IN THE INCOME TAX APPELLATE TRIBUNAL "D" BENCH MUMBAI

BEFORE SHRI SATBEER SINGH GODARA, JUDICIAL MEMBER
AND
SHRI GIRISH AGRAWAL, ACCOUNTANT MEMBER

ITA No.1442/MUM/2024
Assessment Year: 2018-19

Deputy Commissioner of Income Tax, Central Circle – 7(1), Mumbai	Vs.	Rare Enterprises, 151, 15th Floor, Nariman Bhavan, Nariman Point, Mumbai – 400 0021 (PAN : AAEFR8176J)
(Assessee)		**(Respondent)**

Present for:

Assessee : Ms. Purva

Revenue : Smt. Mahita Nair, Sr. DR

Date of Hearing : 11.07.2024
Date of Pronouncement : 27.09.2024

O R D E R

PER GIRISH AGRAWAL, ACCOUNTANT MEMBER:

This appeal filed by the Revenue is against the order of Ld. CIT(A)-49, Mumbai, vide order no. ITBA/APL/S/250/2023-24/1059630932(1), dated 11.01.2024, against the assessment order passed by the Deputy/Assistant Commissioner of Income Tax, Central Circle-7(1), Mumbai, u/s. 143(3) of the Income-tax Act, 1961 (hereinafter referred to as the "Act"), dated 16.04.2021 for Assessment Year 2018-19.

2. The grounds of appeal taken by the Revenue are as under:

1. "On the facts and in circumstances of the case and in Law, the Ld. CIT(A) erred in concluding that the assessee did not receive the interest of Rs 3, 60,00,000/-, without appreciating the fact that neither during the assessment proceedings nor during the appellate proceedings, the assessee could, by producing all its bank statements, establish that it really did not receive the interest of Rs.3,60,00,000/-, which it claimed to have not received."

2. "On the facts and in circumstances of the case and in Law, the Ld. CIT(A) apparently did not consider the fact that the assessee's debtor M/s. Dharti Dredging & Infrastructure Ltd. (DDIL) was classified by State Bank of India as NPA on 30.06.2018, but almost five months after this ie. on 08.11.2018 DDIL paid TDS of Rs.36,00,000/- on interest of Rs.3,60,00,000/-, which implies that mere classification of DDIL as NPA by its bank cannot be said to be the basis of its incapability to pay interest to the assessee, since had it been so, DDIL would have had no reason to pay only the said TDS and not paying the interest of Rs.3,60,00,000/-to the assessee, that too after being classified as NPA."

3. In this appeal, Revenue is aggrieved by the deletion of Rs.3.6 Crores added by the ld. Assessing Officer in respect of interest accrued and receivable by the assessee and credit for TDS thereon amounting to Rs.36 lakhs.

4. The Assessee had advanced Rs.30 Crore to M/s. DHARTI DREDGING & INFRASTRUCTURE LTD (Dharti) as under:

Date	Particulars	Amt.in Rs.
10.10.2016	Amount paid	32,00,000/-
	Amount paid	4,18,00,000/-
	Amount paid	25,50,00,000/-
09.01.2017	Amount paid	200,00,000/-
	Total Rs.	**32,00,00,000**
Less:		
19.01.2017	Amount received	2,00,00,000/-
	Total Rs.	**30,00,00,000/-**

4.1. Dharti paid interest for the year ended 31st March 2017 of Rs.1,71,28,767/- on which TDS of Rs.17,12,877/- was deducted. The same was offered to tax as business income by the assessee. During financial year 2017-18 Dharti became a Non Performing Asset (an NPA) thus, assessee did not receive any interest from it for the year ended 31st March 2018, relevant to Assessment Year 2018-19.

4.2. For Assessment Year 2018-19 return was filed on 31st Oct. 2018 as per Form 26AS available on that date, Dharti had not deducted any tax at source for interest for the period 01.04.2017 to 31.03.2018. Since Dharti had become NPA and was facing financial difficulties, assessee did not account for the interest receivable as interest did not commercially accrue as there was no chance of receiving the same. Dharti on 08.11.2018 however, paid TDS of Rs.36,00,000/- on interest accrual of Rs.3,60,00,000/- for the year ended 31.03.2018. Assessee was unaware of this development as Dharti did not send the TDS Certificate for the TDS done of Rs.36,00,000/-.

4.3. During the course of assessment proceedings, ld. Assessing Officer asked the assessee to reconcile the income offered to tax with the tax deducted at source as per 26AS dated 05.12.2020. Assessee furnished its explanation to state that it had not received any interest income from Dharti. It had also not received any communication from the company regarding payment of interest on advance of Rs.30,00,00,000/-. It was during the assessment proceedings, that assessee found on 08.11.2018 about Dharti depositing TDS of Rs.36,00,000/- on its PAN showing Interest income of

Rs.3,60,00,000/-. Assessee further submitted that it had not claimed the TDS credit of Rs.36,00,000/- in its return as it had not received any interest income from Dharti. Ld. Assessing Officer did not accept assessee's explanation and added Rs.3,60,00,000/- as interest income under the head "Other Sources". Further, the Assessing Officer did not give credit for tax deducted at source of Rs.36 lakhs on the said interest without mentioning any reason. Aggrieved, assessee went in appeal before the ld. CIT(A).

5. Before the ld. CIT(A), assessee submitted that Dharti had become an NPA and in a petition filed by its bankers u/s. 7 of the Insolvency and Bankruptcy Code, (IBC) 2016, the National Company Law Tribunal (NCLT) has passed an order dated 05/04/2022, placing the said company under insolvency proceedings, and, therefore, there was no chance of recovery of the amount of Rs.3.6 Cr. The assessee, therefore, contended that the same cannot be considered as its income. It further submitted that it had not received any amount from Dharti till date and even in A.Y. 2019-20, no interest receivable from it was offered to tax and no addition was also made by the ld. Assessing Officer. Further, in A.Y. 2020-21, since Dharti had become an NPA, the assessee had written off the advance of Rs.30 Cr. in its books and had not claimed the write off of the amount of Rs.3.6 Cr. added by the ld. Assessing Officer in the year under consideration. Assessee placed reliance on various decisions in support of its contention that the interest income is not taxable in its hands in view of the fact that there is no possibility of receiving the same. According to the assessee, since Dharti had become an NPA and was facing financial difficulties, it did not account for the interest receivable. While doing so, the assessee had considered the fact that the income did not commercially accrue, as there was no chance of receiving the same.

5.1. Ld. CIT(A) by laying hands on several judicial precedents held that what is to be taxed should be the real income and not hypothetical income. According to him, it has to be seen whether the income had really accrued or not. In the assessee's case, it is a fact that the financial condition of the debtor was not sound and the debtor had already defaulted the interest payment. In this situation, there was no possibility to recover the interest in future. Even the recovery of principal amount was doubtful. According to him, just because the assessee had not filed the evidence before the ld. Assessing Officer to demonstrate the efforts taken for recovery, the same will not alter the facts. Further, the assessee has written off the debts in its books of accounts in the A.Y. 2020-21. This itself shows that the assessee has not received any interest in the financial Year under consideration. Even the principle amount had not been recovered.

5.2. In view of these facts, ld. CIT(A) held that interest on the advances given to Dharti had not really accrued to assessee in the assessment year under consideration. No real income has resulted. He thus, concluded that hypothetical/notional income cannot be taxed merely on the basis that assessee follows mercantile system of accounting. In A.Y. 2019-20, no interest receivable from Dharti was offered to tax and no addition was also made by the ld. Assessing Officer. Accordingly, the addition made by the ld. Assessing Officer on account of interest income of Rs.3,60,00,000 was deleted. Aggrieved, Revenue is in appeal before the Tribunal.

6. Heard both the parties and perused the material on record along with the orders of the authorities below. Facts as narrated above and

discussed in detail are undisputed. Revenue is aggrieved by the deletion of Rs.3.60 Crores towards interest income receivable by the assessee which has been deleted by applying real income theory. We have perused the observations and findings arrived by ld. CIT(A) in this respect which has been already narrated above. Facts being undisputed in this respect and uncontroverted by the ld. Sr. DR, we do not find any reason to interfere with the said observations and findings arrived at by ld. CIT(A). However, in respect of TDS of Rs.36 lakhs done by Dharti and deposited in the government exchequer which is duly reflected in Form 26AS of the assessee in the year under consideration, needs a consideration since it forms part and parcel of amount of interest receivable of Rs.3.60 Crores.

6.1. In our understanding, in the given set of facts and circumstances, when the principal amount of income which has been subjected to deduction of tax at source bears an element of uncertainty and irrecoverability then in such a situation, the tax so deducted at sources and deposited by the deductor which appears in Form 26AS of the deductee, provisions of section 198 gets attracted. The said section reads as under:

> *"Tax deducted is income received.*
> *198. All sums deducted in accordance with the foregoing provisions of this Chapter shall, for the purpose of computing the income of an assessee, be deemed to be income received :*
> *Provided that the sum being the tax paid, under sub-section (1A) of section 192 for the purpose of computing the income of an assessee, shall not be deemed to be income received:*
> *Provided further that the sum deducted in accordance with the provisions of section 194N for the purpose of computing the income of an assessee, shall not be deemed to be income received."*

6.2. Accordingly, in the present set of facts, TDS of Rs.36,00,000/- done by Dharti and deposited duly reflected in Form 26AS of the assessee for the year under consideration, is deemed to be income received by the assessee under the said section. This section deals with

treating the TDS as income whenever an amount deducted becomes incapable of being adjusted or counted towards tax payable.

6.3. Similar issue had arisen before the Hon'ble High Court of Andhra Pradesh, in the case of Y. Rathiesh vs. Commissioner of Income-tax-I (2014) 51 taxmann.com 59 (AP). Facts of this case are similar to the present set of facts wherein loan was given by the assessee to the company who just showed the accumulated interest in its books of accounts without making payment. However, the said company deducted TDS at source on the amount of interest payable and issued certificate in relation thereto. Assessee did not pay tax on the interest receivable by him from the company but enjoyed benefits of TDS made in that behalf. Ld. AO took objection to this and treated the interest receivable from the company as income and levied tax thereon. Hon'ble High Court on these set of facts and taking into account provisions of section 198 of the Act held that whenever an amount deducted as tax at source become incapable of being adjusted or accounted towards tax payable, it acquires a character of income. In such an event, it partakes the character of any other income and is liable to be dealt with accordingly, in the order of assessment. Hon'ble High Court, further held that since the assessee has adopted cash system and did not receive the interest regarding which TDS was done, the TDS amount deserves to be treated as income. The attempt made by the assessee to treat the amount as tax for the corresponding amount was not permitted by the Hon'ble High Court. The appeal was partly allowed holding that assessee cannot be permitted to give credit to the amount representing TDS as tax and on the other hand, it shall be treated as an item of income for the concerned assessment year.

6.4. Drawing force from the aforesaid judgment of the Hon'ble High Court, we respectfully follow the same to hold that in the present case, the amount of TDS reflected in Form 26AS of the assessee for the year under consideration in respect of TDS done by Dharti is to be treated as an item of income under the head "income from other sources" and provisions of section 198 be applied accordingly. It is important to note that once TDS is deducted, assessee cannot be permitted to use the certificate to cover other amounts while refusing to show the amount of interest in his return by resorting to difference in method of accounting system. The effect of the assessment made by the ld. AO is only that the assessee ought to desist from having the best of both the systems and discarding the one which is disadvantageous to him. If the assessee intends to take the TDS as component of tax paid by him, the corresponding income to the TDS must Form part of the return and the assessment.

6.5. For ease of reference relevant extracts from the above decision are reproduced as under:

> *"The assessee has option to file returns by adopting the cash system or mercantile system. In a given case, he can adopt both the systems for different components in one and the same returns. The broad distinction between these two systems is well known. Under the cash system, the assessee would be under an obligation to pay tax only on such of the amount which has been actually received by him. In contrast, under the mercantile system, mere entitlement to receive would bring about the obligation to pay tax. The assessees choose one of them or both of them for different parts, after taking note of the advantages and disadvantages in adopting these methods.*
>
> *8. We are concerned with the income of the assessee in the form of interest, on the loans which he has advanced to the two companies referred to above. As a matter of fact, he is the Managing Director of the 1st company. His case is that the 2nd company was paying interest regularly and in relation to the transaction of that company, he adopted mercantile system. There is no dispute about payment of tax on that. For the transaction with the 1st company, he has chosen to adopt the cash system. He stated that though the amount payable to him as interest was being shown in the account books of the company, the actual payment of the amount was not done. Another contention was that even while not paying the amount, TDS was affected.*

9. By adopting the cash system for this component of his returns, the appellant did not pay any tax on the interest payable to him by the 1st company, on the ground that the amount has not been paid at all. If that were to have been all, there would not have been any controversy. The reason is that under the cash system, the liability to pay tax arises only when the concerned amount is received as income. The 1st company made TDS in respect of the amount payable to the appellant as interest and issued certificate. The appellant wanted to use the certificate in its entirety. In other words, the amount reflected in the TDS certificate was being shown as tax already paid. This would have devastating effect. The amount covered by the certificate would take care of the interest payable on other income of the appellant. For example, if the amount reflected in TDS constitutes tax payable on a sum of Rs.1,00,000/-, that would have taken care of the income of the appellant to the extent of Rs.1,00,000/- from other sources, though the interest as regards which the TDS was affected, was not reflected in the returns at all. All the authorities under the Act i.e., the assessing officer, the Commissioner and the Tribunal did not approve the method adopted by the appellant.

10. The appellant cannot be permitted to blow hot and cold at one and the same time. If no TDS was affected and interest was not paid, he would not have been under an obligation to show the amount of interest in his returns, much less to pay tax thereon. However, once TDS is affected, he cannot be permitted to use the certificate to cover other amounts even while refusing to show the amount of interest in his returns. The steps taken by the authorities in this behalf cannot be treated as applying the parameters for mercantile system to a component of the returns filed under the cash system. The effect of the order passed by the assessing officer as upheld by the Commissioner and the Tribunal is only that the appellant must desist from having the best of both the systems and discarding the one, which is disadvantageous to him. Once he intends to treat the amount deducted as TDS as a component of tax paid, the corresponding to the TDS must form part of the returns and assessment. On the other hand, if he intends to pay the tax on the interest as and when he receives it, the amount covered by the TDS certificate can be treated as just income outstanding, till the actual date of receipt.

11. In the facts of the present case, Section 198 gets attracted. Whenever an amount deducted as tax at source becomes incapable of being adjusted or counted towards tax payable, it acquires the character of income. In such an event, it partakes the character of any other income and is liable to be dealt with accordingly, in the order of assessment. Since the appellant has adopted the cash system and he did not receive the interest regarding which the TDS was affected, the TDS amount deserves to be treated as income. However, the attempt made by him to treat that amount as tax for the corresponding amount, cannot be permitted."

7. Considering the facts on record, provisions of section 198 and the judicial precedents discussed above, we direct the ld. Assessing Officer to recompute the assessed total income in terms of our above

observations and findings. Accordingly, grounds taken by the Revenue is partly allowed.

8. In the result, appeal of the Revenue is partly allowed.

Order pronounced on day of 27 September, 2024 under Rule 34 of The Income Tax (Appellate Tribunal) Rules, 1963

Sd/-	Sd/-
(Satbeer Singh Godara)	(Girish Agrawal)
Judicial Member	Accountant Member

Dated: 27 September, 2024

MP, Sr.P.S.

Copy to :

1 The Assessee
2 The Respondent
3 DR, ITAT, Mumbai
4 Guard File
5 CIT

BY ORDER,

(Dy./Asstt.Registrar)
ITAT, Mumbai