed in brief. Even though the assessee has maintained several funds for various projects on behalf of Government of India, the AO initially examined the claim made in WDF. The assessee had debited a sum of Rs.81.25 crores in the Profit and Loss account towards provision of interest expenditure. While computing the total income, the assessee had voluntarily disallowed above said amount and claimed the actual expenditure of Rs.151.25 crores. Subsequently, the AO realized that the assessee was having several such kinds of funds. The aggregate amount of interest expenditure debited to the Profit and Loss account in respect of these funds was Rs.105.90 crores, while the actual expenditure incurred aggregated to Rs.318.13 crores. However, the lower of balance available in "Interest payable account" and the actual expenses incurred in each of the funds was worked out to Rs.211.16 crores. Accordingly, in the computation of income for AY 2011-12, the assessee had disallowed the interest expenditure of RS.105.90 crores and claimed deduction for expenses to the tune of Rs.211.16 crores.

10.4 The AO took the view that the deduction of expenses cannot exceed the amount of interest expenditure debited to the profit and loss account in respect of these funds. Accordingly, he restricted the deduction to the extent of Rs.105.90 crores, being the amount of interest debited to the profit and loss account. Accordingly, the AO disallowed balance amount of expenditure of Rs.105.26 crores (Rs.211.16 crores less Rs.105.90 crores). The Ld CIT(A) upheld the view taken by the AO with the following observations in AY 2011-12:-

> "7.3.1 I have considered the submission of the appellant. The Appellant is formed under The National Bank for Agriculture and Rural Development Act, 1981' ("NABARD Act") for providing and regulating credit and other facilities for the promotion and development of agriculture small-scale industries, cottage and village industries, handicrafts and other rural crafts and other allied economic activities in rural areas with a view to promote integrated rural development and securing prosperity of rural areas, and for matters connected therewith or incidental thereto. To achieve the objects laid down out in the Preamble to NABARD Act, the Appellant is undertaking various promotional and developmental expenditure for strengthening of rural financial institutions, promoting micro finance, watershed development, financial inclusion and similar areas for both farm and non-farm sectors.
>
> 7.3.2 It is observed that the appellants while seeking relief in respect of interest portion on the 'Rural Infrastructure Development Fund'- Rs. 7,90,28,00,077/-; and the interest portion on the 'Short Term Co-operative Rural Credit Fund'- Rs. 75,58,01,304/-, stated to be held/retained by the Appellant on behalf of 'Government of India'/'Reserve Bank of India' has admitted that:
>
> The Appellant is merely acting as a Banker to RBI/GOI for mobilization and disbursement of RIDF deposits;
> The Appellant is entitled to only 0.5% interest as fixed/regulated by the RBI/GOI which has been offered to tax by the Appellant;
>
> The interest rate differential/excess or surplus funds remaining with the Appellant is not its own money and is the money of RBI spent/required to be spent as per the directions of RBI and hence, the excess/surplus funds lying with the Appellant credited to TDF during the year under consideration (as per the directions of the RBI/GOI) represents funds belonging to the RBI/GOI and the same are not/cannot be treated as forming part of Appellant's income.
>
> 7.3.3 The appellant has also brought on record the fact that, the Department of Financial Services (DFS), Ministry of Finance, Government of India vide letter (Ref. No. F. No. 3/9/2013-AC) dated 20 February 2013

addressed to The Chairman, Central Board of Direct Taxes" had pointed out that the development funds, viz. Watershed Development Fund, Micro Finance Development and Equity Inclusion Fund, Co-operative Development Fund, Tribunal Development Fund, Farmers Technology Transfer Fund, Farm Innovation and Promotion Fund and Producers Organization Development Fund have been set up at the instance of the GOI and RBI and are kept in trust with NABARD for specific purpose and hence shall not be taxed in the hands of NABARD.

7.3.4 It is thus apparent from the above facts that the appellant is managing the various funds in its fiduciary capacity only. Therefore, neither the interest credited to the specified funds can be considered as income of the appellant as held in the earlier part of the order, nor, for the identical reasoning, the expenditure incurred from the aforesaid funds are the expenditure incurred by the appellant. Both, the income credited to the aforesaid development funds and the expenditure incurred from these funds, cannot be included in the income and expenditure account of the appellant. Therefore, in my view the AO is justified in restricting the claim of the appellant to the extent of interest debited to the P&L."

Identical view was taken by Ld CIT(A) in all the years. Hence the assessee is aggrieved. According to the assessee, the actual expenditure claimed, which was restricted to the balance in 'Interest accrued account' should be allowed as deduction.

10.5 We heard the parties on this issue and perused the record. The undisputed fact is that all these funds have been created out of the interest expenditure claimed by the assessee in respect of various funds like RIDF, STCRC etc. We have held earlier that, since the assessee had used these funds for its own business purposes, the interest income attributable to these funds shall get diverted at source itself and hence equal amount claimed as interest expenditure by the assessee should be allowed as deduction. Accordingly, we have deleted the disallowance made by the AO. The tax authorities have also accepted the fact that the above said interest income was not paid to anyone, but was credited to various kinds of funds like WDF, TDF etc. Hence these funds also are akin to RIDF, STCRC etc., and these funds also belong to the GOI and do not belong to the assessee.

10.6 It is the submission of the assessee that it is spending money out of these funds as per the direction given by GOI. We noticed earlier that, in respect of various funds like WDF, TDF etc., the assessee has made provision for interest expenses and claimed the same as expenditure in the Profit and Loss account. However, while computing total income for income tax purposes, the above said interest expenditure was disallowed voluntarily. Instead, the lower of the balance standing in "Interest accrued account" and the actual expenditure was claimed as deduction. It was submitted by Ld A.R that the assessee is following the very same system for the past so many years and the AO had accepted this method of accounting in the past as well as in the subsequent years except in AY 2011-12 to 2013-14.

10.7 We notice that the Ld CIT(A) has accepted the fact that these funds are held by the assessee in fiduciary capacity on behalf of GOI. Accordingly, he has held that the interest credited to these funds cannot be considered as income of the assessee. By applying the very same reasoning, the Ld CIT(A) has held that the expenditure claimed by the assessee cannot be considered as expenditure of the assessee.

10.8 The expenditure claimed by the assessee relates to these funds, which have been held by the assessee in fiduciary capacity. Hence the assessee is constrained spend money in respect of these funds as per the directions given by GOI. Hence the Ld CIT(A) has held that these funds are held by the assessee in fiduciary capacity and hence the income and also expenditure relating to these funds are not related to the business activities of the assessee. Accordingly, he has held that, if the income attributable to these funds is excluded, then the expenditure related to these funds cannot be claimed as deduction.

10.9 In our view, the reasoning given by the Ld CIT(A) is correct. When all these funds belong to Government of India and the assessee is holding them

in fiduciary capacity, then the income attributable/arising in these funds cannot be considered as assessee's income. Similarly, the expenditure incurred in respect of these funds cannot be considered as assessee's expenditure. Hence, the assessee should not have impacted its Profit and Loss account with these items. We notice that the assessee has debited its profit and loss account with the interest provision in respect of these funds and had voluntarily disallowed the same while computing total income for income tax purposes, which has resulted in increasing the total income. Hence, the AO has allowed deduction of expenditure equivalent to the interest expenditure so disallowed. In fact, the correct course is to restrict the expenditure to the extent of actual income earned in respect of WDF/TDF etc.

10.9 It was submitted that the expenditure so incurred by the assessee on the direction of GOI is in the nature of "payment of interest expenditure" and the same is allowable as deduction. It was further submitted that the assessee has claimed deduction of the same on "payment basis", even though it is following mercantile system of accounting. It is submitted that the assessee was required to do so, since it was required to comply with the directions of GOI as and when it is given. He further submitted that any excess claim of expenditure would get offset in the subsequent years by way of reduction in such claim. Accordingly, it was submitted the difference in this matter is related to the "year of claim". Accordingly, it was contended that the disallowance should not have been made only for the reason that the claim pertains to another year, so long as there is no change in the rate of tax. In support of this contention, the Ld A.R placed his reliance on the decision rendered by Hon'ble Supreme Court in the case of CIT vs. Excel Industries Ltd (2013)(38 taxmann.com 100)(SC), the decision rendered by Hon'ble Bombay High Court in the case of CIT vs. Nagri Mills Co Ltd (1958)(33 ITR 681) and the decision rendered by the co-ordinate bench of

Mumbai in the case of DCIT vs. Late Shri Kantilal Virchand Shah (ITA No.7017/Mum/2016 dated 12-12-2018.

10.10 We notice that the assessee has stated before Ld CIT(A) that it is investing amounts belonging to WDF, TDF and like funds in Government securities, i.e., it is not using these amounts for its own business. In that case, the question of allocation of interest income on proportionate basis to these funds (as in the case of RIDF, STCRC etc.,) also will not arise. Hence the assessee could not have claimed interest expenditure at all in respect of these funds, since these funds have not been used by the assessee for its own business purposes, but was invested in Government securities. We have held earlier that the income/expenditure pertaining to these funds should be ignored. In nutshell, the income as well as expenses incurred in respect of these funds should not affect the business profits of the assessee. Accordingly, we are of the view that the Ld CIT(A) was justified in upholding the order of the AO on this issue in all the three years.

11. In the result, all the appeals of assessee as well as revenue are partly allowed.

Order pronounced on 02.04.2024.

Sd/-	Sd/-
(Justice (Retd.) C.V. Bhadang)	(B.R. Baskaran)
President	Accountant Member

Mumbai.; Dated : 02/04/2024

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//

(Assistant Registrar)

PS ITAT, Mumbai