

(2011) 09 DEL CK 0289
In the Delhi High Court
Case No : ITA No. 607 of 2009

Commissioner of Income Tax - II

APPELLANT

Vs

M/s. Jain Studios Ltd.

RESPONDENT

Date of Decision : 30-09-2011

Acts Referred:

Companies Act, 1956 — Section 372

Citation : (2011) 203 TAXMAN 522

Hon'ble Judges : Siddharth Mridul, J;A.K. Sikri, J

Bench : Division Bench

Advocate : N.P. Sahni, Standing Counsel with Mr. Ruchesh Sinha, for the Appellant; Ajay Vohra with Ms. Kavita Jha and Mr. Somnath Shukla, for the Respondent

Judgement

A.K. Sikri, J.—This appeal pertains to one issue only which concerns the interest paid by the respondent-assessee on the borrowed funds. There is no dispute that the interest was, in fact, paid. The only issue is as to whether this interest had accrued in earlier years or in the assessment year in question, viz., 2000-01, in which year the assessee had claimed the deduction thereof. According to the Assessing Officer (AO), such as deduction was not permissible in this year as the interest had accrued in the earlier years, which should have been claimed in those years only.

2. The CIT (A), however, found otherwise and allowed the deduction, which has been affirmed by the Income Tax Appellate Tribunal (hereinafter referred to as "the Tribunal") as well vide impugned decision dated 07.11.2008. Though as many as five questions are proposed on the aforesaid issue, following two questions, out of these would reflect the nature of challenge which has been laid to the orders of the Tribunal:

1. Whether the Income Tax Appellate Tribunal was correct in law and on facts in deleting the addition of Rs. 51,49,180/-?

2. Whether, in view of the facts and circumstances of the case, the Tribunal and CIT (A) are correct in law in ignoring that the liability had crystallized in the earlier years and it was incumbent on the assessee to make the provisions in those years?

3. The genesis of the dispute can be underscored as follows:

On 14.08.1995, Board of Directors of the respondent assessee resolved to borrow a loan of Rs. 1 Crore from M/s. Reliance Capital Limited (hereinafter referred to as "RCL"). Loan Agreement dated 17.08.1995 was signed between the assessee and RCL stating the terms and conditions on which RCL agreed to grant the said loan of Rs. 1 Crore. This loan was to carry an interest @ 24% per annum on quarterly basis on the borrowed amount. In the event of default, the amounts due would be payable along with additional penal amount @ 2% per annum for the period of default on the basis of compound interest. The assessee had also pledged some shares of its company as a security for due repayment of the said loan from RCL and therefore, the stipulation to the agreement to the fact that if the loan is not repaid in time, the RCL was free to transfer those shares in its name. Blank transfer deeds were also lodged with RCL to facilitate the transfer. Period of loan was six months and the entire loan amount including interest was to be repaid by 20.02.1996. The assessee had issued Post Dated Cheque for Rs. 1 Core for repayment of the said loan.

4. The assessee, however, could not pay the loan amount due to some financial problems and also due to the reasons that negotiations were going on for sale of assets. It requested RCL on 19.02.1996 not to deposit the said cheque. The cheque was not deposited by the RCL. However thereafter, some disputes arose between the parties. According to the assessee, as a consequence of default in repaying the loan, it was deemed that RCL had purchased the shares pledged with it. With a result, the entire loan paid was paid off with interest. The assessee rather claimed that the RCL owed money to group concerns of the assessee. RCL disputed the above and demanded the amount from the assessee when the loan was not repaid, RCL filed Suit No. 3527/1998 for declaration against the assessee along with petition under Article XII of the Letters Patent. The assessee contested this Suit by filing its affidavit in reply to the notice of motion filed by the RCL.

5. After sometime, RCL and the assessee entered into settlement and consent terms dated 08.10.2001 were recorded. On these consent terms, decree dated 08.2.2001 was also passed by the Bombay High Court. As per the aforesaid settlement/decreed, the assessee agreed to pay principal sum of Rs. 1 Crore with simple interest @ 24% per annum from 24.08.1995 till the date of payment and it was further agreed that the amount would be paid on or before 01.6.2001. The assessee paid the amount of Rs. 1 Crore along with interest from 24.8.1995.

6. Under these circumstances, the assessee claimed deduction of the aforesaid interest in the year in question, as according to the assess, the liability got

crystallized when the consent decree dated 08.2.2001 was passed which event occurred in the assessment year in question.

7. The AO, on the other hand, took the view that there was no dispute until 14.10.1997. Even when the assessee had defaulted in making payment of exact amount, the liability to pay the interest was always acknowledged to the assessee. The dispute was raised vide letter dated 14.10.1997 and therefore, till that date, there was no dispute. On this basis, he opined that the only liability which did not seem to have crystallized for the period after 14.10.1997 amounting to Rs. 51,49,180/-, as according to him, which pertained to the earlier years, which had been debited to the Profit & Loss Account of the year in question. To this extent, he disallowed the income and added back the same to the account of the assessee. The computation of the interest upto 14.10.1997 is as under

Period

Interest @ 24% P.A.

24.8.1995-30.9.1995

2,49,180

01.10.1995-31.12.1995

6,00,000

01.01.1996-30.03.1996

6,00,000

01.04.1996-30.06.1996

6,00,000

01.07.1996-30.09.1996

6,00,000

01.10.1996-31.12.1996

6,00,000

01.01.1997-31.03.1997

6,00,000

01.04.1997-30.06.1997

6,00,000

01.07.1997-30.09.1997

6,00,000

01.10.1997-14.10.1997

1,00,000

TOTAL

51,49,180

8. The CIT (A), however, accepted the contention of the assessee that there was a dispute regarding payment of not only on interest but on principal amount as well relevant to assessment year 1996-97 itself when the reason for holding this view given by the CIT (A) was that though the assessee had, on 19.2.1996, requested RCL not to deposit the post dated cheques for encashment due to financial difficulties and that the RCL was requested to convert this loan into an acknowledgment by acquiring part of the shares pledged by the assessee, promoter companies with the RCL as the assessee had realized that it was difficult for it to pay the loan and the interest. According to the CIT (A), the dispute which arose on 19.02.1996 kept on pending till the compromise decree was passed by the High Court of Judicature at Bombay. Accordingly, the AO was not right in holding that there was no dispute till 14.10.1997 and it arose only thereafter.

9. The Income Tribunal has simply endorsed the aforesaid view of the CIT (A) on the basis of reasons provided by the CIT (A).

10. We may say, at the outset, that Mr. N.P. Sahni, learned counsel appearing for the Revenue submitted that when the assessee was following mercantile system of account, it could claim the deduction of the expenses, which had accrued in a particular year and not in any year. For this purpose, he referred to the following judgments:

- (i) Indian Timber Corporation Vs. Commissioner of Income Tax, ;
- (ii) Bikaner Gypsum Ltd. Vs. Commissioner of Income Tax, ;
- (iii) Commissioner of Income Tax Vs. S.K.G. Sugar Ltd., .

11. There is no quarrel about the aforesaid proposition. The entire dispute raised on the question, which needs to be addressed, is that whether the AO was right in holding that there was no dispute until 14.10.1997 and the liability to pay the interest had accrued till that date and therefore, interest payable was to claim as deduction during that period, i.e., 24.08.1995 to 14.10.1997, in the relevant assessment years and not in the assessment year in question, i.e., A.Y. 2000-01 or whether the opinion of the CIT (A)/the Tribunal is correct, viz., that there was a dispute throughout the period and no liability to pay interest had accrued in real sense which accrued only in the Assessment Year in question when decree passed by the High Court of Judicature at Bombay was passed.

12. In order to support the view taken by the AO, Mr. Sahni referred to the judgment of this Court in the case of The Commissioner of Income Tax (Central)

Vs. Dalmia Dadri Cement Ltd., holding as under:

"In Commissioner of Income Tax, Madras Vs. Andhra Prabha P. Ltd., a question had arisen as to whether an assessed was entitled to the deduction of the estimated gratuity payable under an agreement. The Supreme Court relying on its earlier decision in the case of Shree Sajjan Mills Ltd. Vs. Commissioner of Income Tax, M.P., Bhopal and Another, held that the liability having arisen under an agreement accrued in the relevant year of accounts and that claim would be admissible provided the provision for gratuity was based on "a legal and scientific basis.

The real test, therefore, is that if the amount eventually payable could be properly ascertained and its value commercially determined by an actuarial valuation, which may be fastened on an assessed, in any year of accounting, that could be considered as deductible from its gross profits for the year, in which such a liability is incurred. Thus, the question to be considered in this case is whether the assessee had incurred enforceable legal liability under the aforesaid arrangement with Caco and it was capable of being commercially valued in the relevant previous year by an actuarial valuation.

xxx xxx xxx

We are, therefore, of the view that the assessed is entitled to the deduction of the freight advantage, which it is liable to pass on to CACO, in the year in which this liability has been incurred under the said Scheme and the opinion expressed by the Allahabad High Court in Commissioner of Income Tax v. Oriental Motor Car Co. (P) Ltd. (supra) is not applicable on the facts of this case. In that case, while holding that assessee's liability on account of infringement commission could not be allowed in the year when it was demanded by its principals, the Court had observed that the amount so claimed was negotiable and till the assessed admitted its liability at a particular rate, it was not an ascertainable liability, which, we feel, is a significant distinguishing feature in the present case. We are, therefore, in agreement with the conclusion of Tribunal that the assessed is entitled to a deduction of the amount of freight advantage payable by it to CACO in respect of the previous years in question.

13. He also relied upon the judgment of the Rajasthan High Court in the case of Commissioner of Income Tax Vs. Vijay Laxmi Trading Co. Ltd., in support of his submission that the interest had accrued from 14.08.1995 and merely because the assessee was not able to pay the amount, could not be a reason to say that the interest liability had not accrued.

14. Mr. Ajay Vohra, learned counsel appearing for the assessee, on the other hand, relied upon the views taken by the CIT (A) as well as by the Tribunal and contended that no liability of payment of interest had accrued till the passing of decree in terms of settlement arrived at between the parties. To demonstrate this, he has filed the pleadings in the suit filed by the RCL against the assessee in the Bombay High Court and the affidavit and reply of the assessee to the notice

of motion along with some other documents have been produced before us. We have perused the same.

15. The facts emerging on record show that the RCL had filed the suit claiming the principal amount along with the entire interest including penalty interest had become due from 24.08.1995. The reply filed by the respondent discloses that the respondent had controverted the allegations made in the plaint filed by the RCL and had denied its liability. The defence put forth by the assessee was that the RCL had already exercised its right under the Pledge Agreements after the incident of default, pursuant to these rights exercised by the RCL, the companies whose shares were pledged had already transferred those shares in the name of RCL. The RCL had done so by filing another blank transfer on 16.07.1997. The RCL has also alleged that the transfer in their name under cover of their letter dated 14.10.1997 accompanied by a resolution passed by the RCL u/s 372 of the Companies Act. According to the assessee, it had duly acted on the basis of RCL's request and, therefore, when shares in question had already been transferred to the name of the RCL in enforcement of the RCL's right under the Pledge Agreements, no amount was due and payable to the RCL. On the contrary, the assessee claimed that a sum of Rs. 4,01,95,919/- was payable by RCL to the assessee.

16. No doubt, on 19.02.1996, the assessee had requested the RCL not to deposit the post dated cheques for encashment due to financial difficulties. At the same time, the RCL was also requested to convert this loan into an acknowledgement by acquiring part of the shares pledged by Jain Studios Ltd. Promoter companies with RCL, as the assessee realized that it would be difficult to repay the loan and the interest. This plea has not been disputed by the AO. Thus, on that date itself, as far as the assessee is concerned, it had taken the position that with the option given to the RCL to get the pledged shares transferred in its name, liability for principal as well as interest had ceased to exist. For this reason, the assessee did not show this liability in its balance sheet for the Assessment Year 1996-97 and onwards, as the assessee kept on maintaining that nothing was payable. In our opinion, the AO was not right in holding the view that the assessee did not dispute the liability to pay interest upto 14.10.1997. It is difficult to accept that the dispute about payment of interest was not prior to a particular date, but arose after 14.10.1997. The pleadings in the Suit before the Bombay High Court belie this view taken by the AO.

17. We, therefore, agree with the conclusion of the CIT (A) as well as the Tribunal that the exact liability of the assessee to pay the interest to RCL got settled finally only when compromise decree was passed at High Court of Judicature at Bombay. Since this compromise decree was passed on 08.02.2001, it was, but natural for the assessee to claim the deductions of this liability in the year in question.

18. We, thus, hold that no question of law arises. This appeal is bereft of any merit and the same is accordingly dismissed.