
(2004) 11 AHC CK 0130

In the Allahabad High Court

Case No : Income-tax Reference No. 113 of 1986

Commissioner of Income Tax

APPELLANT

Vs

Abbas Wazir (P.) Ltd.

RESPONDENT

Date of Decision : 10-11-2004

Acts Referred:

Income Tax Act, 1961 — Section 119, 256(1)

Citation : (2005) 274 ITR 448

Hon'ble Judges : R.K. Agarwal, J;Prakash Krishna, J

Bench : Division Bench

Advocate : Dhananjay Awasthi, for the Appellant; Shambhoo Chopra, for the Respondent

Judgement

R.K. Agarwal, J.—The Income Tax Appellate Tribunal, Allahabad, has referred the following questions of law u/s 256(1) of the Income Tax Act, 1961, hereinafter referred to as "the Act", for opinion to this court for the assessment year 1978-79 :

"1. Whether, on the facts of the case, there was material before the Tribunal to hold that the financial position of the debtors had deteriorated and the recovery of even the principal amount had become doubtful ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in deleting the addition of Rs. 37,776 made on account of accrual of interest ?"

2. and for the assessment year 1979-80:

"1. Whether, on the facts of the case, there was material before the Tribunal to hold that the financial position of the debtors had deteriorated and the recovery of even the principal amount had become doubtful ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in deleting the addition of Rs. 31,560 (Rs. 10,500 + 21,060) made

on account of accrual of interest ?"

3. The aforesaid questions for the two years are similar except that there is difference in the amount of interest.

4. Briefly stated the facts giving rise to the present reference are as follows :

5. The present reference relates to the assessment years 1978-79 and 1979-80. The respondent is a private limited company and is engaged in the manufacture and export of carpets. It had advanced loan to two firms, Carpet Traders and Bhadohi Cold Storage, on which it had charged interest in the earlier years. However, during the previous years relevant to the assessment years in question it had not charged interest from these two firms. The Inspecting Assistant Commissioner (Assessment) in the course of the assessment proceedings added the following amounts while making the assessments :

Assessment year 1978-79 Rs. 1,07,700.

Assessment year 1979-80 Rs. 60,000

6. The addition was made on the ground that the respondent had borrowed money and had paid interest on its borrowing but had not charged interest from the aforesaid two firms in respect of the loans advanced to them. In appeal, however, the Commissioner of Income Tax (Appeals) reduced the addition to Rs. 4,500 for the assessment year 1978-79 and to Rs. 10,500 for the assessment year 1979-80. On further appeal the Income Tax Appellate Tribunal found that the facts were not clear and hence restored the matter to the Commissioner of Income Tax (Appeals) to be decided afresh in accordance with law. It may be mentioned here that in the assessment year 1978-79 addition of Rs. 4,500 was not challenged by the respondent before the Tribunal. The Commissioner of Income Tax (Appeals) passed a fresh order in which he had held that there was an agreement for charging interest even though it was an unwritten one. He then worked out the interest which could be added at Rs. 37,776 in the assessment year 1978-79 and Rs. 21,060 for the assessment year 1979-80. In addition, he further held that an amount of Rs. 10,500 in the assessment year 1979-80 was liable to be added on account of accrued interest in the account of Carpet Traders. In further appeal before the Income Tax Appellate Tribunal, the Tribunal deleted the additions on the ground that the financial position of the debtors had deteriorated and recovery even of the principal amount had become doubtful.

7. We have heard Sri Dhananjay Awasthi, learned standing counsel for the Revenue. Sri Shambhoo Chopra, learned counsel appearing for the respondent states that he has no instruction in the matter.

8. Learned standing counsel for the Revenue submitted that as the respondent had borrowed money and had paid interest thereon, the Assessing Officer was perfectly justified in disallowing the proportionate income on the amount of loan advanced by it to the two firms on which it had not charged any interest. He has relied upon a decision of the apex court in the case of State Bank of Travancore

Vs. Commissioner of Income Tax, Kerala, .

9. Having heard learned counsel and after perusing the order of the Tribunal we find that the Tribunal had recorded a categorical finding of fact that the financial position of the debtors was certainly not good. It had examined the accounts of the debtors for the two years and had found that apart from the outstanding loan advances of small amounts in cash and by cheque have been made during the assessment years in question in order to enable the debtor to clear off its taxes and its liabilities as the respondent wanted to take over this cold storage in satisfaction of its debt. In this view of the matter the Tribunal had held that the financial position of the debtors had deteriorated to such an extent that even the recovery of the principal amount was in doubt and further that the respondents board of directors had considered the proposal of taking over the cold storage from Bhadohi Cold Storage in discharge of its debt. Thus, the recovery of interest was not possible.

10. In the case of State Bank of Travancore Vs. Commissioner of Income Tax, Kerala, , the apex court has held that where interest has accrued and the assessee has debited the account of the debtor, the difficulty of recovery would not make its accrual non-accrual. However, the apex court in the case of UCO Bank, Calcutta Vs. Commissioner of Income Tax, West Bengal, , has held that the majority decision in State Bank of Travancore Vs. Commissioner of Income Tax, Kerala, cannot be looked upon as laying down that a circular which is properly issued u/s 119 of the Act for proper administration of the Act and for relieving the rigour of too literal a construction of the law for the benefit of the assessee in certain situation would not be binding on the departmental authorities. The very fact that the assessee, although generally using a mercantile system of accounting, keeps such interest amounts in a suspense account and does not bring these amounts to the profit and loss account, goes to show that the assessee is following a mixed system of accounting by which such interest is included in its income only when it is actually received. The apex court had further given benefit of the circular issued by the Central Board of Direct Taxes and had applied it to interest accruing to a money-lender on loans entered in a suspense account because of the extreme unlikelihood of their being recovered. As already mentioned hereinbefore the Tribunal from the evidence and material on record had found that the financial position of the debtors had deteriorated to such an extent that even the chance of the principal amount being recovered was very dim. If in these circumstances, it had not charged any interest from its debtors it cannot be said that it had not acted as a prudent businessman.

11. Recently, this court in Income Tax Reference No. 196 of 1985 (Commissioner of Income Tax Vs. Dhampur Sugar Mills Ltd. (No. 2), , decided on September 30, 2004, has held that where on account of commercial expediency and on account of continued losses suffered by the subsidiary the interest was not charged, the Tribunal, was justified in deleting the amount towards interest disallowed by the Assessing Officer in respect of the interest paid on borrowed funds.

12. In view of the foregoing discussions, we are of the considered opinion that the Tribunal has not committed any error in deleting the amount in question and the findings recorded by it are based on relevant material and evidence. Consequently, we answer the above questions referred to us in the affirmative, i.e., in favour of the assessee and against the Revenue. However, there shall be no order as to costs.