आयकर अपीलीय न्यायाधिकरण में, हैदराबाद 'B' बेंच, हैदराबाद
IN THE INCOME TAX APPELLATE TRIBUNAL
Hyderabad 'B' Bench, Hyderabad

श्री रवीश सूद, माननीय न्यायिक सदस्य एवं श्री मधुसूदन सावडिया, माननीय लेखा सदस्य
SHRI RAVISH SOOD, HON'BLE JUDICIAL MEMBER
AND
SHRI MADHUSUDAN SAWDIA, ACCOUNTANT MEMBER

आयकर अपीलसं./**I.T.A.No.821/Hyd/2025**
(निर्धारण वर्ष/ **Assessment Year: 2017-18)**

Spandana Sphoorty Financial Limited Hyderabad PAN : AAICS8213N	*Vs.*	Asst.Commissioner of Income Tax Circle-3(1) Hyderabad
(अपीलार्थी/ Appellant)		**(प्रत्यर्थी/ Respondent)**

करदाता का प्रतिनिधित्व/ Assessee Represented by	:	Shri Nikhil Tiwari, CA, AR
राजस्व का प्रतिनिधित्व/ Department Represented by	:	Dr. Narendra Kumar Naik, CIT-DR
सुनवाई समाप्त होने की तिथि/ Date of Conclusion of Hearing	:	07.08.2025
घोषणा की तारीख/ Date of Pronouncement	:	17.10.2025

O R D E R

प्रति रवीश सूद, जे.एम./**PER RAVISH SOOD, J.M.**

The present appeal filed by the assessee company is directed against the order passed by the Commissioner of Income Tax (Appeals) ["CIT(A)"] National Faceless Appeal Centre ("NFAC"),

Delhi dated 19.03.2025, which in turn arises from the order passed by the AO under Section 143(3) of the Income Tax Act, 1961 (for short, "the Act") dated 31.12.2019 for the A.Y.2017-18. The assessee company has assailed the impugned order on the following grounds of appeal before us:

"1. GENERAL

1.1 That on facts and in circumstances of the case and in law, the order dated 19 March 2025 issued by the Ld. Commissioner of Income-tax (Appeals), National Faceless Appeal Centre ['Ld. CIT(A)'] is bad in law and liable to be quashed.

2. ERRONEOUS ADDITION UNDER SECTION 69A OF THE INCOME-TAX ACT, 1961 ['THE ACT']

2.1 That on facts and in circumstances of the case and in law, the Ld. CIT(A) erred in affirming the action of the Ld. Assistant Commissioner of Income-tax - Circle 3(2), Hyderabad ['Ld. AO'] of invoking the provisions of section 69A of the Act w.r.t. Specified Bank Notes accepted by the Appellant, and of making addition of INR 564,100,000 under section 69A of the Act.

2.2 That on facts and in circumstances of the case and in law, the Ld. CIT(A) erred in not appreciating that the provisions of section 69A of the Act can be invoked only if assessee is found to be the owner of any money, other valuable article, etc and such money, valuable article, etc is not recorded in the books of account and the assessee offers no explanation about the nature and source of acquisition of such money, valuable article, etc.

2.3 That on facts and in circumstances of the case and in law, the Ld. CIT(A) erred in not appreciating that the alleged amount of Specified Bank Notes was duly recorded in the books of accounts of the Appellant, and as such, pre-condition for invoking section 69A of the Act was not duly adhered.

2.4 That on facts and in circumstances of the case and in law, the Ld. CIT(A) also erred in not appreciating that the provisions of section 69A of the Act can only be initiated in cases where an assessee offers no explanation or where the assessing officer is not satisfied

by the explanation offered by the assessee w.r.t any money, other valuable article, etc owned by such assessee and the Ld. CIT(A) thereby erred in affirming the action of the Ld. AO of making addition under section 69A of the Act, even though no dissatisfaction was recorded by the Ld. AO w.r.t. acceptance of Specified Bank Notes by the Appellant.

2.5 Without prejudice to the above, that on facts and in circumstances of the case and in law, the Ld. CIT(A) erroneously failed to appreciate that accepting Specified Bank Notes during 9 November 2016 to 30 December 2016 was not an illegal activity committed by the Appellant.

2.6 That on facts and in circumstances of the case and in law, the Ld. CIT(A) erroneously ignored the submissions of the Appellant and the decisions of various Coordinate Benches of the Hon'ble Income Tax Appellate Tribunal wherein it was held that merely accepting and depositing Specified Bank Notes during 9 November 2016 to 30 December 2016 would not tantamount to disallowance of such amounts deposited in the bank account. 3. ERRONEOUS ADJUSTMENT UNDER SECTION 145 OF THE ACT

3.1 That on facts and in circumstances of the case and in law, the Ld. CIT(A) erred in confirming the action of the Ld. AO of making adjustment of INR 114,451,818 towards processing fees under section 145 of the Act.

3.2 That on facts and in circumstances of the case and in law, the Ld. CIT(A) erroneously failed to appreciate that the Appellant had not deviated from accrual or mercantile system of accounting being regularly employed by the Appellant, and had merely, adhered to the accounting requirement as prescribed by the Hon'ble Reserve Bank of India.

3.3 That on facts and in circumstances of the case and in law, the Ld. CIT(A) erred in ignoring the decision of the Hon'ble Supreme Court of India in the case of Taparia Tools Limited [TS-5013- SC-2015-O], wherein, the Hon'ble Supreme Court laid down that interest on debentures is allowable as deduction upfront, instead of spreading the same over the term of the debentures.

3.4 Without prejudice to the above, that on facts and in circumstances of the case and in law, the Ld. CIT(A) erroneously failed to appreciate that this issue in any case is only a matter of timing difference with no monetary loss to revenue, and if not in AY 2017-18, the loan processing fees disallowed should be allowable as deduction in subsequent years(s).

4. RELIEF

4.1 That on facts and in circumstances of the case and in law, the Appellant prays that directions be issued to grant all consequential reliefs to the Appellant arising from the aforesaid grounds of appeal.

The Appellant craves leave to add or alter, by deletion, substitution or otherwise, any or all of the above grounds of appeal, at any time before or during the hearing of the appeal."

2. Succinctly stated, the assessee is a non-banking financial company (NBFC), engaged in the business of extending unsecured microfinance loans to women borrowers from low-income households through the Joint Liability Group model. The assessee company had filed its return of income for the assessment year 2017–18 on 31.03.2018, declaring nil income (after set-off of brought forward losses of Rs. 55,64,23,653/-) and "book profit" under section 115JB of Rs. 102,27,40,249/-. Thereafter, the case of the assessee company was selected for scrutiny assessment under CASS. Notice under section 143(2), dated 09.08.2018, was issued to the assessee.

3. During the course of the assessment proceedings, it was observed by the A.O. that the assessee company had deposited cash in its bank accounts during the demonetization period, i.e., 09.11.2016 to 30.12.2016 aggregating to Rs. 135,62,10,311/-. On being queried, it was submitted by the assessee company that the

subject cash deposits were sourced from the collections from loan borrowers. The assessee company, to fortify its claim, had filed with the A.O. the branch-wise and borrower-wise details. Also, it was observed by the AO that the auditor of the assessee company in its report for the subject year, had at Note 4.31, reported about the collections and had stated that the Specified Bank Notes (SBN's) deposited by the assessee company during the demonetization period were sourced from the collections made from its borrowers during the said period.

4. On a perusal of the assessment order, we find that the A.O. out of the total cash deposits had identified collections in SBN's amounting to Rs. 56,41,00,000/-. The A.O., by relying on the Government of India Notification S.O. No. 3407(E) dated 08.11.2016, withdrawing the legal tender status of Rs. 500/- and Rs. 1000/- currency notes w.e.f 09.11.2016, concluded that the collection and deposit of such demonetized currency by the assessee during the demonetization period contravened the statutory scheme and the public policy underlying the notification. Accordingly, the A.O held the amount of cash deposits (SBN's) of Rs. 56.41 crores (supra) as

having been sourced from the unexplained money of the assessee company under section 69A of the Act.

5. Apart from that, the A.O. observed that the assessee company had, during the subject year, changed its accounting policy, which was stated to have been so done pursuant to the RBI clarification dated 14.10.2016. The A.O. observed that pursuant to its change in accounting policy, the ancillary borrowing costs were, during the subject year, recognised in the period in which they were incurred rather than amortizing the same over the tenure of borrowings, which, thus, increased the finance cost and reduced the profit before tax by an amount of Rs. 23,26,99,652/-. Also, pursuant to the said change in the accounting policy, the loan processing fees during the subject year was recognised upfront rather than amortizing the same over the tenure of the loan, which, thus, increased the income of the assessee company by an amount of Rs. 11,82,47,834/- before tax. The AO observed that the net effect of the change in accounting policy was a reduction in the profit of the assessee company before tax by an amount of Rs. 11,44,51,818/- [Rs. 23,26,99,652/- (minus) RS. 11,44,51,818/-]. It was the claim of the assessee company that the

aforesaid changes in its accounting policy were in line with RBI guidelines. However, the explanation of the assessee company did not find favour with the A.O. It was observed by him that the Income-tax Act was a special statute and the RBI guidelines cannot override Section 145 of the Act. The A.O. was of the view that, as the assessee company had followed the mercantile system of accounting, therefore, the amounts were required to be assessed on an accrual basis. Accordingly, the A.O., based on his aforesaid conviction, made an addition of Rs. 11,44,51,818/- (supra) to the returned income of the assessee company.

6. Accordingly, the A.O. vide his order passed under Section 143(3) of the Act, dated 31/12/2019, made two additions, viz. (i) addition of the cash deposits (SBN's) made in bank accounts by treating the same as having been sourced out of the assessee's unexplained money under Section 69A of the Act: Rs. 56,41,00,000/-; and (ii) addition on account of deviation in accounting treatment: Rs. 11,44,51,818/-. Thus, the A.O. determined the income of the assessee company at Rs. Nil (subject to C/forward of losses of Rs.

228,09,55,598/-) and made a separate addition of Rs. 56.41 crores under Section 69A of the Act.

7. Aggrieved, the assessee company carried the matter in appeal before the CIT(A). On a perusal of the record, we find that the CIT(A) considered the documents filed by the assessee company, viz., written submissions, audited financial statements (including Note 4.31), borrower-wise schedules, and the assessment order. However, the CIT(A), after considering the observations of the A.O. on both the aforementioned issues, viz. (i). cash deposits of SBNs; and (ii). addition made on account of deviation in accounting treatment, did not find favour with the explanation of the assessee company, and, based on his detailed findings, upheld the additions made by the A.O., viz. (i). treating the SBN deposits as unexplained money under section 69A of the Act: Rs. 56.41 crores; and (ii) the addition on account of deviation in accounting treatment: Rs. 11,44,51,818/-, and thus, dismissed the assessee's appeal. For the sake of clarity, we deem it apposite to cull out the observations of the CIT(A), as under:

"**5. DETERMINATION**:

5.1 Ground no. 1 of the appeal is directed against the impugned assessment order dated 31.12.2019 and the appellant has stated that it is contrary to the facts and also the law applicable to the facts in the case of the appellant. In this regard, the appellant has submitted only general facts of the case. Nothing specific in support of its claim was submitted by the appellant before me. The appellant has only made baseless allegations against the assessment order by stating that it is contrary to the facts and the law applicable to the facts in the case of the appellant. The appellant completely failed to substantiate its claim along with the documentary evidences. Even the appellant did not even try to prove its allegations correct. Considering the cited facts, this ground of appeal is *dismissed*.

5.2 **Ground no. 2** of the appeal is directed against the addition of Rs.56,41,00,000/- made under section 69A of the Act by the AO vide assessment order dated 31.12.2019. In its ground of appeal, the appellant has stated that the assessing officer is not justified in making the addition of towards acceptance of SBN during demonetization period due to the following:

i. The relevant prerequisites are not fulfilled to warrant use of the section 69A.

ii. The assessing officer is not justified in concluding that the SBNs are no longer legal tender w.e.f. 09.11.2016 and by invoking provisions of section 69A that prerequisites the assessee to be found the owner of any money.

iii. The acceptance of SBNs has been mentioned in the audit report. During assessment the assessee has also submitted borrower wise details of such collection. The assessment order acknowledges both these facts. Hence section 69A cannot be applied as all receipts have been duly recorded in books of accounts.

iv. Assessee has offered full explanation about the nature and source of such collections being collections from borrower's regular loan repayments. Hence another condition of section 69A is not fulfilled.

v. Another compulsory condition of section 69A is that the 'Explanation offered by him is not, in the opinion of the assessing officer satisfactory…..' The assessing officer has no where mentioned in the assessing officer as to why the explanations about the source and nature of the receipts were not satisfactory.

vi. Also, no government agency has, till date, declared the collections of SBN by all NBFC's across India as illegal. The permissibility or legality of

an act cannot be disputed unless same is expressly declared to be not permitted or illegal by any statuette.

5.2.1 During the appellate proceeding, the appellant has also submitted following additional facts/arguments in support of this ground of appeal:

1) Rs. 56,41,00,000 has been disallowed under section 69A on the basis that these were in form of SBNs and collection of these currency notes were in contravention of instruction to the contrary issued by the Central Government and the RBI and hence the collection was to treated as 'unexplained income' and added back to income. In this context, we further submit the following:

i) As already submitted, none of the conditions mentioned for application of section 69 A is present in our case. This has also been admitted in the assessment order

ii) It seems in an attempt to bring to tax a receipt, which otherwise is not even an income, the Assessing Officer has charged it under a section that nowhere relates or cannot even remotely be attributed to the facts in case.

iii) We attach a similar case where section 68 was used to charge to tax collection of SBNs in case of Sri-Bhageeratha Pattina SahakaraVs-ITO. In this case the Hon'ble Bangalore Bench of ITAT decided that section 68 cannot be used to bring to tax receipts or collection in SBNs. As conditions laid down under section 68 and 69A are quite similar, we request your good self to analyse the decision and appreciate that the same can be applied to our case also. The decision is attached for your reference (pls refer from Para 5 on [page 9 till para 15 on page 9)

iv) Additionally, various appellate forums have held that where books of accounts/other records are maintained by the assessee and the disputed transactions has been recorded/disclosed in the books/recors and also that the assessee offers suitable explanation about the same, then Section 69 A cannot be applied. Your kind attention is drawn to the following decisions on similar grounds:

(a) Chandigarh Bench of the ITAT in the case of M/s. Bhagwati Motors Vs. ITO (ITA No. 1084/CHD/2008)

(b) Ahmedabad Bench of the Income Tax Appellate Tribunal in the case of (ITO Vs. Nagardas Jashraj- 28 ITD 386 Ahd) Advertisement

(c) Hon'ble Calcutta High Court in the case of Kantilal Chandulal & Co., Vs. Commissioner of Income Tax (136 ITR 889 (Cal))

(d) Mumbai Bench of the Income Tax Appellate Tribunal in Deputy Commissioner of Income Tax Vs. M/s. Karthik Construction Co., (ITA No. 2292/Mum./2016 and,

(e) Income Tax Officer Vs. Shri. Parvez Mohammed Hussain Ghaswala in ITA 3318/Mum./2013)

5.2.3 I have gone through the materialistic facts of the case and contention of the appellant. During the course of appellate proceedings, the appellant has furnished the statement of facts and form no. 35 along with his submission which has been taken on record. The contention put forth by the appellant is that the Appellant's business activities include providing unsecured microfinance loans mainly to women borrowers from low-income households through the Joint Liability Group model. Such small borrowers repay the loan in cash which is deposited in the bank account of the Appellant. As such, during financial year ['FY'] 2016-17, the Appellant, inter alia, had cash deposits arising from such repayment of loans by borrowers.

5.2.4 The appellant has further stated that on 8 November 2016, the Government of India had withdrawn the legal tender status of certain currency denominations. In pursuance thereof, from 9 November 2016 to 30 December 2016, such discontinued currency could either be exchanged for specific products/utilities or be deposited in banks or other prescribed organizations. Whereas, even during the aforesaid period of 9 November 2016 to 30 December 2016, the appellant continued to accept repayment of loans from borrowers in such currency and deposited such cash in its bank accounts. The appellant stated that the aforesaid fact was duly disclosed in the audited financial statements of the Appellant for FY 2016-17 (refer note no. 4.31 of the audited financial statements). The appellant further stated that the Ld. AO has treated deposit of such SBNs as unexplained income and has sought to tax the same under section 69A read with section 115BBE of the Act.

5.2.5 The appellant has claimed that the Ld. AO has not independently evaluated whether the conditions for trigger of section 69A of the Act with regard to nature and source of deposits have been satisfied by the Appellant. The appellant in its support claimed that the opinion of the assessing officer was required to be formed objectively with reference to the material available on record. While considering the explanation of the assessee, it is the responsibility of the revenue authorities to consider the same with responsibility, and to clearly state the dissatisfaction, if any. In its support, the appellant has referred several judicial pronouncements.

5.3 The matter at hand has been perpended at length by me along with the statement of facts and impugned assessment order. The assessment has been

culminated in the instant case u/s 143(3) of the I.T. Act, 1961 wherein the assessment was completed after making addition of Rs.56,41,00,000/- under section 69A of the Act. The appellant could not reply satisfactorily to the notices issued by the AO. Now, the appellant has filed appeal before me and submitting its reply in support of its claim.

5.3.1 After going through all the facts before me, it is established that the appellant has deposited Rs.56,41,00,000/- in cash in SBN during the demonetization period into its accounts. This fact was not denied by the appellant. There is no contradiction into this. The only question raises here is whether the appellant has did the right thing by accepting the cash deposits from its member during the demonetization period, which was further deposited into the bank accounts of the appellant, however accepting cash in such currency was not allowed at that time.

5.3.2 The appellant is stating before me through its submission that the opinion of the Assessing Officer for not accepting the explanation offered by the assessee as not satisfactory is required to be based on proper appreciation of material and other attending circumstances available on record. Further, the opinion of the Assessing Officer is required to be formed objectively with reference to the material available on record. In this regard, to find the correctness into the claim of the appellant, it is relevant to revisit the assessment order.

5.3.3 In the assessment order, the AO has specifically mentioned that the appellant has deposited cash in their bank accounts during demonetization period to the extent of Rs.135,62,10,311/-. The appellant itself submitted before the AO that it received the said amounts from the loan borrowers from 09.11.2016 to 30.12.2016 and deposited the money received there from in their bank accounts. However, the AO found that out of this cash deposit, the appellant has collected Non-Permitted receipts (SBNs) to the extent of Rs. 56.41 Crores during the demonetization period, i.e., from 09.11.2016 to 30.12.2016. In this regard, the AO has at length discussed the guidelines/instructions issued by the Government of India in this regard which are summarized as under:

> The AO referred to the gazette notification in No. 2652 dated 08.11.2016 that 500 and 1000 denominations of bank notes of existing series issued by the RBI shall cease to be legal tender w.e.f. 09.11.2016 to the extent specified in the notification. Consequently, on the night of 08-11-2016, the Hon'ble Prime Minister of India while addressing the Nation has announced the decision of the Central Government to withdraw the legal tender status to the existing series of bank notes of the value of Rs.500 and Rs.1000 w.e.f. 09-11-2016, which was said to be a measure to tackle black money in the economy, to lower the cash circulation which is directly related to corruption in our Country, and to eliminate fake currency.

Accordingly, a Notification in S.O. No. 3407(E) dated 08-11-2016 was also issued withdrawing the legal tender status to the bank notes of the value of Rs.500 and Rs.1000 (referred to as specified bank notes or SBNs).

However, in the said Notification, a facility was granted to the holders of SBNs for the deposit of such SBNs in their account maintained with any bank on or before 30-12-2016 so that the equivalent value of SBNs will be credited to such accounts. The Government has further announced that the SBNs will continue to be legal tender during demonetization period for the limited purpose of making payments at places like petrol bunks, gas agencies, etc. Thus, except where the SBNs were deposited in a bank, or exchanged for goods / services at designated places like petrol bunks etc., in all other cases such SBNs were no longer legal tender w.e.f. 09-11-2016. If the SBNs are claimed to have been dealt by the persons who held the SBNs as on 09-11-2016, in a manner other than what was prescribed in the statutory Notification, like exchanging the same with unauthorized persons other than banks, and if such a claim is accepted, it would bring the said statutory Notification, which was issued as a measure to tackle black money, to ridicule and renders it nugatory. Also, since the 'public policy' behind the withdrawal of legal tender status to the SBNs from 09-11-2016 onwards was explained by the Central Government to be a measure to tackle the black money in the economy, to lower cash circulation which is directly linked to corruption, fake currency etc., any claim of acceptance of SBNs as a part of contract of sale is opposed to the said 'public policy' as announced by the Central Government and vitiates the whole exercise of demonetization.

5.3.4 The AO has found the appellant at fault due to collection from other persons of SBNs and deposition of those SBNs in its own bank accounts against the Notification in S.O. No. 3407(E) dt. 08-11-2016 issued by the Central Government, due to which entire amount collected and deposited in SBNs of Rs.56,41,00,000/- was treated as unexplained money u/s 69A and was brought to tax accordingly.

5.3.5 Further, the appellant has requested to provide opportunity of video conference to explain its case before the undersigned. In this regard, following the principle of natural justice, the undersigned has provided video conference facility to the appellant on 12.03.2025 which was rescheduled to 17.03.2025 due to technical errors. The video conference was conducted successfully and the appellant has attended the video conference and explained its stance before the undersigned. The appellant has re-submitted the submissions filed earlier during the appellate proceedings. The appellant has repeated all the material that is already discussed here. The appellant could not produce any new arguments or

substantive material in its support. The submission of the appellant relating to this ground of appeal is reproduced for ready reference:

XXX XX XXX

5.3.6 However, the submissions made and the averments of the appellant have been comprehensively gone through by me. From the perusal and examination of appellant's submission, impugned assessment order and material on record and analysis discussed in the preceeding paras, it is conclusively proven that the appellant's action in unlawfully and in violation of the declared law of the land in collection of SBNs from other persons and its deposit of those SBNs in its own bank accounts against the Notification in S.O. No. 3407(E) dt. 08-11-2016 issued by the Central Government is not acceptable as per the provisions of the Act. The AO was correct in concluding that the entire amount collected and deposited in SBNs of Rs.56,41,00,000/- should be treated as unexplained money u/s 69A and was brought to tax accordingly.

5.3.7 The appellant has relied on the decision of ITAT Bengalore wherein the Tribunal had given relief to the extant assessee holding that the assessee appellant had collected demonetized SBNs till before the Gazette notification on 14.11.2016 issued by RBI, which has clearly clarified that the assessee society should not collect the demonetized notes. In the case of the instant assessee under appellate proceedings before me following observations about dissimilarity of pattern are noted:

1.The appellant continued accepting demonetized cash from lenders and depositing the SBNs in its bank accounts even after the publication of the said gazette notification which had stopped, prohibited acceptance of SBNs from third parties as illegal.

2. The appellant was not under the exempted categories of institutions/offices/ organizations like banks/Petrol Pumps/Gas Stations/Specified Hospitals/ Chemists, etc permitted to collect SBNs from third parties/customers/lenders.

3. In the case of appellant, it is incorrect to postulate that it was not permitted to deposit SBNs in its bank accounts. The appellant assessee was very much within its legal rights and correct in its action of depositing the demonetized SBNs in its bank accounts out of the closing cash balance till before the beginning of the demonetization period i.e. 08.11.2016. However, the appellant went beyond what was legally permissible, and thereby violated the statutory compliance in so far as it kept collecting cash from the micro finance lenders and its customers/sundry debtors.

4. The case law (supra) relied upon by the appellant in fact goes against its contention and do not help the case of the appellant as facts and circumstances and their respective grounds of appeal are distinctive and hence distinguishable from the present facts and circumstances.

5.3.8 In my considered view, the Assessing Officer has given sufficient cause for not accepting the explanation offered by the assessee and the findings of the AO was based on proper appreciation of material available on record. Since the AO has given detailed reasoning behind making this addition, hence it can be said that the opinion/findings of the Assessing Officer were formed objectively with reference to the material available on record. Therefore, based on the finding stated above, this ground of the appellant is dismissed and addition of Rs.56,41,00,000/- made by the AO is sustained.

5.4 Ground no. 3 of the appeal is directed against the addition of Rs.11,44,51,818/- made by the AO vide assessment order dated 31.12.2019. In its ground of appeal, the appellant has stated that the assessing officer is not justified in making the addition of Rs.11,44,51,818/- as a deviation to section 145 of the Income Tax Act due to the following:

i. The assessee has prepared the books of accounts entirely in agreement with section 145(1) of the Income Tax Act.

ii. Merely because any accounting treatment has resulted in decrease in profits cannot be the ground for rejecting such treatment and treating the resulting change as taxable income.

iii. Rejection of the books of accounts, or part of it, can be done only if conditions mentioned under section 145(3) of the Act are fulfilled. None of the conditions mentioned therein are present in the assessee's case.

5.4.1 I have gone through the materialistic facts of the case and contention of the appellant. During the course of appellate proceedings, the appellant has furnished the statement of facts and form no. 35 along with his submission which has been taken on record. The contention put forth by the appellant is that the Appellant is required to prepare its financial statements on accrual basis, in accordance with the provisions of Ind-AS accounting standards, read with specific guidance issued by the Hon'ble RBI. The Appellant has stated that it has duly complied with the same in preparation of its financial statements.

5.4.2 The appellant has further stated that Section 145 of Act permits a taxpayer to adopt cash or mercantile system of accounting, regularly employed by it, read with applicable income computation and disclosure standards ['ICDS']. Further, the appellant has referred to sub-section (3) of section 145 of the Act as: *"Where*

the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) has not been regularly followed by the assessee, or income has not been computed in accordance with the standards notified under sub-section (2), the Assessing Officer may make an assessment in the manner provided in section 144."

5.4.3 The Appellant in its support has stated that it has been preparing its financial statements under accrual or mercantile system of accounting and has not changed this basis of accounting in FY 2016-17. Only pursuant to a legal requirement mandated by the governing regulatory body the Hon'ble RBI, the Appellant has updated the accounting policy in relation to loan processing fees. This does not result in deviation from accrual or mercantile system of accounting. The income / expense in relation to loan processing fees become 'due' at the time of disbursal of the underlying loan. Accordingly, it accrues at the time of incurrence. As such upfront recognition of the same in line with the prescribed accounting obligations by the Appellant did not tantamount to deviation from accrual or mercantile system of accounting by the Appellant. The appellant has referred to the decision of the Hon'ble Supreme Court of India in the case of Taparia Tools Limited [TS-5013-SC-2015-O], by stating that therein, the Hon'ble Supreme Court laid down that revenue expense that does not provide any enduring benefit to the assessee should be allowed as deduction in the year of incurrence. Accordingly, in the said case, the Hon'ble Supreme Court allowed deduction of interest on debentures paid upfront by the assessee.

5.4.4 Further, the appellant drew my attention to clause no. 13(a) and 13(b) of the tax audit report, whereby, the tax auditor has also certified that the Appellant has continued to follow mercantile system of accounting and there has been no change in the mercantile system of accounting per se during FY 2016-17. Without prejudice to the above, the appellant stated that even if it is considered that the change in accounting policy has tantamount to adoption of cash basis of accounting for loan processing fees, it claimed that any change in accounting policy for a bona fide reason is permissible by the Act if the same results in taxability of real income of the assessee.

5.4.5 The matter at hand has been perpended at length by me along with the statement of facts and impugned assessment order. The assessment has been culminated in the instant case u/s 143(3) of the I.T. Act, 1961 wherein the assessment was completed after making addition of Rs.11,44,51,818/-.

5.4.6 After going through all the facts before me, it is established that the appellant has changed its accounting policy for recognizing the loan processing fee collected from the borrowers in the period in which it is collected against amortizing it over the tenure of the loan, in pursuant to clarification issued by RBI

on 14.10.2016. Consequently, the loan processing fee for income and profit before the tax for the year was higher by Rs. 11,82,47,834/-.

5.4.7 The appellant is stating before me through its submission that it has been preparing its financial statements under accrual or mercantile system of accounting and has not changed this basis of accounting in FY 2016-17. Only pursuant to a legal requirement mandated by the governing regulatory body the Hon'ble RBI, the Appellant has updated the accounting policy in relation to loan processing fees. This does not result in deviation from accrual or mercantile system of accounting. The income / expense in relation to loan processing fees become 'due' at the time of disbursal of the underlying loan. Accordingly, it accrues at the time of incurrence. As such upfront recognition of the same in line with the prescribed accounting obligations by the Appellant did not tantamount to deviation from accrual or mercantile system of accounting by the Appellant. Further, the appellant stated that the tax auditor has also certified that the Appellant has continued to follow mercantile system of accounting and there has been no change in the mercantile system of accounting per se during FY 2016-17. Moreover, the appellant stated that even if it is considered that the change in accounting policy has tantamount to adoption of cash basis of accounting for loan processing fees, it claimed that any change in accounting policy for a bona fide reason is permissible by the Act if the same results in taxability of real income of the assessee.

5.4.8 In the assessment order, the AO has specifically mentioned that the overall effect of change in accounting policy by the appellant is that the finance costs for the year are higher and profit before tax is lower by Rs.11,44,51,818/-. Further, the AO has categorically mentioned that the I.T. Act, 1961 is a special Act. RBI guidelines have been issued under delegated legislation for the purpose of effective supervision and control of monetary and credit system. The RBI guidelines have not been issued to override the mandatory provisions of section 145 of the I.T. Act. Since the assessee was following mercantile system of accounting, the amounts received during the year will be assessed to tax on accrual basis. Hence, the said amount of Rs.11,44,51,818/- was added back to the income returned by the AO.

5.4.9 It is understood that the Reserve Bank of India (RBI) issued a clarification notification on October 14, 2016, regarding Income Computation and Disclosure Standards (ICDS) adjustments by NonBanking Financial Companies (NBFCs). The key points of this notification are:

1. Background of the Notification

    - The Ministry of Finance had notified ICDS under Section 145 of the Income Tax Act, 1961.

- These standards were meant to standardize income computation for taxation purposes and applied to all taxpayers following the mercantile system of accounting.

- However, there was confusion about whether NBFCs were required to follow ICDS while computing taxable income.

2. Key Clarifications by RBI (Notification dated 14-Oct-2016)

- NBFCs are to follow RBI's prudential norms: The notification clarified that NBFCs should adhere to the existing regulatory framework prescribed by RBI.

- Since NBFCs follow prudential norms for income recognition, asset classification, and provisioning, ICDS provisions should not conflict with these regulatory requirements.

- Accounting vs. Tax Computation:

- NBFCs must continue following RBI's norms for financial statements.

- For tax computation, adjustments can be made as per ICDS, but without violating RBI guidelines.

3. Impact of This Notification:

- Minimized ambiguity on whether NBFCs should adopt ICDS in their accounting policies.

- Ensured compliance with both RBI's prudential norms and income tax requirements.

- Reduced tax disputes by clarifying that tax adjustments should be made only for income computation, not for financial reporting.

5.4.10 The appellant has violated both RBI policy and Income Tax Act provisions by shifting to the cash method of accounting for loan processing income, citing the RBI circular dated 14 October 2016 due to following reasons:

1. Violation of RBI Policy

- NBFCs must follow accrual accounting: RBI's prudential norms require NBFCs to follow the accrual basis of accounting for income recognition, except in cases of nonperforming assets (NPAs).

- RBI's 14 Oct 2016 Circular does not permit a shift to cash accounting:

- The circular only clarifies that NBFCs must follow RBI norms for financial reporting and make ICDS adjustments for tax purposes.

- It does not allow companies to shift their entire accounting method for specific income streams.

2. Violation of the Income Tax Act, 1961

- Section 145 of the Income Tax Act mandates that businesses must follow either the cash or mercantile (accrual) system of accounting consistently. Therefore, selective switching between these methods is not allowed.

- ICDS does not permit a shift to cash accounting:

- ICDS-IV (Revenue Recognition) states that income from services must be recognized on an accrual basis, except where ultimate collection is uncertain.

- Loan processing fees are typically earned upfront and should be recognized when due, not when received.

- It is important to understand the tax Avoidance Concern: In this regard, the company's move is aimed at reducing taxable profit.

5.4.11 The supreme court in the **CIT v. McDowell & Co. Ltd. (2009) 180 Taxman 514 (SC)** has held that Change in accounting policy purely to gain tax benefits can be disregarded. The revenue's contention is also fortified by the decision of the apex court in the case of **CIT v. Realest Builders & Services Ltd. (2008) 307 ITR 202 (SC)** wherein the Supreme Court held that accounting changes that are not consistently followed cannot be accepted. It is therefore fallacious on the part of the appellant in so far as since the company switched to cash system of accounting only for loan processing income (while keeping other incomes on the accrual basis), it is an inconsistent accounting practice. This therefore allows the tax authorities to prevent the leakage of revenue in such conditions and the AO's action was rightfully correct in disallowing the ICDS adjustment in disregard of violation of RBI's prudential norms and of the

provisions of the Income Tax Act. It is important to highlight that the method adopted by appellant is in contravention of ICDS (Income Computation and Disclosure Standards). The ICDS-IV (Revenue Recognition) explicitly requires that income from services must be recognized on an accrual basis, unless there is uncertainty in collection.

- Loan processing income is earned upfront when the loan is sanctioned, not when received.

- ICDS was applicable from AY 2017-18, meaning the company cannot justify this change under ICDS provisions.

5.4.12 It is therefore reiterated that the appellant NBFC's shift to cash accounting directly violates ICDS-IV, making its claim legally unsustainable. Further, there is clear cut Violation of RBI's Prudential Norms for NBFCs by the appellant in so far as it has disregarded the RBI's Master Directions on Prudential Norms for NBFCs mandating that income recognition should be on an accrual basis, except in the case of NPAs. As per the facts of the case, and as per the analysis and conclusion arrive at the loan processing income is not linked to NPAs, so it must be recognized on an accrual basis as per RBI rules. The RBI Circular dated 14 October 2016 did not allow NBFCs to shift to cash accounting for specific income streams. Reliance is placed on the following legal decision of several courts with there respective head notes:

1. CIT v. Bank of Rajasthan Ltd. (2010) 326 ITR 526 (Raj.) – Held that RBI norms cannot be ignored for income recognition.

2. McDowell & Co. Ltd. v. CTO (1985) 154 ITR 148 (SC).

a) **CIT V. MCMILLAN & CO. (1958) 33 ITR 182 (SC)** : 'The Supreme Court held that a change in accounting method must be bona fide and should not be used as a tool for tax evasion.'

B) **CIT V. PUNJAB STAINLESS STEEL INDUSTRIES (2014) 364 ITR 144)**: 'The Court ruled that an assessee cannot adopt an inconsistent method of accounting if it results in artificial reduction of income.'

5.4.13 The sum and substance of the aforesaid discussion and in view of the decisions of the aforementioned courts is that as the shift to cash accounting was done by the appellant only to reduce tax liability, it has therefore correctly been treated as colorable device and claim of tax relief has been denied under the principles laid down under the principle of Sham Transaction Doctrine which clearly underlines that if the accounting change does not reflect real income, the tax authorities can disregard the change and assess tax as per accrual

accounting. Further, since the change in accounting policy has reduced taxable profit without any business rationale, the same has correctly been overturned by the AO and necessary disallowance has correctly been made by the AO.

5.4.14 Further, the appellant has requested to provide opportunity of video conference to explain its case before the undersigned. In this regard, following the principle of natural justice, the undersigned has provided video conference facility to the appellant on 12.03.2025 which was rescheduled to 17.03.2025 due to technical errors. The video conference was conducted successfully on 17.03.2025 and the appellant has attended the video conference and explained its stance before the undersigned. The appellant has re-submitted the submissions filed earlier during the appellate proceedings. The appellant has repeated all the material that is already discussed here. The appellant could not produce any new arguments or substantive material in its support. The submission of the appellant relating to this ground of appeal is reproduced for ready reference:

XXX XX XXX

5.4.15 Therefore, in my considered view, the Assessing Officer has given sufficient cause for not accepting the explanation offered by the assessee and the findings of the AO was based on proper appreciation of material available on record. The AO has given detailed reasoning behind making this addition. The appellant NBFC's shift to cash accounting directly violates ICDS-IV, making its claim legally unsustainable. Further, there is clear cut Violation of RBI's Prudential Norms for NBFCs by the appellant as noted above in so far as it has disregarded the RBI's Master Directions on Prudential Norms for NBFCs mandating that income recognition should be on an accrual basis, except in the case of NPAs. As per the facts of the case, and as per the analysis and conclusion arrive at the loan processing income is not linked to NPAs, so it must be recognized on an accrual basis as per RBI rules. The RBI Circular dated 14 October 2016 did not allow NBFCs to shift to cash accounting for specific income streams. The appellant has failed on its part how the claim of the assessing officer that overall effect of change in accounting policy by the appellant is that the finance costs for the year are higher and profit before tax is lower by Rs.11,44,51,818/-, is not justified. Therefore, based on the finding stated above, this ground of the appellant is dismissed and addition of Rs.11,44,51,818/- made by the AO is sustained.

5.5 **Ground no. 4** of the appellant is general in nature. Nothing specific was stated by the appellant in this ground. Hence, this ground of the appeal is dismissed.

6. In the result, the appeal of the appellant is **dismissed."**

8. The assessee company, being aggrieved with the CIT(A) order, has carried the matter in appeal before us.

9. We have heard the Learned Authorized Representatives of both the parties, perused the orders of the lower authorities and the material available on record, as well as considered the judicial pronouncements and instructions, notifications, etc., as have been brought to our notice by the Learned Authorized Representatives of both the parties.

10. Sri Nikhil Tiwari, Chartered Accountant, the Learned Authorized Representative (for short, "Ld. AR") for the assessee company, at the threshold of hearing of the appeal, submitted that the authorities below had grossly erred in law and facts of the case in treating the cash deposits of Rs. 56.41 crores made in Specified bank notes (SBNs) by the assessee company during the demonetization period, i.e., 09/11/2016 to 30/12/2016 in its bank accounts held with 346 branches of various banks across the country as the assessee's unexplained money under section 69A of the Act. Elaborating on his contention, the Ld. AR submitted that the assessee company is an

NBFC, and the subject cash deposits made in its bank accounts during the demonetization period were sourced out of the repayment of the loans/borrowings by the woman borrowers to whom it had advanced the amounts in the normal course of its business. The Ld. A.R. submitted that the auditors of the assessee company had reported the subject cash deposits at Para 4.31 of its audit report for the subject year. The Ld. AR further submitted that the assessee company to dispel any doubt regarding the veracity of its aforesaid claim regarding the source of the subject cash deposits made during the demonetization period, had vide its reply filed with the CIT(A) on 12.03.2025 had furnished the borrower wise cash collection details made by the assessee comapny during the period 09/11/2016 to 31/12/2016, Page 240-305 of APB. The Ld. AR submitted that as the assessee company had collected the subject amount against the borrowers loan obligations which had fallen due in the ordinary course of its business and had deposited the same in its bank accounts; therefore, there was no justification for the AO to have held the same as having been sourced out of the its unexplained money under Section 69A of the Act. The Ld. AR submitted that the standalone

reason that had weighed in the AO's mind while summarily discarding the assessee's explanation regarding the source of the subject cash deposit of Rs. 56.41 crores (supra) in its bank accounts during the demonetization period, was, that now when the Government of India vide its Notification No. 2652, dated 08/11/2016 had demonetized Rs. 500/- and Rs. 1000/- denominations of bank notes (SBNs) which, thus, ceased to be legal tender anymore w.e.f. 09/11/2016, therefore, it was incomprehensible and unlawful for the assessee company to have continued receiving such demonetized currency (SBNs) in the course of its business. The Ld. AR submitted that the AO had further observed that the Government of India had issued a Notification S.O. No. 3407(E), dated 08/11/2016 withdrawing the legal tender status to the bank notes of the value of Rs. 500/- and Rs. 1000/-, but, had provided a window to the holders of such SBNs to deposit the same in their accounts maintained with any bank on or before 30/12/2016, so that the equivalent value of the same be credited to their respective accounts. The Ld. AR submitted that the AO held a firm conviction that the Government had carved out an exemption, wherein transactions in the demonetized currency (SBNs) were allowed for the

limited purpose of making payments for essential services at places viz., petrol bunks, gas agencies etc., but had observed that the business of the assessee company, i.e., an NBFC did not fall within the meaning of the said exemptions. Accordingly, the A.O was of the view that as the assessee company was not exempted from transacting in SBN's, therefore, its claim of that it had continued to transact its business and received the repayment of loans from its borrowers in demonetized currency (SBNs) was not only incomprehensible but also ridiculed and rendered the demonetization scheme introduced by the Government to be nugatory. The Ld. AR submitted that the AO had based on his predetermined and halfhearted approach drawn adverse inferences, and without bringing on record any material which would have irrefutably dislodged the veracity of its explanation regarding the source of the cash deposits (SBN's) of Rs. 56.41 crores made in its bank accounts held with 346 branches across the country as having been sourced out of its unexplained money under section 69A of the Act.

11. Elaborating further on his contention, the Ld. AR had drawn our attention to The Specified bank notes (Cessation of Liabilities)

Ordinance, 2016. Also, the Ld. AR had taken us through the dictionary meaning of the term “legal tender”. Also, the Ld. AR had taken us through the relevant extract of The Reserve Bank of India Act, 1934 (for short, “RBI Act”), and submitted that as per section 26 of the said Act, every bank note shall be a legal tender at any place in India in payment; or on account for the amount expressed therein, and shall be guaranteed by the Central Government. Also, it was submitted by him that as per Section 34 of the RBI Act, the liabilities of the Issuing Department, i.e., the Reserve Bank of India (RBI) shall be an amount equal to the total of the amount of the currency notes of the Government of India and bank notes for the time being in circulation. Apart from that, the Ld. AR had drawn our attention to the Frequently Asked Questions (FAQs) issued by the Reserve Bank of India on 15th April, 2025, wherein the term “legal tender” was explained, Page 641 of APB. Further, the Ld. AR had drawn our attention to the Notification No. S.O. 3408(E), dated 08/11/2016, issued by the Ministry of Finance (Department of Economic Affairs), wherein the Central Government had declared that the bank notes of the existing series of the denominations of the value of Rs. 500/- and Rs. 1000/-

(hereinafter referred to as, “SBN’s”) shall cease to be a legal tender from 09/11/2016. The Ld. AR had further drawn our attention to “The Specified Bank Notes (Cessation of Liabilities) Act, 2017” (Act No.2 of 2017), dated 27/02/2017. The Ld. AR submitted that the said Act provided for in the public interest for the cessation of liabilities on the specified bank notes. The Ld. AR submitted that the said Act, i.e., The Specified bank notes (Cessation of Liabilities) Act, 2017 (Act No.2 of 2017, had come into force on 31/12/2016. Elaborating further on his contention, the Ld. AR submitted that as per Section 3 of the said Act, the Specified Bank Notes (SBNs) ceased to be a liability of the Reserve Bank of India or Central Government on and from 31/12/2016, i.e., the appointed day (as defined in the said Act), notwithstanding anything contained in The Reserve Bank of India Act, 1934 (2 of 1934) or any other law for the time being in force. The Ld. AR submitted that Section 5 of the Act further provided that on and from 31/12/2016, i.e., the appointed day, no person shall, knowingly or voluntarily, hold, transfer or receive any specified bank note (SBN). The Ld. AR, based on his aforesaid contention, had vehemently submitted that, as per The Specified bank notes (Cessation of

Liabilities) Act, 2017 (Act No.2 of 2017), it was only on and from 31/12/2016, that no person shall, knowingly or voluntarily, hold, transfer or receive any specified bank note. Elaborating on his contention, the Ld. AR submitted that as per The Specified bank notes (Cessation of Liabilities) Act, 2017 (Act No.2 of 2017), there was no prohibition on any person from either holding, transferring, or receiving any specified bank note up to the appointed day, i.e., 31/12/2106. The Ld. AR based on his aforesaid contention submitted that the cash amounting to Rs. 56.41 crores (supra) received by the assessee company from its borrowers towards repayment of their loans during the demonetization period, i.e., from 09/11/2016 to 30/12/2016 was supported by the concession provided by Section 5 of The Specified bank notes (Cessation of Liabilities) Act, 2017 (Act No.2 of 2017). The Ld. AR submitted, that as the cash amounting to Rs. 56.41 crores (supra) was received by the assessee company towards repayment from its identifiable borrowers during the demonetization period, and the said respective transactions was recorded in its duly audited books of accounts, therefore, there was no justification for the AO to have held brought the same within the

meaning of unexplained money under section 69A of the Act. The Ld. AR to support his aforesaid contention relied on a host of judicial pronouncements (copies placed on record).

12. The Ld. AR further submitted that the AO had grossly erred in law and facts of the case in losing sight of the reason for deviation by the assessee company from recognizing both its finance costs and the loan processing fee collected from the borrowers during the subject year, which in turn was based on the clarification issued by the Reserve Bank of India, dated 14/10/2016 and, thus, had on wrong premises, by wrongly observing that the assessee company which was following the mercantile system of accounting had failed to account for an amount of Rs. 11,44,51,818/- that was assessable in its hands on accrual basis, had made an addition of the same to its returned income. Elaborating on his contention, the Ld. AR submitted that the addition of Rs. 11,44,51,818/- (supra) made by the A.O. was double facet, viz., (i) that based on the clarification issued by the Reserve Bank of India on 14/10/2016 the assessee company had changed its accounting policy for recognizing its ancillary borrowing costs in the period in which they were incurred as against amortizing

them over the tenure of the borrowing as was done in the preceding years, which, thus had escalated the finance costs and lowered its profits for the year under consideration by an amount of Rs. 23,26,99,652/-; and (ii) that based on the clarification issued by the Reserve Bank of India, dated 14/10/2016, the assessee company had changed its accounting policy for recognizing the loan processing fee collected from the borrowers in the period in which it was collected as against amortizing it over the tenure of the loan as was done in the preceding years, which, thus had increased the loan processing fee income and the consequential profit by an amount of Rs.11,82,47,834/-. The Ld. AR submitted that based on the netting of the aforesaid increase in the finance cost and loan processing fee income, there was a resultant reduction in the profits of the assessee company by an amount of Rs. 11,44,51,818/-. The Ld. AR submitted that as the assessee company was constrained to deviate from its accounting policy and recognize both the ancillary borrowing cost and the loan processing fee collected from the borrowers as per the guidelines of the mother bank, i.e., Reserve Bank of India, therefore, there was no justification for the AO to have alleged that the assessee

company had violated the mandatory provisions of section 145 of the Act. The Ld. AR to buttress his claim that the shift in the method of accounting, i.e., recognizing the ancillary borrowing costs by the assessee company was permissible as per the mandate of law, had relied upon the judgment of the Hon'ble Supreme Court in the case of Taparia Tools Ltd. vs. JCIT (2015) 372 ITR 605 (SC) and that of the Hon'ble High Court of Delhi in the case of CIT v. Citi Financial Consumer Fin. Ltd (2011) 335 ITR 29 (Delhi). Also, the Ld. AR had pressed into service the order of the coordinate Bench of the Tribunal, i.e., ITAT, Kolkata in the case of Magma Fincorp Limited vs. DCIT, Circle-8(1), Kolkata (2017) 82 taxmann.com 481 (Kolkata).

13. Per contra, the Learned Commissioner of Income Tax-Departmental Representative (for short, "Ld. CIT-DR") at the threshold of hearing, submitted that as the Government of India vide its Notification S.O. No. 3407(E), dated 08/11/2016 had in exercise of the powers conferred by sub-section (2) of section 26 of the Reserve Bank of India Act, 1934 (2 of 1934), had declared that the bank notes of the denominations of the existing series of the value of Rs. 500/- and Rs. 1000/- (SBN's) shall cease to be legal tender w.e.f.

09/11/2016, therefore, it was not only incomprehensible but in fact unlawful for any person (subject to the exemption for the specific class of persons to facilitate making payments for essential services) to have continued transacting in such demonetized currency (SBNs) which had ceased to be a legal tender anymore. The Ld. CIT-DR submitted that as the assessee company had failed to come forth with any plausible explanation regarding the source of the cash deposits of Rs. 56.41 crores (supra) made in its bank accounts held with 346 branches across the country during the demonetization period, therefore, both the authorities below had rightly held that the subject cash deposits were sourced out of the unexplained money of the assessee company and brought the same to tax under section 69A of the Act. The Ld. CIT-DR, in his attempt to support his aforesaid contention, had relied upon a host of judicial pronouncements. Also, the Ld. CIT-DR had placed on record the judgment of the Hon'ble Supreme Court in the case of Vivek Narayan Sharma vs. Union of India, Writ Petition (Civil) No. 906 of 2016, dated 02/01/2023. The Ld. CIT-DR submitted that the Hon'ble Supreme Court (by a majority decision) had, inter alia, held that the Notification S.O. No. 3407(E),

dated 08/11/2016, does not suffer from any flaw in the decision making process and satisfied the test of proportionality and, thus, cannot be struck down. The Ld. CIT-DR had placed on record the aforesaid judgment in the case of Vivek Narayan Sharma vs. Union of India, Writ Petition (Civil) No. 906 of 2016, dated 02/01/2023 (supra) and, had claimed that as the same was not considered in the judicial pronouncements that have been relied upon by the Learned A.R., therefore, the same will not hold the ground. Apart from that, the Ld. CIT-DR had placed on record the judgment of the Hon'ble Supreme Court in the case of Pankaj Gupta Vs. Principal Chief Commissioner of Income Tax (2025) 175 taxmann.com 238 (SC), wherein the Special Leave Petition (SLP) filed by the assessee against the judgment of the High Court of Orissa was dismissed. The Hon'ble High Court of Orissa, in its order, had upheld the order of the Tribunal, which had rejected the assessee's unsubstantiated explanation that the cash deposits in SBNs of Rs. 28 lacs made in his bank account during the demonetization period were sourced from the cash sales made by him in the normal course of his business during the said period. On a perusal of the order of the ITAT, SMC

Bench, Cuttack in ITA No.66/CTK/2023, we find that the Tribunal taking cognizance of the fact that as the assessee who was engaged in the business of wholesale/retail trading of goods did not fall within the exempted categories of persons who were permitted to transact/deal in demonetized currency during the period of demonetization period, had, thus, observed that his claim that the cash deposits (SBNs) of Rs. 28 lacs made in his bank account during the demonetization period was sourced out of the cash sale proceeds received by him during the demonetization did not merit acceptance. Also, we find that the Hon'ble High Court of Orissa, in its order passed the case of Pankaj Gupta vs. Principal Chief Commissioner of Income Tax (2025) 174 taxmann.com 747 (Orissa), had approved the view taken by the Tribunal.

14. The Ld. CIT-DR had placed on our record the CBDT Instruction No.3/2017, dated 21/02/2017, which provides for the Standard Operating Procedure (SOP) to be followed by the Assessing Officers in verification of the cash transactions relating to the demonetization period. Also, the Ld. CIT-DR had placed on our record the CBDT Instruction, i.e., F. No. 225/363/2017-ITA.II, dated 05/03/2019, which

provides for the SOP for handling of cases related to substantial cash deposit during the demonetization period, where the notice under Section 142(1) of the Act has not been complied with by the assessee. The Ld. CIT-DR based on his aforesaid contention states that as no infirmity emerges from the orders of the authorities below who have rightly held that as the assessee company had failed to come forth with any plausible explanation regarding the source of the cash deposits (SBNs) of Rs. 56.41 crores (supra) made in its bank accounts during the demonetization period, therefore, the same was to be held as having been sourced out of its unexplained money under section 69A of the Act.

15. Apropos the addition of Rs. 11.44 crores (approx.) made by the AO, the Ld. CIT-DR relied upon the orders of the authorities below. The Ld. CIT-DR submitted that, as the Reserve Bank of India guidelines that the assessee had claimed to have followed were issued under delegated legislation for the purpose of effective supervision and control of the monetary and credit system, therefore, the same cannot be permitted to override the mandatory provisions of Section 145 of the Act. Elaborating further on his contention, the

Ld. CIT-DR submitted that as the assessee company is following the mercantile system of accounting, therefore, the finance cost and loan processing fee collected from the borrowers were to be assessed in its hands on an accrual basis. It was, thus, the Ld. CIT-DR's contention that as both the authorities below have rightly made/sustained the addition of Rs. 11.44 crores (supra), therefore, no infirmity arises from their respective orders.

16. We have thoughtfully considered the contentions advanced by the Learned Authorized Representatives of both parties in the backdrop of the orders of the lower authorities and the material available on record.

17. We shall first take up the Ld. AR's contention that both the authorities below had grossly erred in law and facts of the case in treating the duly disclosed cash deposits of Rs. 56.41 crores (supra) deposited by the assessee company during the demonetization period in its various bank accounts with 346 branches across the country, as having been sourced out of its unexplained money under section 69A of the Act.

18. Admittedly, it is a matter of fact borne from the record that the assessee company had, during the demonetization period, i.e., 09.11.2016 to 30.12.2016, made cash deposits aggregating to Rs. 135,62,10,311/- in its bank accounts held with 346 branches across the country during the demonetization period. On a perusal of the record, we find that the aforesaid cash deposits of Rs. 135,62,10,311/- (supra) made by the assessee company during the demonetization period, i.e., 09/11/2016 to 30/12/2016, comprised of cash deposits (SBNs) of Rs. 56.41 crores made during the said period in its said bank accounts.

19. Controversy involved in the present appeal hinges around the explanation of the assessee company with respect to the cash deposits (SBNs) of Rs. 56.41 crores made during the demonetization period in the bank accounts of the assessee company held with 346 branches across the country. As observed herein above, it was the claim of the assessee company that the cash deposits (SBNs) of Rs. 56.41 crores (supra) were sourced out of the cash repayment of the unsecured micro finance loans that it had in the normal course of its business as that of an NBFC advanced to woman borrowers

belonging to the low-income households in villages through the Joint Liability Group model. However, we find that the AO had outrightly rejected the explanation of the assessee company for the standalone reason that now when the Government of India vide its Notification S.O. No.3407(E), dated 08/11/2016 had withdrawn the legal tender status to the bank notes of the value of Rs. 500/- and Rs. 1000/- (i.e. SBNs), therefore, it was not only incomprehensible but also unlawful for the assessee company to have thereafter received cash amounts in discharge of the outstanding loan obligations of the aforementioned borrowers. Also, we find that the AO while so concluding had specifically taken note of the fact that the Government had while demonetizing the legal tender status of the aforesaid currency, i.e., SBNs had carved out an exemption wherein such SBNs continued to be a legal tender during the demonetization period for the limited purpose of making payments at places like petrol bunks, gas agencies, etc. It was, thus Ld. AO's observation that as the business of the assessee company, i.e., an NBFC, was not covered by the aforesaid exempted category of services, therefore, its claim of

having received SBNs towards repayment of loans from its borrowers did not merit acceptance.

20. We have thoughtfully considered the view taken by the authorities below in the backdrop of the contentions of both the Learned Authorized Representatives. At the threshold, we may herein observe that the Hon'ble Supreme Court in its order in **Vivek Narayan Sharma Vs. Union of India, Writ Petition (Civil) No. 906 of 2016, dated 02/01/2023**, had held that the Notification S.O. No.3407(E), dated 08/11/2016 based on which the legal tender status to the bank notes of the value of Rs. 500/- and Rs. 1000/- (SBNs) had been withdrawn did not suffer from any flaws and satisfied the test of proportionality and thus, was not liable to be struck down. Accordingly, the Ld. AR's contentions that the demonetized currency was a legal tender cannot be accepted and is accordingly rejected.

21. Apart from that, we find that the view taken by the **ITAT, SMC Bench, Cuttack** in **Pankaj Gupta Vs. ITO, Baragarh** in **ITA No.66/CTK/2023, dated 16/05/2023**, wherein it was, inter alia, held that as on the date of demonetization except for specified persons no other persons were permitted to transact in the demonetized currency

unless they fall within the exempt category of persons who are permitted to deal with the demonetized currency, had therafter been approved by the **Hon'ble High Court of Orissa** in **Pankaj Gupta vs. Principal Commissioner of Income Tax (2025) 174 taxmann.com 747 (Orissa)**. Also, the **Special Leave Petition (SLP)** filed by the aforementioned assessee before the **Hon'ble Supreme Court** had been dismissed in **Pankaj Gupta vs. Principal Commissioner of Income Tax (2025) 175 taxmann.com 238 (SC)**. We, thus, are of a firm conviction that the claim of an assessee that the cash deposits (SBNs) made in his bank account during the demonetization period, cannot be summarily accepted and would require thorough verification.

22. At the same time, we find that the CBDT vide its Instruction No. 3/2017 (F.No. 225/100/2017/ITA-II), dated 21/02/2017, had laid down the Standard Operating Procedure (SOP) to be followed by the Assessing Officers in verification of cash transactions relating to demonetization. On a perusal of the aforesaid Instruction No. 3/2017 (supra), we find that the same, inter alia, provide the SOP that has to be followed by the Assessing Officers for verification of cash

transactions relating to demonetization, viz., (i) cash received from identifiable persons (with PAN); (ii) cash received from identified persons (without PAN); and (iii) cash received from un-identified persons. For the sake of clarity, we deem it apposite to cull out the relevant extract of the CBDT Instruction No. 03/2017, dated 21/02/2017, as under (relevant extract):

"GOVERNMENT OF INDIA
MINISTRY OF FINANCE
DEPARTMENT OF REVENUE
CENTRAL BOARD OF DIRECT TAXES
NEW DELHI

Instruction No. 3/2017 February 21, 2017

Subject: - Standard Operating Procedure (SOP) to be followed by the Assessing Officers in verification of Cash transactions relating to demonetisation - regd.

Post demonetisation of Rs. 500 and Rs. 1000 notes on November 8, 2016, several malpractices has been noticed. The Income Tax Department is enquiring/seeking information and analysing instances of deposits to identify cases involving risk of tax evasion. Based upon vast amount of information of cash deposits collected and analysed by CBDT, a number of persons have been identified in whose case the cash transactions did not appear to be in line with their profile available with the Income-tax Department ('ITD'). In such cases, it has been decided to undertake online verification of select transactions through jurisdictional Assessing Officers ('AOs').

XX XXX XX

Source Specific General Verification Guidelines

1. Cash out of earlier income or savings

1.1 In case of an individual (other than minors) not having any business income, no further verification is required to be made if total cash deposit is up to Rs. 2.5 lakh. In case of taxpayers above 70 years of age, the limit is Rs. 5.0 lakh per person. The source of such amount can be either household savings/savings from past income or amounts claimed to have been received from any of the sources mentioned in Paras 2 to 6 below. Amounts above this cut-off may require verification to ascertain whether the same is explained or not. The basis for verification can be income earned during past years and its source, filing of ROI and income shown therein, cash withdrawals made from accounts etc.

1.2 In case the individual claims that cash deposit includes savings of other person(s), the necessary information is required to be submitted under Para 4 or Para 5 below, as the case may be.

1.3 In case of an individual having no business income, if the cash out of earlier income or savings exceeds the above mentioned threshold, the AO needs to consider the remarks provided by the person under verification and seek further relevant information. During verification, the AO needs to consider the information provided by the person concerned, income earned during past years, source of such income, filing of ROI and income shown therein, cash withdrawals made from accounts etc. before quantifying the undisclosed amount, if any. In case the person under verification has filed return of Income, a reasonable quantum can be considered as explained while quantifying the undisclosed amount, if any.

1.4 In case of persons engaged in business or requirement to maintain books of accounts, no additional information is required to be submitted by the person under verification if total cash out of earlier income or savings (sum of responses for all cash transactions) is not more than the closing cash balance as on 31st March 2016 in the return for AY 2016-17. However, if the AO has reason to believe that the closing cash balance as on 31st March 2016 has been increased by revising the return or backdating transactions in the books of account, further verification may be carried out.

1.5 In case of persons engaged in business or required to maintain books of accounts, if total cash out of earlier income or savings (sum of responses for all cash transactions) is more than the closing cash balance as on 31st March 2016 in the return for AY 2016-17, the AO needs to consider the remarks provided by the taxpayer and seek relevant information, i.e. closing balance as on 31st March 2016 as reflected in the books of account. During verification, the AO may consider the information

provided by the person under verification, income earned during past years, source of such income, filing of ROI and income shown therein, cash withdrawals made from accounts etc. before quantifying the undisclosed amount, if any.

1.6 If the person under verification has claimed that the cash deposit has been disclosed in IDS 2016 and if the same is found to be correct, no further verification should be made. 1.7 In case, there is information or apprehension/suspicion that a particular bank account(s) has been misused for money laundering/tax evasion/entry operations in shell companies, the monetary cut-off or cash-balance based cut off prescribed in clauses above requiring no-verification, shall not be applicable.

2. Cash out of receipts exempt from tax

2.1 If the cash is explained to be out of receipts exempt from tax, and the same is not in line with the earlier returns filed by the person under verification, the AO needs to consider the remarks provided by the person and seek relevant information (e.g. records of land-holding and other relevant evidences etc. in case of agricultural income), to form appropriate view and quantify unexplained income.

3. Cash withdrawn out of bank account

3.1 The AO needs to consider the remarks provided by the person under verification and seek relevant information i.e. copy of bank statement/passbook to form appropriate view and quantify unexplained income.

3.2 Bank statement/passbook may be verified to confirm the name of the account holder. The date and amount of cash withdrawals and cash deposits in the bank account may be matched to verify whether claim that the cash deposited is out of cash withdrawn out of bank account is acceptable. Further removed in time the withdrawal is from the date of demonetization i.e. 8th November, 2016, the more suspicious it looks. The AO should take a balanced view in analyzing the time gap from the point of view of normal human behaviour and specific circumstances of the case.

4. Cash received from identifiable persons (with PAN)

4.1 No additional information is required to be submitted by the person under verification as the information will be pushed to the AO of the identifiable persons (with PAN).

4.2 In case the identifiable person (with PAN) does not confirm the transaction, the response will be referred back for further verification.

4.3 In case of a gift, it may be seen whether the same is taxable in the hands of the recipient under section 56(2) of the Act.

5. Cash received from identifiable persons (without PAN)

5.1 The AO needs to verify if the cash receipts are not in line with the normal practices of concerned business as mentioned in the earlier returns of Income after considering the remarks provided by the taxpayer, nature of business and earlier history before seeking additional information.

5.2 In case of other cash receipts, strategies for verification may be made in consultation with the Pr. CIT so that consistency is maintained in the entire charge based on nature of transaction.

6. Cash received from un-identifiable persons

6.1 The AO needs to verify if the cash transactions or its quantum are not in line with the normal practices of concerned business as mentioned in the earlier returns of Income.

6.2 During verification, the AO may seek relevant information e.g. monthly sales summary (with breakup of cash sales and credit sales), relevant stock register entries, bank statement etc. to identify cases with preliminary suspicion of back-dating of cash sales or fictitious sales. Some indicators for suspicion of back dating of cash sales or fictitious sales could be;

i. Abnormal jump in the cash sales during the period Nov to Dec 2016 as compared to earlier history.

ii. Abnormal jump in percentage of cash sales to unidentifiable persons as compared to earlier history.

iii. More than one deposit of specified bank notes in the bank account late in the demonetization period.

iv. Non-availability of stock or attempts to inflate stock by introducing fictitious purchases. v. Transfer of deposited cash to another account/entity which is not in line with earlier history.

6.3 In case of receipt of cash on account of donation, indicators similar to above may be kept in mind.

6.4 In case of other cash receipts, strategies for verification may be made in consultation with the Pr. CIT.

7. Cash Disclosed/To be disclosed under PMGKY

7.1 In case the taxpayer mentions that the Cash Disclosed/to be disclosed under PMGKY, the same may be verified.

7.2 If the process of disclosure is informed to be pending, verification can be kept pending till the evidence is furnished.

7.3 The verification should be closed on the basis of evidence of disclosure made under PMGKY."

(emphasis supplied by us)

23. As observed hereinabove, it is the Ld. AR's claim before us that as the complete details of the borrower-wise cash collections made by the assessee company during the demonetization period, i.e., 09/11/2016 to 30/12/2016, had been maintained, and based on the same, its financial statements had been compiled and thereafter audited, therefore, the A.O. was not justified in brushing aside the said details and summarily discarding the assessee'ds duly substantiated explanation regarding the sources of the subject cash deposits (SBNs) of Rs. 56.41 crores made in its bank accounts during the demonetization period. The Ld. AR to buttress his aforesaid claim had drawn our attention to the borrower-wise cash collection details made by the assessee during the demonetization, i.e., 09/11/2016 to 31/12/2016, which are stated to have been filed with the authorities below (on a sample basis), Page 261-380 of APB. It was, thus, the Ld. AR's claim that as the cash deposits (SBNs) of Rs. 56.41 crores (supra) made in the bank accounts of the assessee company in 346

branches of various banks across the country was beyond doubt sourced from the repayment of loans/borrowings by duly identifiable persons, i.e., the woman borrowers to whom unsecured micro finance loans were advanced, therefore, there was no justification for both the authorities below in summarily discarding the assessee's explanation *de hors* any verification and without any cogent reason treating the entire amount as having been sourced out of its unexplained money under section 69A of the Act.

24. We have thoughtfully considered the aforesaid contention of the Ld. AR and find substance in the same. Before proceeding further, we may observe that as per the settled position of law, the Instructions issued by the CBDT are binding on the Income Tax Authorities, who are bound to ritually follow the same. Our aforesaid view is supported by the judgment of the **Hon'ble Supreme Court** in the case of **Union of India and Anr. Vs. Azadi Bachao Andolan and Anr.** (2003) 263 ITR 706 (SC). For the sake of clarity, we deem it apposite to cull out the observations of the Hon'ble Apex Court in its aforesaid order, as under:

"Section 119, strategically placed in Chapter XIII which deals with 'Income-Tax Authorities' is an enabling power of the CBDT, which is recognised as an authority under the Income-tax Act under section 116(a). The CBDT under this section is empowered to issue such orders instructions and directions to other income-tax authorities "as it may deem fit for proper administration of this Act". **Such authorities and all other persons employed in the execution of this Act are bound to observe and follow such orders, instructions and directions of the CBDT**. The proviso to sub-section (1) of section 119 recognises two exceptions to this power. First, that the CBDT cannot require any income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner. Second, is with regard to interference with the discretion of the Commissioner (Appeals) in exercise of his appellate functions. **Sub-section (2) of Section 119 provides for the exercise of power in certain special cases and enables the CBDT, if it considers it necessary or expedient so to do for the purpose of proper and efficient management of the work of assessment and collection of revenue, to issue general or special orders in respect of any class of incomes of class of cases, setting forth directions or instructions as to the guidelines, principles or procedures to be followed by other income-tax authorities in the discharge of their work relating to assessment or initiating proceedings for imposition of penalties.** The powers of the CBDT are wide enough to enable it to grant relaxation from the provisions of several sections enumerated in clause (a). Such orders may be published in the Official Gazette in the prescribed manner, if the CBDT is of the opinion that it is so necessary. The only bar on the exercise of power is that it is not prejudicial to the assessee. We are not concerned with the provisions in clauses (b) and (c) in the present appeals.

In K.P. Varghese v. Income-Tax Officer, Ernakulam it was pointed out by this Court that not only are the circulars and instructions, issued by the CBDT in exercise of the power under section 119, binding on the authorities administering the tax department, but they are also clearly in the nature of contemporanea expositio furnishing legitimate aid to the construction of the Act.

The Rule of contemporanea expositio is that "administrative construction (i.e. contemporaneous construction placed by administrative or executive officers) generally should be clearly wrong before it is overturned; such a construction commonly referred to as practical construction, although non-controlling, is nevertheless entitled to considerable weight, it is highly persuasive." The validity of this principle was recognised in Baleshwar Bagarti v. Bhagirathi Dass where the Calcutta High Court stated the rule in the following words :

"It is a well-settled principle of interpretation that courts In construing a statute will give much weight to the interpretation put upon it, at the time of its enactment and since, by those whose duty it has been to construe, execute and apply it." The statement of this rule has also been quoted with approval by this Court in Deshbandhu Gupta & Company v. Delhi Stock Exchange Association Ltd .

In K.P. Varghese this Court held that the circulars of the CBDT issued in exercise of its power under section 119 are legally binding on the revenue and that this binding character attaches to the circulars "even if they be found not in accordance with the correct interpretation of sub-section (2) and they depart or deviate from such construction." Navnit Lal C. Javeri v. K.K. Sen and Ellerman Lines Ltd. v. CIT clearly establish the principle that circulars issued by the CBDT under section 119 of the Act are binding on all officers and employees employed in the execution of the Act, even if they deviate from the provisions of the Act.

In UCO Bank v. Commissioner of Income-Tax, dealing with the legal status of such circulars, this Court observed:

"Such instructions may be by way of relaxation of any of the provisions of the sections specified there or otherwise. The Board thus has power, inter alia, to tone down the rigour of the law and ensure a fair enforcement of its provisions, by issuing circulars in exercise of its statutory powers under section 119 of the Income-tax Act which are binding on the authorities in the administration of the Act.

Under section 119(2) however, the circulars as contemplated therein cannot be adverse to the assessee. Thus the authority which wields the power for its own advantage under the Act is given the right to forgo the advantage when required to wield it in a manner it considers just by relaxing the rigour of the law or in other permissible manners as laid down in section 119. The power is given for the purpose of just, proper and efficient management of the work of assessment and in public interest. It is a beneficial power given to the Board for proper administration of fiscal law so that undue hardship may not be caused to the assessee and the fiscal laws may be correctly applied. Hard cases which can be properly categorised as belonging to a class, can thus be given the benefit of relaxation of law by issuing circulars binding on the taxing authorities." In Commissioner of Income-Tax v. Anjum M.H.Ghaswala and Others it was pointed out that the circulars issued by CBDT under Section 119 of the Act have statutory force and would be binding on every income-tax authority although such may not be the case with regard to press releases issue by the CBDT for information of the public.

In Collector of Central Excise Vadodra v. Dhiren Chemical Industries , this Court, interpreting the phrase 'appropriate', observed :

"We need to make it clear that, regardless of the interpretation that we have placed on the said phrase, if there are circulars which have been issued by the Central Board of Excise and Customs which place a different interpretation upon the said phrase, that interpretation will be binding upon the Revenue." While commenting adversely upon the validity of the impugned circular, the High Court says "that the circular itself does not show that the same has been issued under Section 119 of the Income-tax Act. Only in a case where the circular is issued under Section 119 of the Income-tax Act, the same would be legally binding on the revenue. The circular does not deal with the power of the ITO to consider the question as to whether although apparently a company is incorporated in Mauritius but whether the company is also a resident of India and/or not a resident of Mauritius at all." It is trite law that as long as an authority has power, which is traceable to a source, the mere fact that source of power is not indicated in an instrument does not render the instrument invalid.

Is the impugned circular ultra-vires Section 119? It was contended successfully before the High Court that the circular is ultra vires the provisions of section 119. Sub-section(1) of section 119 is deliberately worded in general manner so that the CBDT is enabled to issue appropriate orders, instruction or direction to the subordinate authorities "as it may deem fit for the proper administration of the Act". As long as the circular emanates from the CBDT and contains orders, instructions or directions pertaining to proper administration of the Act, it is relatable to the source of power under section 119 irrespective of its nomenclature.

Apart from sub-section(1), sub-section(2) of section 119 also enables the CBDT "for the purpose of proper and efficient management of the work of assessment and collection of revenue, to issue appropriate orders, general or special in respect of any class of income or class of cases, setting forth directions or instructions (not being prejudicial to assessees) as to the guidelines, principles or procedures to be followed by other income tax authorities in the work relating to assessment or collection of revenue or the initiation of proceedings for the imposition of penalties". In our view, the High Court was not justified in reading the circular as not complying with the provisions of section 119. The circular falls well within the parameters of the powers exercisable by the CBDT under Section 119 of the Act.

The High Court persuaded itself to hold that the circular is ultra vires the powers of the CBDT on completely erroneous grounds. The impugned circular provides that whenever a certificate of residence is issued by the

> Mauritius Authorities, such certificate will constitute sufficient evidence for accepting the status of residence as well as beneficial ownership for applying the DTAC accordingly. It also provides that the test of residence mentioned above would also apply in respect of income from capital gains on sale of shares. Accordingly, FIIs etc., which are resident in Mauritius would not be taxable in India on income from capital gains arising in India on sale of shares as per paragraph 4 of Article 13. This, the High Court thought amounts to issuing instructions "de hors the provisions of the Act".
>
> In our view, this thinking of the High Court is erroneous."

Also, support is drawn from the judgment of the **Hon'ble High Court of Chattisgarh** in the case of **Dy. CIT Vs. Sunita Finlease Ltd. (2011) 330 ITR 491 (Chattisgarh)**. It was observed by the Hon'ble High Court that the CBDT instructions are binding on the officers of the Income-tax department.

25. In the backdrop of the aforesaid settled position of law that the CBDT Instructions are to be followed by the Assessing Officer, we are of a firm conviction that the Assessing Officer in the present case before us while verifying the genuineness of the assessee's claim regarding the source of the cash deposits (SBNs) made in its bank accounts during the demonetization period could not have bypassed and lost sight of the aforesaid CBDT Instruction No.3/2017, dated 21/02/2017, wherein the Standard Operating Procedure (SOP) to be followed by the Assessing Officers in verification of cash transactions

relating to demonetization is provided for. In our view, now when the assessee company had claimed that the cash deposits (SBNs) of Rs. 56.41 crores made in its bank accounts during the demonetization period were sourced from the repayment of loans that it had in the normal course of its business advanced to the woman borrowers through the Joint Liability Group Model, then, the AO remained under a statutory obligation to have carried out necessary verifications regarding the said explanation of the assessee company in the backdrop of the CBDT Instruction No.3/2017, dated 21/02/2017. At this stage, we may herein observe that the aforesaid Instruction No.3/2017, dated 21/02/2017, takes care of the situations, viz., (i) cash is received by an assessee from identifiable persons (with PAN); (ii) cash is received by an assessee from identifiable persons (without PAN); and (iii) cash is received by an assessee from un-identifiable persons. As it is the claim of the assessee company that the cash deposits (SBNs) of Rs. 56.41 crores (SBNs) made in its bank accounts during the demonetization period was sourced from the cash received from identifiable woman borrowers whose complete details were available with it, therefore, the only issue that remains for

our consideration is as to whether or not the said borrowers would fall within the meaning of viz., (i) identifiable persons (with PAN); or (ii) identifiable persons (without PAN). In either case, the AO is statutorily obligated to follow the SOP provided by the CBDT Instruction No.3/2017, dated 21/02/2017, before drawing any inference regarding the veracity of the assessee's claim regarding the source of the subject cash deposits.

26. Be that as it may, we are of the firm conviction that the claim of the assessee company regarding the source of the subject cash deposits (SBNs) of Rs. 56.41 crores made in its 346 bank accounts across the country during the demonetization period ought not to have been summarily discarded by the AO, based on his view that as the legal tender status of the bank notes of the value of Rs. 500/- and Rs. 1000/- (SBNs) was withdrawn by the Central Government vide Notification S.O. No. 3407(E), dated 08/11/2016, therefore, for the said reason the explanation of the assessee company did not merit acceptance. We say so, for the reason that the A.O., while so concluding, ought to have carried out necessary verifications in line

with the SOP provided in the CBDT Instruction No.3/2017, dated 21/02/2017.

27. We thus, in the backdrop of our aforesaid deliberations are of a firm conviction that the view taken by both the authorities below, who have without carrying out any verifications summarily rejected the assessee's explanation regarding the source of the subject cash deposits (SBNs) of Rs. 56.41 crores made in its bank accounts, and held the same as having been sourced out its unexplained money made an addition of the said amount under Section 69A of the Act, cannot be approved as such on our part. We are of the view that the matter, in all fairness, requires to be set aside to the file of the AO, who is directed to verify the explanation of the assessee company regarding the source of the cash deposits (SBNs) of Rs. 56.41 crores (supra) made in its bank accounts during the demonetization period by strictly following the CBDT Instruction No. 3/2017, dated 21/02/2017. We, thus, set aside the matter to the file of the AO in terms of our aforesaid directions. The **Grounds of appeal Nos. 2.1 to 2.6** are allowed for statistical purposes in terms of our aforesaid observations.

28. We shall now deal with the claim of the assessee company that both the authorities below had grossly erred in law and facts of the case by making an addition of Rs. 11,44,51,818/- in its hands.

29. As observed hereinabove, we find that the assessee company had, pursuant to the clarification issued by the Reserve Bank of India, dated 14/10/2016, changed its accounting policy, viz., (i). recognised the ancillary borrowing costs in the period in which they were incurred as against amortizing them over the tenure of the borrowings, which, thus had resulted to an increase in its costs and reduced the profits by an amount of Rs.23,26,99,652/-; and (ii) recognised the loan processing fee collected from the borrowers in the period in which it was collected as against amortizing it over the tenure of the loan, which, thus, had resulted to increase in its profits by an amount of Rs. 11,82,47,834/-. The AO observed that in consequence of the aforesaid change in the accounting policy of the assessee company, its profits had reduced by a net amount of Rs. 11,44,51,818/-. As observed hereinabove, the AO was of the view that, as the Reserve Bank of India guidelines could not override the mandatory provisions of section 145 of the Act, thus, there was no justification for the

assessee company that was following the mercantile system of accounting to have reduced its profits by an amount of Rs. 11,44,51,818/- (supra).

30. We have thoughtfully considered the aforesaid issue in the backdrop of the contentions of the Learned Authorized Representatives of both parties. On a perusal of the "Notes to Financial Statements" of the assessee company, we find that it is therein stated that the change in the accounting policy was made due to the instruction issued by the Reserve Bank of India under which the assessee company is statutorily registered as a non-deposit accepting NBFC - MFI. We concur with the Ld. AR that as the Reserve Bank of India is the statutory governing body controlling all such NBFCs - MFIs, therefore, any clarification or instruction issued by the said governing body is to be mandatorily followed.

31. We find that the assessee company had, in the course of the assessment proceedings, vide its reply dated 20/12/2019 (furnished in response to notice issued by AO, dated 30/10/2019), replied on the query regarding its change in accounting policies, stating as under:

"We have been asked to provide explanations to the following queries made that are as follows:

1) Treatment of changes in profit due to change in accounting policies as mentioned in Para 3.1 of Notes to Financial Statements: This change was made due to an instruction issued by the RBI, under the which the assessee is statutorily registered as a non-deposit accepting NBFC-MFI, As RBI is the statutory governing body controlling all such NBFC-MFIs, any clarification or instruction by RBI is to be followed mandatorily by the assessees.

With respect to the processing fee charged by MFIs from its borrowers and the processing fee paid by MFIs to its lenders, RBI provided a clarification vide Q9 on its FAQ portal (link: https://www.rbi.org.in/scripts/FS FAQs.aspx?Id=102&fn=14) that "Processing fees should be booked in the accounting period in which these are paid/ received and amortization of the same is not permitted." Based on this clarification from RBI, Spandana changed the way of recognising and recording the ancillary finance costs and loan processing income.

We have been asked that why the above changes should not be disregarded under income tax computation. In this regard, we submit that:

(i) The change was made under a statutory compliance. The Income Tax Act does not contain any specific provision for disallowing/rejecting changes made in accounting treatment made under such statutory regulations that apply to the tax payer.
(ii) The accounting principles used for adopting the methods and system of accounting are in agreement with the relevant Accounting standards and are prepared under accrual basis and under historical cost convention as expressly mentioned in Para 3 of Notes to Accounts.
(iii) The assessee has prepared the books of accounts entirely in agreement with section 145(1) of the Income Tax Act.
(iv) Rejection of the books of accounts, or part of it, can be done only if conditions mentioned under section 145(3) of the Act are fulfilled. None of the conditions mentioned therein are present in the assessee's case.
(v) Merely because any accounting treatment has resulted in decrease in profits cannot be the ground for rejecting such treatment and treating the resulting change as taxable income.
(vi) The following can be Instances of rejection of books of account-

- Where entries in respect of certain transactions are altogether omitted or incorrect,

- Where the accounts show an abnormally low rate of profit
- Where there is an inherent lacuna in the system of accounting
  It can be seen that none on these instances exist in the present case

vii) We submit following case laws in our support:

a) In CIT v. Margadarshi Chit Funds (P.)Ltd. [1985] 155 ITR 442/[1984] 19 Taxman 73 (AP). It was held that 'that the assessing officer cannot reject the books of accounts merely because in his view, a different method of accounting would be better suited."

b) The Hon'ble Karnataka High Court, in CIT v. Anil Kumar & Co. [2016] 386 ITR 702/67 taxmann.com 278 held that jurisdiction to estimate assessee's income is not available when books of account have not been rejected.

c) The Allahabad High Court, in CIT v. Pashupati Nath Agro Food Products (P.) Ltd held that the Assessing Officer did not reject the books of account; it shows that the assessee has maintained the books of account as prescribed under Section 145 of the Act. If so, the Assessing Officer is not entitled to make any addition

In view of these submissions you are requested to accept the accounting treatment as specified in Para 3.1"

In our view, as the aforesaid change in the accounting policy of the assessee company was made in pursuance of a statutory compliance, therefore, the AO, in the absence of any mandate of law, ought not to have rejected the same. As the accounting principles used by the assessee company for adopting the method and system of accounting are in agreement with the relevant Accounting Standards and are prepared under accrual basis under historical cost convention as expressly mentioned in Para 3 of the "Notes to

Accounts", therefore, we find no justification for the AO to have drawn adverse inferences regarding the change in the accounting policy by the assessee company which in turn was prompted by the clarification issued by the Reserve Bank of India. Our aforesaid view that the ancillary borrowing costs incurred by the assessee company were to be recognized in the period in which they were incurred is supported by the judgment of the **Hon'ble High Court of Delhi** in the case of **CIT v. Citi Financial Consumer Fin. Ltd (2011) 335 ITR 29 (Delhi)**. The Hon'ble High Court had observed, that as the expenditure that was incurred once and for all in the form of stamping duty as well as commission paid to the direct selling agents for procuring the loan assignments was not dependent upon the working out of the agreements entered into between the assessee and the customers, therefore, the commission that was paid by the assessee company to the direct selling agents, for their services rendered in sourcing hires in the year in which the loan was disbursed was to be allowed as business expenditure in the year in which the transactions were entered into. Also, our aforesaid view is supported by the order of the **ITAT, Kolkata**, in the case of **Magma Fincorp Ltd vs. Deputy**

Commissioner of Income Tax, Circle-8(1), Kolkata (2017) 165 ITD 375 (Kolkata). In the said case, the assessee company, i.e., an NBFC, that followed the mercantile system of accounting, had during the subject year and onwards recognised income and expenses based on the matching concept by following the amortization method of accounting in consonance with the Reserve Bank of India guidelines. However, the assessee company had offered the entire income upfront and claimed the entire upfront expenses in the year of accrual and incurrence. The AO disallowed the assessee's claim for deduction of expenditure on the ground that they were though claimed on an accrual basis in its return of income, but in the profit and loss account, it was amortized over the life of the loan transactions. On appeal, the Tribunal observed that since the assessee company had merely followed the amortization method of recognising income and expenses in its books so as to be in consonance with the Reserve Bank of India guidelines mandating NBFCs to follow the matching principle, therefore, the upfront expenditure claimed by the assessee company on an accrual basis was to be allowed as a deduction. Also, our aforesaid view that the claim of the assessee company for

recognising the ancillary borrowing cost in the period in which they were incurred instead of amortizing them over the tenure of the borrowings is also supported by an analogy that can be drawn from the judgment of the **Hon'ble Supreme Court** in the case of **Taparia Tools Ltd vs. Joint Commissioner of Income Tax, Nasik (2015) 372 ITR 605 (SC)**. In the said case, the assessee company had issued debentures for five years and, as per one of the payment options, had made a one-time upfront discounted interest payment instead of making the payment of interest periodically. The Hon'ble Apex Court had observed that the entire amount so paid by the assessee company was to be allowed as a deduction in the year of payment itself. Also, support is drawn from a similar view taken by the **Hon'ble Supreme Court** in the case of **Madras Industrial Investment Corporation Ltd vs. Commissioner of Income Tax (1997) 225 ITR 802 (SC)**. Further, reliance is placed on the judgment of the **Hon'ble High Court of Delhi** in the case of **Principal Commissioner of Income Tax vs. Indus Towers Ltd (2023) 459 ITR 719 (Delhi)**. In the said case, the Hon'ble High Court had observed that the upfront loan processing fee on loan that was

claimed by the assessee on the loan raised by it for the purpose of its business which, however, was amortized over a period of five years to bring it in consonance with the mercantile system of accounting, was to be allowed as a deduction in lumpsum in the year in which the same was paid.

32. We thus, in terms of our aforesaid observations, are unable to persuade ourselves to concur with the view taken by the authorities below, who had contrary to the settled position of the law, declined the claim of the assessee company for deduction of the ancillary borrowing costs in the period in which they have been incurred. Accordingly, the addition of Rs. 11,44,51,818/- (supra) made by the AO, which, thereafter, had been sustained by the CIT(A), is vacated. The **Grounds of appeal Nos. 3.1 to 3.4** are allowed in terms of our aforesaid observations. The **Grounds of appeal No. 1.1 and 4.1** being general in nature, are dismissed as not pressed.

33. Resultantly, the appeal filed by the assessee company is partly allowed in terms of our aforesaid observations.

Order pronounced in the Open Court on 17th October, 2025.

Sd/- **(श्री मधुसूदन सावडिया)** **(MADHUSUDAN SAWDIA)** **लेखा सदस्य/ACCOUNTANT MEMBER**	Sd/- **(श्री रवीश सूद)** **(RAVISH SOOD)** **न्यायिक सदस्य/JUDICIAL MEMBER**

Hyderabad,
Dated 17.10.2025.
L.Rama/sps

आदेशकी प्रतिलिपि अग्रेषित/ **Copy of the order forwarded to:-**

1.	निर्धारिती/The Assessee	:	M/s Spandana Sphoorty Financial Limited, Galaxy, Wing B, 16th Floor, Plot No.1, Sy.No.83/1, Hyderabad Knowledge City, TSIIC, Raidurg, Panmaktha, Madhapur, Shaikpet, Hyderabad
2.	राजस्व/ The Revenue	:	The Asst.Commissioner of Income Tax, Circle-3(1), Hyderabad
3.	The Principal Commissioner of Income Tax, Hyderabad.		
4.	विभागीयप्रतिनिधि, आयकर अपीलीय अधिकरण, हैदराबाद / DR, ITAT, Hyderabad		
5.	गार्डफ़ाईल / Guard file		

आदेशानुसार / BY ORDER

Sr. Private Secretary
ITAT, Hyderabad