
(1984) 03 BOM CK 0042

In the Bombay High Court

Case No : I. T. APPEAL NO. 5055 (BOM.) OF 1982

D. R. D. TATA

APPELLANT

Vs

Income Tax OFFICER.

RESPONDENT

Date of Decision : 12-03-1984

Acts Referred:

Citation : (1986) 17 ITD 642

Hon'ble Judges : K. S. Viswanathan, A.M.

Bench : Division Bench

Judgement

Per Shri K. S. Viswanathan, Accountant Member - The only issue in this appeal is whether the assessee should be assessee in respect of interest of Rs. 4,000 which, according to the department, is due from a party. The assessee is an individual. He had advanced a loan of Rs. 50,000 to a firm by name Shevade Camera Works on 3-4-1975 at 8 per cent interest. For the first year, the assessee received an interest of Rs. 4,000 which was shown as the income of that year. Thereafter, the assessee did not receive any interest. In spite of that, in the returns filed, the assessee did not receive any interest. In spite of that, in the returns filed, the assessee showed these amounts as due and was assessed. For the assessment year 1979-80, no such income was shown. We are concerned with the assessment year 1980-81. In this year also, no interest was shown as receivable.

2. The ITO found that the assessee was maintaining his accounts on mercantile basis. He further found that the assessee had not relinquished any of his rights to receive the interest. He, therefore, held that the interest had accrued and should be included in the assessment.

3. Against this finding, the assessee appealed. The AAC found that the amount due has not become a bad debt. As the accounts were maintained on an accrual basis, the interest due must be included in the assessment.

4. Against this finding, the assessee is on further appeal before us. Shri Dastur,

the learned counsel for the assessee, submitted that the assessee does not have money-lending business. Although there is income by way of interest amounting to Rs. 73,691 as per the assessment order, it consisted mostly of income from deposits made in limited companies and friendly loans given to friends at nominal rate of interest of 2 per cent. He further submitted that the income has to be assessed under other sources and not as business income. Even for other sources, the method of accounting followed by the assessee has to be considered. He admitted that the assessee had maintained books of account. But, according to him, no income had accrued during the year. Relying on the decision of the Madras High Court in the case of Commissioner of Income Tax, Tamil Nadu-V Vs. Motor Credit Co. P. Ltd., , he submitted that the method of accounting determines only the mode of computing the taxable income and it does not determine the issue whether any income at all has accrued. He stated that the assessee had not taken action against the debtor nor the debtor had acknowledged any indebtedness.

5. As an alternative submission, Shri Dastur stated that the fact that the assessee had not credited any interest in the books of account would show that he had changed over the method of accounting to cash. Since nothing has been received during this accounting year under this method, no income could be brought to assessment. To a query whether such change of method has been followed in respect of each of the other loans, he submitted that no change had been effected by them but, according to him, each loan is a separate source of income. For this purpose, he relied on the decision of the Supreme Court in the case of Commissioner of Income Tax, Madhya Pradesh, Nagpur and Bhandara Vs. Lady Kanchanbai and Another, .

6. Shri Tuli, for the department, submitted that there is no evidence to show that the assessee had changed the method of accounting. He submitted that the assessee cannot change his method according to his sweet will. He then pointed out that there is no evidence also to show that the debtor has become financially weak so that it could be said that no income had accrued.

7. We have considered the facts of the case. It is an admitted position that the assessee is maintaining books of accounts. It is also an admitted position that in the earlier years the interest due has been credited in the interest account on mercantile basis. But, according to the assessee's counsel, the assessee has changed his method of accounting from 1979 when he did not credit any interest. It is open for an assessee to change the method of accounting followed by him. But the change has to be in respect of the entire source of that income. He cannot pick up one item in respect of a source of that income and deal with it differently from the other items. This is a well known principle and it has been referred to by the Calcutta High Court in the case of Reform Flour Mills P. Ltd. Vs. Commissioner of Income Tax, . Insofar as the assessee has not changed the method of accounting changed into cash. Reliance had been placed on the decision of the Supreme Court in the case of Lady Kanchanbai (supra). We do not

find this case of any help in deciding the issue. The Supreme Court therein had pointed out that the assessee could have the previous year for each separate sources of income. They had quoted with approval the observations of the Privy Council that the source means not a legal concept which a practical man would regard as a source of income. This observation will not allow us to give to a finding that each transaction of loan should be treated as a separate source of income. All the transactions together would constitute one source of income.

8. Since we find that there is no material to show that the assessee has changed the method of accounting to cash, we have to consider the next submission as to whether any income has accrued during the accounting year. It is true that merely because the method of accounting followed is mercantile, the income should be treated as accrued. In a case where the debtor is quite unable to pay the principle or interest, no income would accrue. As the Madras High Court has laid down, whether the income has accrued or not has to be seen with reference to the commercial and business realities of the situation in which the assessee is placed and not with reference to his system of accounting. So, this would take us to the issue as to whether the debtor was in a position to pay the interest or principal back. The ITO had made an observation that the assessee had not relinquished his right to receive interest. But that would not be conclusive. Even from the assessee's right to receive interest does not necessarily follow that interest has accrued. The AAC has also given a finding that the loan cannot be considered as a bad debt for the assessment year 1980-81. However, neither the ITO nor the AAC had referred to such facts which had been brought to their notice by the assessee's chartered accountants in their letter dated 22-2-1981. It has been stated therein that the debtor, Shevade Camera Works was in serious financial difficulties and it had incurred losses exceeding its capital. It appears quite unlikely that the assessee had claimed that no income had in fact accrued. Since their submissions in their letter had not been controverted by the department, it would appear safe to draw a conclusion that the position of the debtor was so unsound that it would not be possible to expect any payment of interest. In this connection, it may not be necessary to say that the debt had become bad. If the debt had become bad, the assessee would not receive either the interest or the principal back. In this case, it may be that the assessee had hopes of getting some part of the principal back. That does not mean that the assessee would be able to get the interest for these years. Therefore, considering the facts of the case against the background of commercial and business realities of the situation, it will not be possible to say that the assessee is in receipt of income by way of interest.

9. On these grounds, we will accept the assessee's appeal. The interest addition will stand deleted.