

IN THE INCOME TAX APPELLATE TRIBUNAL

"C" BENCH, MUMBAI

BEFORE SHRI OM PRAKASH KANT, ACCOUNTANT MEMBER AND

SHRI SANDEEP SINGH KARHAIL, JUDICIAL MEMBER

ITA no. 1944/Mum./2024

(Assessment Year : 2019-20)

IL & FS Financial Services Ltd.
Plot No.C-22, G-Block,
The IL & FS Financial Centre,
BKC, Bandra (E),
Mumbai - 400051
PAN : AAAC14805L

..... Appellant

v/s

PCIT-6,
Mumbai

..... Respondent

Assessee by : Ms. Fereshte D. Sethna and
Ms. Mrunal Parekh
Revenue by : Shri R.A. Dhyani, CIT DR

Date of Hearing – 01/10/2024

Date of Order – 20/12/2024

ORDER

PER SANDEEP SINGH KARHAIL, J.M.

The assessee has filed the present appeal against the impugned order dated 26/02/2024, passed under section 263 of the Income Tax Act, 1961 (*"the Act"*) by the learned Principal Commissioner of Income Tax, Mumbai – 6, [*"learned PCIT"*], for the assessment year 2019-20.

2. In this appeal, the assessee has raised the following grounds: -

"1. On the facts and circumstances of the case and in law, the order passed by the PCIT under section 263 of the Act enhancing and modifying the assessment framed under section 143(3) of the Act vide order dated 29

September 2021 and treating it as erroneous and prejudicial to the interest of the revenue is without jurisdiction, bad in law and void ab-initio.

The Appellant prays that the order dated 26 February 2024 passed under section 263 of the Act be struck down as invalid, null and void ab initio and the original assessment order of the Assessing Officer be restored.

2. Disallowance of Claim of Bad debts written off:

2.1. On the facts and circumstances of the case and in law, the PCIT has erred in holding that the Assessing Officer has passed the assessment order dated 29 September 2021 under section 143(3) of the Act without making proper enquiry.

2.2. On the facts and circumstances of the case and in law, the PCIT has erred in disallowing the Deduction claimed for "Bad debts written off amounting to Rs. 354,32,35,520 without considering the second proviso to section 36(1)(vii) of the Act and Income Computation and Disclosure Standards ('ICDS')-IV-Revenue Recognition.

The Appellant prays that the allowance of claim of Bad debts written off is as per provisions of the Act and hence the revision proceedings on this matter is not permissible.

The Appellant submits that all the grounds of appeal stated above are independent and without prejudice to one another."

3. In the present appeal, the assessee is aggrieved against the invocation of revisionary proceedings under section 263 of the Act by the learned PCIT.

4. The brief facts of the case pertaining to this issue, as emanated from the record, are: The assessee is a Non-Banking Financial Company registered with the Reserve Bank of India and is engaged in related activities of providing loans, trading in securities, etc. The assessee also provides financial support to its group companies. For the year under consideration, the assessee filed its original return of income on 29/11/2019 declaring a total loss of INR 873,66,13,561. The assessee revised its return of income on 10/09/2020 declaring a total loss of INR 914,23,23,579. The return filed by the assessee was selected for scrutiny and statutory notices under

section 143(2) and section 142(1) of the Act were issued and served on the assessee. After considering the submissions of the assessee in response to the notices issued during the assessment proceedings, the Assessing Officer ("AO") vide order dated 29/09/2021 passed under section 143(3) of the Act assessed the total income of the assessee at INR (-) 896,84,80,669 after making disallowance of INR 17,38,42,910 under section 14A read with Rule 8D of the Income Tax Rules, 1962.

5. Subsequently, the learned PCIT issued show cause notice under section 263 of the Act on the basis that an amount of INR 354,32,35,520 has been added to the taxable income on account of adjustment in respect of Income Computation and Disclosure Standard ("ICDS")- IV and the same has been reduced on account of "*bad debts on non-receipts of interest*". The learned PCIT alleged that the said claim was allowed vide assessment order passed under section 143(3) of the Act in contravention to the provisions of section 36(1)(vii) of the Act, as the said amount was not written off as irrecoverable and directly claimed in the computation of income. Accordingly, the assessee was asked to show cause why the assessment order passed under section 143(3) of the Act be not set aside on the above issue as the said order is erroneous insofar as it is prejudicial to the interest of the Revenue.

6. In response thereto, the assessee submitted that while computing the income for the year under consideration, the assessee suo moto included the sum of INR 354,32,35,520 as income in accordance with the provisions of ICDS-IV-Revenue Recognition and has claimed the same as bad debts in

its computation of income without rooting the same to its profit and loss account as per the provisions of 2nd proviso to section 36(1)(vii) of the Act. Accordingly, the assessee requested that the proceedings initiated under section 263 of the Act be dropped in the absence of an order which is erroneous insofar as it is prejudicial to the interest of the Revenue.

7. The learned PCIT, vide impugned order, passed under section 263 of the Act disagreed with the submissions of the assessee and by invoking the provisions of Explanation 2 to section 263 of the Act held that the assessment order allowing bad debts claimed by the assessee under section 36(1)(vii) is erroneous insofar as it is prejudicial to the interest of the Revenue. Accordingly, the learned PCIT set aside the assessment order on the issue of allowance of bad debt under section 36(1)(vii) of the Act with a direction to pass the assessment order taking into consideration the observation made after affording adequate opportunity to the assessee. Being aggrieved, the assessee is in appeal before us.

8. During the hearing, the learned Authorised Representative ("*learned AR*") submitted that during the assessment proceedings specific query was raised by the AO in respect of bad debts claimed, which was duly responded to by the assessee. Thus, after considering the submissions of the assessee, the AO allowed the claim of bad debt under section 36(1)(vii) of the Act. The learned AR submitted that the impugned order does not disclose what examination was required which was not done by the AO. The learned AR by referring to the provisions of the 2nd proviso to section 36(1)(vii) of the Act and Circular no.19 of 2018 issued by CBDT submitted that since the income

recognised by the assessee as per the provisions of ICDS was not recoverable, the same was rightly claimed under section 36(1)(vii) of the Act.

9. On the contrary, the learned Departmental Representative by vehemently relying upon the order passed by the learned PCIT submitted that the revisionary proceedings under section 263 of the Act have rightly been initiated in the present case as the assessment order was passed without making any enquiry on the issue of claim of bad debt under section 36(1)(vii) of the Act.

10. We have considered the submissions of both sides and perused the material available on record. Pursuant to the report filed by the Registrar of Companies, Mumbai ("ROC") under section 208 of the Companies Act, 2013, the Government of India vide their order dated 30/09/2018 directed that the affairs of the holding company, i.e. Infrastructure Leasing and Financial Services Ltd, and its specified subsidiaries including the assessee be investigated by the Serious Fraud Investigation Office. Subsequently, the Union of India filed a petition with the Hon'ble National Company Law Tribunal ("*Hon'ble NCLT*") on the basis of the interim reports of the ROC. Based on the petition, the Hon'ble NCLT vide its order dated 01/10/2018 suspended the erstwhile Board of the holding company and appointed a new Board of Directors. Even the Board of Directors of the assessee company were reconstituted in pursuance of the order passed by the Hon'ble NCLT. Subsequently, during the pendency of certain applications filed before the Hon'ble National Company Law Appellate Tribunal ("*Hon'ble NCLAT*"), in line

with the affidavit filed by the Ministry of Corporate Affairs with the Hon'ble NCLAT, the cut-off date of 15/10/2018 was proposed and in terms of the Resolution Framework Reports, the proposal was made that all the liabilities relating to the relevant group entity, whether financial, operational debt as well as statutory claims, whether existing at or relating to a period after 15/10/2018 should not continue accruing. Accordingly, interest income excluding penal interest and delayed payment interest for the year on loans made to the group companies only for the period up to 15/10/2018 was recognised, which approximately is INR 354,32,35,520 on a gross basis. Further, no such income was recognised for the period from 16/10/2018 to 31/03/2019.

11. As per the assessee in its original return of income filed on 29/11/2019 based on draft financial accounts for the year ending 31/03/2019, the assessee did not consider INR 354,32,35,520 as interest income and did not claim a deduction of bad debts under section 36(1)(vii) of the Act. Subsequently, the statutory auditor issued a qualified report for the year ending 31/03/2019, stating as follows: –

"2.5. We draw your attention to Note 11 of the Standalone Ind AS Financial Statements which describes the reasons, the Company has not accounted for contractual interest income from its subsidiaries and associates (of Rs.3,543.24 million on a gross basis) and contractually payable finance costs on borrowings (of Rs.6,566.82 million, excluding penal/other interest and charges), for the period from October 16, 2018 to March 31, 2019. In our opinion, the Company may be required to account for such interest income and interest expenses, and the related assets and liabilities as at March 31, 2019 subject to accounting principles and legal position."

12. Accordingly, in recognition of the qualified report of the statutory auditor, the assessee recognised the income of INR 354,22,35,520 as its

income under ICDS-IV-Revenue Recognition, which is also duly recorded In the Tax Audit Report dated 07/09/2020, on page 335 of the paper book. Accordingly, the assessee filed a revised return of income on 10/09/2020 recognising the income of INR 354,32,25,520 and writing off correspondingly that some as irrecoverable interest.

13. As per the assessee, during the assessment proceedings statutory notice dated 13/05/2021 was issued under section 142(1) of the Act seeking details of the list of persons where bad debts written off in its case. We find that in response thereto the assessee vide submission dated 18/08/2021 submitted as follows: –

"9. Give details of list of persons where bad debts written off in your case and also give justification for not shown correct deemed income u/s 41 of L.T.Act, 1961:

In line with the affidavit filed by the Ministry of Corporate Affairs ("MCA") with the Hon'ble NCLAT on May 21, 2019, the cut-off date of October 15, 2018 ("Cut-Off Date") was proposed, on account of inter alia the fact that the Hon'ble NCLAT had passed the Order on October 15, 2018, which inter alia granted certain reliefs to the IL&FS group and also restricted certain coercive actions by the creditors of the IL&FS group.

In terms of the Resolution Framework Reports, the proposal was made that all liabilities relating to the relevant IL&FS Group Entity, whether financial (including interest, default interest, indemnity claims and additional charges), operational debt (including interest, indemnity or other claims) as well as statutory claims (including tax, employment and labour related claims), whether existing at or relating to a period after October 15, 2018 (the Cut-Off Date, as explained in the previous paragraph) should not continue accruing.

Furthermore, the new management based on the recommendation of the Resolution Consultant has evolved a 'payment protocol' as a part of the resolution process. The payment protocol provides classification of IL&FS and its group entities into three categories 'Green', 'Amber' and 'Red' based on a 12-month cash-flow-based solvency test' ('Testing Period') as follows:

(a) Green entities:

- I. *Where there is no payment default/overdues subsisting currently and cash flows to be generated by the entity in the Testing Period from its operations (and available cash balances) are sufficient to meet all the payment obligations of the entity (both operational and financial, secured as well as*

unsecured) as and when such payment obligations fall due in the Testing Period; and

- II. Which do not rely upon IL&FS group entities for any financial support to service its debt obligations (financial and operational).

Such entities are permitted to make all payments in normal course of business.

(b) Entities within the IL&FS group that do not meet the criteria set out in paragraph (a) above; for the sake of convenience this group has been further segregated into two sub-categories, namely:

- I. Amber' entities i.e, those which are not able to meet all their respective obligations (financial and operational) as and when they fall due in the Testing Period but can only meet operational payment obligations and payment obligations to senior secured financial creditors during the Testing Period
- II. 'Red' entities i.e. those entities which cannot meet their respective payment obligations towards even senior secured financial creditors as and when they fall due during the Testing Period.

Such entities are permitted to make only those payments necessary to maintain and preserve the going concern status.

NCLT had appointment Retired Justice D. K. Jain to supervise the payment protocol and resolution process for the IL&FS group.

This proposal made by IL&FS Group has been accepted by the Hon'ble NCLAT vide its order dated March 12, 2020

Accordingly, management had on basis of the order dated 12 March 2020 and on basis of the procedure is laid down in the resolution framework under the supervision of Justice D. K. Jain sets out crystallisation of claims as of 'cut-off date' (i.e. 15 October 2018) i.e. no interest, additional interest, default interest, penal charges or other similar charges are to accrue after the cut-off date of 15 October 2018 (being the date of initiation of resolution process).

- a) Recognised interest income excluding penal interest and delayed payment interest for the year on loans made, to group companies only for the period up to October 15, 2018. No such income has been recognised for the period from October 16, 2018 to March 31, 2019, which approximates Rs 3,543.24 million on a gross basis.
- b) Recognised finance costs on borrowings (including from third parties) for the year, only for the period up to October 15, 2018. No such finance costs has been recognised for the period from October 16, 2018 to March 31, 2019, which approximates Rs 6,566.82 million.
- c) The lenders have shown in the statements and documents sent by them the finance cost and interest charges for the period of 1st October 2018 to 31st

March 2019 amount of Rs. 3879.41 million. The Company has not accepted these charges based on the legal advice.

The amounts mentioned in (a) and (b) above were based on contractually agreed terms, and excluded penal/other interest and charges. Further, the above (a) and (b) were not applied to entities classified as "Green" category, i.e, entities which are in a position to honor their respective financial and operational liabilities. The above basis of accounting is on the basis of the proposal made by IL&FS with NCLT.

However, while computing income for the AY 2019-20 the assessee had suo-moto included the aforesaid sum of Rs. Rs 3,543.24 million i.e. Rs. 3,54,32,35,520 /- as income in accordance with provisions of ICDS IV Revenue Recognition. Please refer to details regarding amount admissible under section 145 as mentioned in clause 13(e) and Annexure B of signed Tax Audit Report in Form 3CD enclosed herewith marked as **Annexure A in respect of income offered under ICDS**

Allowability of aforesaid income as Bad Debts due to non-recoverability

As per Section 36(1)(vii) of the Act, the assessee is eligible for deductions of the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee.

Relevant extract of Section 36 of the Act is as follows:-

"Other deductions.

36. (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28-

vii) subject to the provisions of sub-section (2), the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year]:

Provided further that where the amount of such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof becomes irrecoverable or of an earlier previous year on the basis of income computation and disclosure standards notified under sub-section (2) of section 145 without recording the same in the accounts, then, such debt or part thereof shall be allowed in the previous year in which such debt or part thereof becomes irrecoverable and it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the purposes of this clause."

It may happen that an income is recognized as per ICDS but not as per normal accounting standards (AS) or accounting policies. And finally such income is found as non-recoverable and bad debts. To address this situation, Finance Act 2015 has amended section 36(1)(vii) of the Act, by inserting a new second proviso thereto with effect from AY 2016-17 onwards.

In view of the amendment by insertion of aforesaid second proviso, deduction for bad debts is allowed in all cases where such income offered to tax under ICDS without recording the same in accounts and which becomes

irrecoverable. The law treats such non-recoverability as deemed to be written off in the accounts for the purpose of allowing deduction of bad debts.

As explained and mentioned above, since the company has offered to tax a sum of Rs. 3,54,32,35,520 as income as per provisions of ICDS-IV relating to Revenue Recognition, which was not recoverable and accordingly it is treated as bad debts for AY 2019-20.

Break-up of the Income non recoverable from Red/Amber Entities as explained above is given in table below;

Name of the borrower	Amount of interest offered to tax under ICDS-IV and claimed as bad debts due to it being non-recoverable
Avash Logistic Park Private Limited	26,320,887
DIGHI PORT LIMITED	9333,237
East Delhi Waste Processing Co Ltd (Formerly Pvt Ltd)	75,028,436
Gujarat Integrated Maritime Complex Private Limited (GIMCO)	81,089,808
HILL COUNTY PROPERTIES LTD	168,634,705
Hill County Sez Private Limited	79,715,987
IL&FS Airports Limited	209,356.032
1L&FS CLUSTER DEVELOPMENT INITIATIVE LIMITED	211,001,012
IL&FS Employees Welfare Trust	143,829,786
IL&FS ENGINEERING & CONSTRUCTION COMPANY LIMITED.	71,669,346
IL&FS Environmental Infrastructure & Services Ltd. (IEISL)	2,662,066
IL&FS Maritime Infrastructure Company Limited	154,101,017
IL&FS Wind Energy Limited (Mandvi LNG Terminal Limited)	482,876
IMICL Dighi Maritime Limited	101,259,558
Moradabad Bareilly Expressway Limited	158,641,783
Nana Layja Power Company Ltd	129,183,874
Pune Sholapur Road Development Co Ltd	155.658,268
RDF POWER PROJECT LTD	3,863,531
RIDCOR INFRA PROJECTS LIMITED	237,260,279
ROAD INFRASTRUCTURE DEVELOPMENT CO OF	231,525.674

<i>RAJASTHAN LTD</i>	
<i>Rohtas Bio Energy Limited</i>	<i>187,817,709</i>
<i>Sabarmati Capital One Limited</i>	<i>146,215,036</i>
<i>Sabarmati Capital Two Limited</i>	<i>434,227,878</i>
<i>Skill Training Assessment Management Partners Limited</i>	<i>69,933,010</i>
<i>Tierra Enviro Limited</i>	<i>127,897,013</i>
<i>Unique Waste Processing Company Ltd</i>	<i>132,526,030</i>
<i>Vejas Power Projects Limited</i>	<i>194,000,684</i>
Grand Total	3,54,32,35,520

In other words on combined reading of ICDS and Section 36(1)(vii) such write-off of income offered under ICDS meets all the conditions of section 36(1) (vii) and accordingly the said sum of Rs. 3,54,32,35,520 is eligible for deduction while computing income from business.

*The company also submits that it has no deemed income under section 41 of the Income Tax Act, 1961. Further, please refer to disclosure as per clause 25 of signed Tax Audit Report in Form 3CD enclosed herewith marked as **Annexure A.**"*

14. We find that on 27/09/2021, the AO issued a show cause notice, however, the same was only confined to the additional disallowance under section 14A read with Rule 8D of the Rules. Thus, from the perusal of the material available on record, we find that the AO made enquiry and only after being satisfied with the submission of the assessee allowed the claim of bad debt under section 36(1)(vii) of the Act in respect of interest income recognised as per ICDS-IV.

15. We find that as per the provisions of the 2nd proviso to section 36(1)(vii) of the Act, the income which has been recognised as per the ICDS and is required to be written off as irrecoverable as per the provisions of the

ICDS, shall be deemed to have been written off as irrecoverable in the accounts for the purpose of section 36(1)(vii) of the Act. The provisions of 2nd proviso to section 36(1)(vii) of the Act reads as follows: –

"Provided further that where the amount of such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof becomes irrecoverable or of an earlier previous year on the basis of income computation and disclosure standards notified under sub-section (2) of section 145 without recording the same in the accounts, then, such debt or part thereof shall be allowed in the previous year in which such debt or part thereof becomes irrecoverable and it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the purposes of this clause."

16. We further find that the CBDT vide Circular no.19 of 2015, dated 27/11/2015 while explaining the provisions of the 2nd proviso to section 36(1)(vii) of the Act, as inserted by Finance Act, 2015, with effect from 01/04/2016, observed as follows: –

"16.4 The provisions of the ICDS are applicable for computation of income and not for the purposes of maintenance of books of account. There may be cases where the income is recognised for computation of taxable income in accordance with the provisions of ICDS without recording the same in the books of account and such income may be required to be reversed in accordance with the provisions of the ICDS. For claiming bad debt, the provisions of section 36(1)(vii) of the Income-tax Act, inter alia, require that the amount should be written off in the accounts of the assessee."

16.5 Therefore, the reversal of income in accordance with the provisions of the ICDS may not be allowable on the ground that same has not been written off in the accounts as per the provisions of section 36(1)(vii) of the Income-tax Act, In view of this, a proviso has been inserted in section 36(1)(vii) of the Income-tax Act so as to provide that for claiming deduction under section 36(1)(vii) of the Income-tax Act, the income which have been recognised as per the provisions of ICDS without recording in the accounts and is required to be written off as irrecoverable as per the provisions of ICDS, it shall be deemed to be written off as irrecoverable in the accounts."

17. Therefore, having considered the Explanatory Notes to the provisions of the Finance Act, 2015, whereby the provisions of the 2nd proviso to section 36(1)(vii) of the Act were introduced in the Act, we are of considered

view that claim of the assessee in respect of the income recognised as per the provisions of the ICDS-IV, which is not recoverable and therefore is treated as bad debt for the year under consideration is duly supported by the provisions of the Act and is based on the provisions of section 36(1)(vii) read with 2nd proviso and the ICDS read with Circular no.19 of 2015 dated 27/11/2015. Such being the facts, we are of the considered view that the assessment order allowing the claim of the assessee under section 36(1)(vii) of the Act can not be called erroneous, as the same being in conformity with the provisions of the Act in respect of the issue under consideration. Accordingly, we find no merits in the revisionary proceedings invoked by the learned PCIT under section 263 of the Act in the present case. Therefore, the impugned revision order passed under section 263 of the Act is quashed. As a result, the grounds raised by the assessee are allowed.

18. In the result, the appeal by the assessee is allowed.

Order pronounced in the open Court on 20/12/2024.

Sd/-

**OM PRAKASH KANT
ACCOUNTANT MEMBER**

MUMBAI, DATED: 20/12/2024

Sd/-

**SANDEEP SINGH KARHAIL
JUDICIAL MEMBER**

Copy of the order forwarded to:

- (1) The Assessee;
- (2) The Revenue;
- (3) The PCIT / CIT (Judicial);
- (4) The DR, ITAT, Mumbai; and
- (5) Guard file.

By Order

Assistant Registrar
ITAT, Mumbai