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Chief Justice's Court
Case :- INCOME TAX APPEAL No. - 88 of 2014

Appellant :- Commissoner Of Income Tax (Ii) Kanpur
Respondent :- M/S. Shivam Motors (P) Ltd.
Counsel for Appellant :- Shambhu Chopra

Hon'ble Dr. Dhananjaya Yeshwant Chandrachud,Chief Justice
Hon'ble Dilip Gupta,J.

This appeal under Section 260-A of the Income Tax Act, 1961 arises from a decision of the Lucknow Bench of the Income Tax Appellate Tribunal dated 12 November 2013. The Assessment Year to which the appeal relates is AY-2008-09. Three questions have been framed by the Revenue in this appeal of which, the following two, as submitted by the learned counsel, would be sufficient to cover the controversy:

> "1. Whether on the facts and in the circumstances of the case and in law, the Income Tax Appellate Tribunal was justified in upholding the decision of CIT (A) in allowing the interest of Rs.1,72,78,000/- of earlier years in the A.Y. 2008-09 on the basis of a supplementary agreement without considering that liability for such payment flowed from the original agreement with NEL and as per the system of accounting followed by the assessee was payable in years in which it accrued.
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> 3. Whether on the facts and in the circumstances of the case and in law, the Income Tax Appellate Tribunal was justified in upholding the decision of CIT(A) in deleting the disallowance of Rs.2,03,752/- u/s. 14A ignoring the fact that there is difference of opinion of various courts on the view taken by the ITAT that in the absence of tax free income, no disallowance u/s 14A is permissible."

The assessee is a dealer of Tata Motors for the territory of Bilaspur and surrounding districts. The vehicles of the Company were being supplied to the assessee on credit of 45 days. The assessee would make payment to

the Company when the sale proceeds were realised. Eventually the balance due and outstanding remained unpaid.

On 30 March 2000, an agreement was entered into by which a financial arrangement was made between the assessee, Tata Motors Ltd. (TML) and a Company by the name of Niskalp Investments & Trading Company Ltd. Under the arrangement, a loan of Rs.4.80 crores was provided to the assessee by Niskalp on an interest of 12% per annum. The loan was utilized by the assessee to pay the outstanding dues of TML. Under the financial arrangement, the assessee was to pay interest at 12% per annum. The assessee did not, at any point of time, pay the amount of interest under the agreement dated 30 March 2000. On the contrary, as the Tribunal noticed, the assessee was agitating the issue as regards the rate of interest. The notes of account to the balance-sheet contained a specific observation of the auditors of the assessee that no provision has been made in the accounts in respect of interest on dues relating to supply of vehicles which had been converted into a term loan from Niskalp, which had resulted in understating the loss by the same amount. The issue as regards the payment of interest by the assessee to Niskalp was eventually resolved by a supplementary agreement dated 12 April 2007. Under the supplementary agreement, the rate of interest was reduced from 12% to 6% on a reducing balance method with effect from 1 April 2000.

The relevant part of the agreement which has been extracted in the order of the Tribunal reads as follows:

> "G. In or about March 2007, the Borrower approached the Lender and requested the Lender to grant additional concessions and reliefs in respect of the amounts payable in respect of the Loan Agreement. Accordingly, the Borrower has requested the Lender to grant relief and concessions as set out hereinunder:
>
> (i) to reduce interest rate @6% per annum on reducing balance method with effect from 1st April, 2000.
>
> (ii) All the payments made after 1st April 2000 against the Finance Facilities to adjust against principal amount.
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> (iii) To waive penal/additional interest.
>
> (iv) To accept the repayment in Revised Monthly Installments ("RMIs") towards repayment of the outstanding dues in 36 monthly installments of Rs.10,94,000/- each with effect from April 2007 till March 2010, and
>
> (v) The liability in respect of the accrued interest @6% p.a. due and payable on the revised principal amount of Rs.229.32 lacs for the period starting from 1st April, 2000 till repayment of the principal amount will be paid by the Borrower in three equal installments commencing from April 2010 to June 2010. The Revised Monthly Installment (RMI) include the part of amount to be adjusted against interest payment. Accordingly, the differential amount of interest liability arising out of computation of recovery of principal amount first against RMI determined on the basis of part payment of principal amount and interest will be computed at the end of tenure or in or about April 2010 when the appropriate amount of rebate may be considered on the basis of tract record of payment of RMI on stipulated dates till March 2010."

On the basis of the agreement, the assessee debited interest amount of 1.72 crores under the head of interest in Schedule 17 to the profit and loss account. The Assessing Officer made a disallowance of a claim of interest of 1.72 crores on the ground that the assessee had followed the mercantile system of accounting and hence, the liability in terms of payment of interest could be quantified and made in the corresponding assessment year. The CIT (A) deleted the disallowance observing that the liability to pay interest

to Niskalp was not a statutory liability but a contractual liability; there was a serious disagreement between the assessee and Niskalp regarding the rate of interest and to resolve it, a meeting had been held on 10 May 2002 by the Directors of the Company and the Management of the Tata Group. This impasse continued till 2007 when a fresh agreement was entered into on 12 April 2007. The CIT(A) held that liability to pay interest was crystallized only upon the execution of the agreement on 12 April 2007. This view has been affirmed by the Tribunal which has observed as follows:

> "12. Turning to the facts of the case, we find that in the instant case the liability was not statutory liability. Admittedly, it was a contractual liability. Though it accrued at the time of execution of first agreement through which loan was obtained by the assessee but that liability was disputed by the assessee by raising a dispute with regard to rate of interest through various correspondences and auditors notes attached to the balance sheet. Finally the dispute was resolved in the impugned assessment year through a supplementary agreement through which the rate of interest was reduced from 12% to 6% per annum besides other terms of payments. Therefore, the contractual liability is finally accrued on its crystallization in the impugned assessment year, and on the basis of the said agreement the assessee has made debit entry to the profit & loss account. Since the contractual liability has been crystallized in the impugned assessment year, the entries passed by the assessee in its accounts is in accordance with law and no disallowance can be made on the ground that the assessee has been following mercantile system of accounting and the debit entries are to made in corresponding assessment years. We have carefully examined the order of CIT(A) and we find that he has adjudicated the issue in right perspective following the judicial pronouncements rendered on the subject. Since we find no infirmity in his order, we confirm the order of CIT(A)."

The contention of learned counsel appearing on behalf of the Revenue is that the liability of the assessee, which had followed the mercantile system

accounting, to pay interest had arisen under the agreement dated 30 March 2000.

Both the CIT(A) and the Tribunal have noted that initially an agreement was entered on 30 March 2000 under which the outstanding dues of the assessee to TML in the amount of Rs.4.80 crores was squared off by the grant of a loan from Niskalp to the assessee for that purpose. However, the issue as regards the payment of interest remained unresolved because though the contractual agreement stipulated interest of 12% per annum, the assessee had disputed this amount consistently and no interest was paid. Eventually, it was only on the execution of a supplementary agreement on 12 April 2007 that the liability to pay interest @6% per annum was agreed upon and in pursuance whereof, the assessee debited an amount of Rs.1.72 crores towards interest in the year in question.

In this view of the matter, we do not find any reason to interfere with the order of the Tribunal. The judgment of the Supreme Court in **Rotork Controls India P. Ltd. Vs. Commissioner of Income Tax**[1] upon which reliance was placed by the learned counsel appearing on behalf of the Revenue involved a situation where the assessee had issued a warranty. For the assessment year in question, the provision for warranty was disallowed by the Assessing Officer on the ground that it was merely a contingent liability. The Supreme Court held that the present value of a contingent liability, like the warranty expenses, if properly ascertained on accrual basis, could be an item of deduction under Section 37. Though, the principle of

1 [2009] 314 ITR 62 (SC)

estimation of the contingent liability is not a normal rule, it would depend on the nature of the business, the nature of sales, the nature of the product manufactured and sold and the scientific method of accounting adopted by the assessee.

This decision will really not carry the case of the department any further. In the present case, it was not a statutory liability of the assessee but a contractual dispute with the assessee under the agreement dated 30 March 2000 which eventually was resolved and the liability was crystallized only when the subsequent agreement dated 12 April 2007 was made. Consequently, there is no reason to interfere with the order of the CIT(A) and of the Tribunal.

As regards the second question, Section 14A of the Act provides that for the purposes of computing the total income under the Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under the Act. Hence, what Section 14A provides is that if there is any income which does not form part of the income under the Act, the expenditure which is incurred for earning the income is not an allowable deduction. For the year in question, the finding of fact is that the assessee had not earned any tax free income. Hence, in the absence of any tax free income, the corresponding expenditure could not be worked out for disallowance. The view of the CIT(A), which has been affirmed by the Tribunal, hence does not give rise to any substantial question of law. Hence, the deletion of the disallowance of Rs.2,03,752/- made by the Assessing Officer was in order.

No substantial question of law would hence arise. For these reasons, we are of the view that the appeal by the Revenue does not give rise to any substantial question of law.

The appeal shall, accordingly, stand dismissed.

Order Date :- 5.5.2014
NSC

(Dr. D.Y. Chandrachud, C.J.)

(Dilip Gupta, J.)

IN THE INCOME TAX APPELLATE TRIBUNAL
LUCKNOW BENCH 'A' : LUCKNOW

BEFORE SHRI SUNIL KUMAR YADAV, JUDICIAL MEMBER
AND SHRI SAMIM YAHYA, ACCOUNTANT MEMBER

I.T.A. No.17/Lkw/2012
Assessment Year:2008-09

Jt. C.I.T. (OSD)/ Dy. C.I.T.-6, Kanpur.	Vs.	M/s Shivam Motors (P) Ltd. 84/105, G. T. Road, Kanpur. PAN:AABCS9330D
(Appellant)		(Respondent)

Appellant by : Shri Alok Mitra, D.R.
Respondent by : Shri Rakesh Garg, Advocate

Date of hearing :16/09/2013
Date of Pronouncement :12/11/2013

ORDER

PER SUNIL KUMAR YADAV:

This appeal is preferred by the Revenue against the order of CIT(A), inter alia, on following grounds:

"1. That the Ld. Commissioner of Income Tax (Appeals) Kanpur, has erred in law and on facts in deleting the addition of Rs.2,03,752/- made u/s 14A of I.T. Act, 1961 ignoring the facts that there is difference of opinion on this issue as the Special Bench of ITAT in the case of Chem Investment Ltd. Vs. ITO (2009) 121 ITD 318 (Delhi) (SB) has held that disallowance u/s 14A can be made in a year in which no exempt income

has been earned or received by the assessee where the assessee has incurred the expenses for earning exempt income.

2. That the Ld. CIT (A) has erred in law and on facts in deleting the addition of Rs.1,72,78,000/- being interest paid to Nishkalp Energy Limited and Tata Motors Ltd. By ignoring the following facts:

(i) The liability to pay interest was due on year to year basis as per agreement between assessee and Tata Motors Ltd. The accounting method was mercantile and the same has been maintained regularly on year to year basis.

(ii) As per agreement the assessee was liable to pay interest on year to year basis.

(iii) Assessee has never objected to pay interest and was doing business i.e. purchase and sale of Tata Vehicle. As such, there was no dispute.

(iv) There was a clause for arbitration, in the case of any dispute arised. The parties had to approach to the arbitrator when there was a dispute.

(v) Although it was contractual liability but it was due for payment on year to year basis as per agreement held in 2000 because there was no dispute between the parties and method of accounting was adopted mercantile. In fact assessee itself made default in making provision on payment of interest/installments.

(vi) No suit has been lodged before the judicial authority for the settlement of dispute, if any arised.

(vii) Therefore, the liability to pay interest relating to earlier years was not accrued in the previous year. Hence the claim was not allowable.

(viii) The cases relied by the CIT(A) are not applicable in the case of assessee since the facts are quite different.

3. The order of the Ld. Commissioner of income Tax (Appeals) being erroneous, unjust and bad in law be vacated and the order of the assessing officer be restored.

4. The appellant craves leave to modify any of the grounds of the appeal given above and or add any fresh grounds as and when it is considered to do so."

2. With regard to first ground, the brief facts, borne out from the record, are that the Assessing Officer has made an addition of Rs.2,03,752/- after invoking the provisions of section 14A of the Act (hereinafter referred to as "the Act"), against which an appeal was filed before the CIT(A) with the submissions that the assessee has not made any investment for the purpose of earning tax free income in the impugned assessment year. Moreover, no taxable income was earned by the assessee, therefore, the disallowance u/a 14A of the Act is not called for. It was also contended before the CIT(A) that the assessee company has sufficient surplus fund and no part of borrowed funds have been utilized for making any investment in earlier years. In support thereof he has filed the details of total share capital and reserve over last several years and the investments made in order to demonstrate that its own funds are more than the borrowed funds utilized for the business purpose, therefore, the investments would come out from own funds only. Besides, it was also contended that investment in the shares of M/s Kailash Auto Finance Limited, which is a finance company, with whom the assessee

company has business relations, are made for the business purpose. In support of its contention that the provisions of section 14A would be applicable only if the total income includes an income, which does not form part of total income and is exempt u/s 10 of the Act, the assessee has placed the reliance upon the judgment of Chennai Bench of the Tribunal in the case of Siva Industries & Holdings Ltd. (Formerly known as Sterling Infotech Ltd.) vs. ACIT, Company Circle-VI(9) in I.T.A.No.2148/Mad/2010.

3. The CIT(A) examined the issue and finding force in the contention of the assessee has deleted the addition.

4. Aggrieved, the Revenue has preferred an appeal before the Tribunal with the submissions that after the assessment year 2008-2009 the disallowances u/s 14A are to be computed as per the provisions of Rule 8D of the I.T. Rules. The assessee has made the investment in shares and the dividend income is exempt from tax, therefore, the Assessing Officer has rightly made the corresponding disallowance of expenditure to be incurred in earning the interest free income.

5. The learned counsel for the assessee, besides placing reliance upon the order of CIT(A), has submitted that the provisions of section 14A can only be invoked when the interest free income is included in the total income of the assessee. In the impugned assessment year the assessee has not earned any tax free income, therefore, the corresponding disallowance of the expenditures incurred in earning the tax free income cannot be made. The learned counsel for the assessee further invited our

attention to the financial position of the assessee company with the submission that he had sufficient funds to make the investment in shares, therefore, no borrowed funds were invested in shares to earn the dividend income.

6. Having heard the rival submissions and from a careful perusal of the record in the light of the relevant provisions of the Act, we find that as per the provisions of Section 14A, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income, which does not form part of the total income under this Act. Meaning thereby the basic condition precedent for invoking the provisions of section 14A is that there should be income, which does not form part of the total income under this Act. Thus, wherever the assessee earned the interest free income, the corresponding expenditure incurred in earning that income is to be disallowed. In the absence of any interest free income, there cannot be any disallowance as no corresponding expenditures were incurred to earn a particular tax free income. For the sake of reference, we extract the provisions of section 14A of the Act as under:

> "14A. [(1)] For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act.]
>
> [(2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed , if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such

> expenditure in relation to income which does not form part of the total income under this Act.
>
> (3) The provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act."

6.1 Turning to the facts of the case, we find that undisputedly the assessee has made the investment in the shares of M/s Kailash Auto Finance Ltd. in earlier years and in the impugned assessment year the assessee has not earned any tax free income, which can form part of total income of the assessee. In the absence of tax free income, the corresponding expenditure to earn that income cannot be worked out for its disallowance. Therefore, in a situation where there is no tax free income, no disallowance u/s 14A is possible.

6.2 The similar view was also expressed by the Tribunal in the case of Siva Industries & Holdings Ltd. (Formerly known as Sterling Infotech Ltd.) vs. ACIT, Company Circle-VI(9) (supra). Therefore, the CIT(A) has rightly held that in the absence of tax free income, no disallowance u/s 14A is permissible. Since we do not find any infirmity in the order of CIT(A), we confirm his order.

7. Apropos ground No. 2, the facts in brief, borne out from the record, are that the Assessing Officer has noticed during the course of assessment proceedings that the assessee has claimed interest of Rs.1,72,78,000/- under the head 'interest' in Schedule-17 forming part of profit & loss account. It was also noticed that as per notes on accounts of the annual

report, the assessee company has provided interest of Rs.1,64,51,000/- towards interest on loan from M/s Niskalp Investment and Trading Company Limited, now known as M/s Niskalp Energy Limited (NEL). on the basis of the final settlement. The assessee was asked to explain the details of interest and also to justify its claim. In response thereto, the detailed reply was filed along with the relevant documents stating therein that the assessee company is a dealer of M/s Tata Motors Limited (TML) in the territory of Bilaspur (Chhatishgarh) and its surrounding districts. The modus operandi of the business is selling of commercial vehicles supplied by the Tata Motors Limited. The vehicles were being supplied to the assessee on 45 days credit and as and when the sale proceeds were realized the assessee company made payment to Tata Motors Limited. Due to lack of demand and decline in sales, the credit balance in the name of TML increased considerably.

7.1 In the year 2000 an arrangement was made with TML through its group concern M/s Niskalp Investment and Trading Co. Ltd. to provide a loan of Rs.4,80,76,000/- to the assessee company vide agreement dated 13/03/2000 @12% interest per annum. The said loan was immediately utilized by TML for squaring up its outstanding dues recoverable from the assessee company. Since the assessee was dealer of TML, it could not resist the conversion of credit balance into loan account by TML but no interest has ever been paid or provided on loan provided by NEL. A note to the this effect was made by the auditors in the notes to the accounts attached to the balance sheet each year. The matter became disputed and the assessee company did not either provide or pay the interest

during any of the last several years though there was constant pressure by NEL / TML that the interest be paid. Finally, in the impugned assessment year i.e. 2008-2009, a fresh agreement was drawn wherein the midway was worked out and the rate of interest was reduced from 12% to 6% per annum. The liability to pay interest was crystallized and frozen and that too with a rider that first whatever amount had been retained by TML are paid by the assessee was first to be adjusted towards the principal and thereafter whatever balance was left outstanding as on 31/03/2007 would be crystallized as principal amount payable. Interest on the same @6% would be payable from 2001 onwards till 31/03/2007. The said amount i.e. principal and interest was determined as total outstanding as on 31/03/2007 and the 36 equal installments were granted. Since factum of payment of interest was settled during the year under consideration, the liability to pay interest was crystallized in the previous year relevant to the year under consideration and the interest for the period 30/03/2000 to 31/03/2007 was debited, TDS was deducted and payments were made. On the basis of this agreement, the assessee has debited the payment of interest to the profit & loss account.

7.2 The Assessing Officer was not convinced with the explanation of the assessee and made a disallowance of claim of interest of Rs.1,72,78,000/- having observed that the assessee had followed mercantile system of accounting from year to year including previous year, therefore, the liability of payment of interest can be quantified and made in the corresponding assessment years.

8. The assessee preferred an appeal before the CIT(A) and reiterated its contentions. He has also placed heavy reliance upon the judgment in the case of CIT vs. Oriental Motor Car Co. Pvt. Ltd. 124 ITR 74 (All), CIT vs. Nathmal Tolaram [1973] 88 ITR 234 (Guj), Saurashtra Cement and Chemical Industries Ltd. Vs. CIT [1995] 213 ITR 523 and CIT vs. Nagri Mills Co. Ltd. [1958] 33 ITR 684 in support of its contention that where liability is contractual in nature, it would be allowed on its crystallization only and not in earlier years. The Learned counsel for the assessee further contended that undisputedly the assessee was a dealer of TML and the financial arrangement with M/s Niskalp Investment and Trading Company Limited, later changed to M/s Niskalp Energy Limited, was made at the behest of TML and the entire loan was immediately utilized by TML for squaring up its outstanding dues recoverable from the assessee company. Since the assessee company was dealer of TML, it could not resist the conversion of credit balance into the loan account but no interest was ever paid or provided on a loan provided by NEL. In support of its contention, attention of CIT(A) was also invited to the agreement and other documents. Finding force in the contention of the assessee the CIT(A) has accepted the claim of the assessee and deleted the disallowance. The relevant observations of the CIT(A) are extracted hereunder for the sake of reference:

> "6.1
>
> "The 1st important document in the instant dispute is the Loan Agreement dated 30/03/2000 between the appellant company and the Tata group. As per this agreement, the appellant company was required to pay interest @12% on the loan amount and also to make payment of principal & interest

amount within the stipulated time frame. However, facts on records suggest that the appellant company followed the said agreement more in its breach than in its compliance. The Ld. A.R has submitted viz written submission and also oral arguments that the appellant company had no intention to honour this agreement as the same had been an almost a "forced down" agreement by the Tata group on the appellant company. The Ld. A.R also stated that interest payment under the impugned agreement was not a statutory liability but merely a contractual liability and; the records show, the appellant company had no intention to honour the said agreement, since the ledger account of the appellant company in the books of Tata group of companies (which is part of records), shows that no payment at all on account of interest had been made by the appellant company. The Ld. A.R has also stated that the appellant company had voiced its serious disagreement over the term of the said agreement, a meeting was held on 10th May, 2002 which was attended by the directors of the company and also the top brass of the Tata group. A copy of the Minutes of the said meeting is on record. The Ld. A.R. further submitted that the appellant company's objection/dispute/concerns were not allayed even in this meeting/and thus, it had no intention to comply with the decision made in that meeting too, which is evident from the fact that no payments on account of interest were made by the appellant company even after that meeting. This impasse continued till 2007 when a fresh agreement, dated 12/04/2007 was signed (between the appellant company & the Tata group) wherein various concessions were allowed to the appellant company which included reduction of interest rate to 6% p.a. In accordance with this agreement, the appellant company made payment of interest of Rs.1,64,51,896/- on and from April 2007 to July 2007 and claimed it as an expenditure during the F.Y. 2007-08.

6.1.1 After going through the entire chronology of events, which I have tried to summarise as above, am of the considered view that the said interest liability (even though pertaining to earlier years) never crystallized in the hands of the appellant company since it had no intention to pay such interest as it had serious objections/dispute with the terms of the agreement. Such interest payment was not a statutory liability but only a contractual liability and if one of the parties to the contract (i.e. the appellant company) did not wish to honour the contract or practically

reneges on the contract, such contractual liability had no meaning. Even in mercantile system of accounting, only that liability is required to be accounted which get crystallized during the year. In this case, the appellant company even though had signed the agreement which fastened the liability of interest payment on the appellant company but in practical/commercial world, no such liability, could be said to have crystallized since facts on record (discussed above) clearly demonstrate that the appellant never had any intention to comply with the terms of that agreement as it had serious dispute/objections with the rate of interest payment and other conditions set out in the impugned agreement. Under these circumstances, even though such interest payment refer to earlier years, the liability to pay got crystallized only during the year under reference when the appellant company had no dispute/objection with terms of the fresh agreement on 12/04/2007. There is an old saying that "the proof of pudding is in its eating"; the present base is a good example of this saying - What better proof is required of non-acceptance/ dispute/ objections by the appellant company with regard to the terms of the earlier agreement(s) when the final agreement gives substantial relief/concession to the appellant company.

6.1.2 My aforesaid view is also fortified by the decision of Hon'ble Jurisdiction High Court in the case of CIT vs. Raj Motors [204 ITR 489 (All)] wherein the question before the Hon'ble High Court was:

> "The short question for consideration is when the liability accrues whether liability to payment accrued in the year 1971 when after the decision of the Apex Court the demand has been raised by M/s Premier Automobiles Ltd for Rs.339571/- or the date when the settlement had arrived between the parties on 20th September, 1981."

6.1.3 Their Lordships while adjudicating the aforesaid question held as under:-

> "The aforesaid correspondence clearly shows that it is the claim of the Premier Automobiles Ltd. that the assesses was responsible for making the payment of the differential amount and the assessee has not accepted such liability. In any view of the matter, the nature of the liability was a

> contractual liability, which was finally settled, vide agreement/letter dated 20th September, 1981 and, therefore, the liability to payment accrued only when it has been finally settled on 20th September, 1981. The various decisions of Court referred hereinabove, clearly held that the liability of a contractual in nature accrues when it is finally settled. The facts of the present case is almost similar to the facts in the decision of this Court in the case of CIT v. Oriental Motors Car Co. (P) Ltd (supra), which has been referred hereinabove. In the said case, the decision of the Supreme Court in the case of Kedar Nath Jute Manufacturing Co. Ltd v. CIT reported in 82 ITR 363 has also been considered and distinguished on the ground that in the said case, liability of sales tax arose by virtue of the statute as soon as the sale was effected. The Division Bench of this Court clearly held that the contractual liability accrues when it is finally settled. From the fact stated hereinabove, it is clear that in the present case the liability was not in the nature of statutory liability. The demand raised by Automobiles Ltd was disputed, by the assessee which was in the nature of contractual liability which was finally settled only on 20th September, 1981 and thus, liability to pay accrued only on 20th September, 1981 relating to the year under consideration and has been rightly held as allowable deduction by the Tribunal in the year under consideration."
>
> 6.1.4 In this view of the matter, the disallowance made by the A.O. was uncalled for and the same is hereby deleted."

9. Aggrieved, the Revenue has preferred an appeal before the Tribunal with the submissions that the assessee has been following the mercantile system of accounting, therefore, the corresponding provisions for the payment of interest are required to be made in the relevant assessment years. He has also invited our attention to the terms of agreement with the submissions that in case of dispute the assessee should have approached arbitrator for the resolution of dispute but instead of doing so

he did not pay the interest in the relevant assessment year and now the entire interest liability is claimed in the impugned assessment year on the basis of agreement which is not permissible in the eyes of law.

10. On the other hand the learned counsel for the assessee besides placing heavy reliance upon the order of CIT(A) has submitted that though the financial arrangement was made at the behest of the TML at a higher rate of interest at 12% per annum but no interest has ever been paid or provided on loan provided by NEL. Meaning thereby the assessee has never had an intention to pay higher rate of interest on the loan. He has also invited our attention to different correspondence exchanged between the assessee and the NEL raising dispute with regard to the rate of interest. Finally, the dispute was resolved through an agreement dated 12/04/2007 according to which the rate of interest was reduced from 12% to 6% per annum on reducing balance method with effect from 01/04/2000. The Learned counsel for the assessee contended that since the liability of payment of interest has been crystallized in the impugned assessment year, the assessee has rightly debited the same by making corresponding entries in the books of account. Therefore, the CIT(A) has correctly appreciated the claim of the assessee.

11. Having given a thoughtful consideration to the rival submissions and from a carefully perusal of the orders of the lower authorities and judgments referred to by the parties, we find that undisputedly the assessee was a dealer of TML for sale of its commercial vehicles and at the relevant point of time there was substantial outstanding credit balance due to TML without any liability of interest. At the behest of TML, financial

arrangements were made between the assessee and NEL, a subsidiary of Tata Group, and a loan of Rs.4,80,76,000/- was provided to the assessee company @12% per annum. It is also undisputed fact that the entire loan was immediately utilized by TML for squaring up its outstanding dues recoverable from the assessee company. Though the financial arrangement was made @12% per annum but the assessee has never paid or provided any interest on loan provided by NEL and since beginning the assessee has been disputing the rate of interest with the lender i.e. NEL. A note to this effect was also made by the auditors in the notes to the accounts attached with the balance sheet each year.

11.1 We have also carefully examined the notes of auditors attached to the balance sheet since beginning. From the notes attached to the balance sheet as on 31/03/2011, in the first balance sheet the auditor has given a note at Item No. 10 that no provision has been made in the account in respect of interest on dues relating to supply of vehicles converted to term loan from M/s Niskalp Investment & Trading Co. Ltd. The contents of notes is as under for the sake of reference:

> "No provision has been made in the account in respect of interest on dues relating to supply of vehicles converted to term loan from M/s Niskalp Investment & Trading Co. Ltd. During the year amounting Rs.62,82,841/-(Rupees Sixty two lac Eighty Two Thousand Eight Hundred Forty One Only). This has resultedin understating the loss by the same amount."

11.2 Similarly, in other years also the auditor has given a note on account to this effect with the same narration. The copies of balance sheets of

different assessment years along with the notes on account are placed before us. Besides the assessee has also agitated the higher rate of interest through various correspondences, therefore, the dispute of higher rate of interest was under consideration. The correspondences exchanged between the assessee and the NEL are also placed on record. Finally, the controversy was resolved vide supplementary agreement dated 12/04/2007. Through this agreement, the rate of interest was reduced from 12% to 6% per annum on reducing balance method with effect from 01/04/2000. Besides the modalities of payments were also worked out. The details of modalities of payments are given in clause –G of the agreement, which are extracted as under for the sake of reference:

> "G. In or about March 2007, the Borrower approached the Lender and requested the Lender to grant additional concessions and reliefs in respect of the amounts payable in respect of the Loan Agreement. Accordingly, the Borrower has requested the Lender to grant relief and concessions as set out hereinunder:
>
> (i) to reduce interest rate @6% per annum on reducing balance method with effect from 1st April, 2000.
>
> (ii) All the payments made after 1st April 2000 against the Finance Facilities to adjust against principal amount.
>
> (iii) To waive penal / additional interest.
>
> (iv) To accept the repayment in Revised Monthly Installments ("RMIs") towards repayment of the outstanding dues in 36 monthly installments of Rs.10,94,000/- each with effect from April 2007 till March 2010, and
>
> (v) The liability in respect of the accrued interest @6% p.a. due and payable on the revised principal amount of Rs.229.32 lacs for the period starting from 1st April, 2007 till

> repayment of the principal amount will be paid by the Borrower in three equal installments commencing from April 2010 to June 2010. The Revised Monthly Installment (RMI) include the part of amount to be adjusted against interest payment. Accordingly, the differential amount of interest liability arising out of computation of recovery of principal amount first against RMI determined on the basis of part payment of principal amount and interest will be computed at the end of tenure or in or about April 2010 when the appropriate amount of rebate may be considered on the basis of tract record of payment of RMI on stipulated dates till March 2010."

11.3 On the basis of this agreement through which the liability has been crystallized, the assessee has debited the interest of Rs.1,72,80,000/- under the head interest in Schedule-17 forming part of profit & loss account and corresponding entries were passed in the books of account of the assessee. We have also carefully examined various judgments referred to by the parties. In the case of CIT vs. Raj Motors [2006] 284 ITR 489 (All), their Lordships of Jurisdictional High Court have held having examined various judicial pronouncements rendered on the subject that liability to payment accrued only when the contractual liability is finally settled irrespective of the fact that the assessee has been following mercantile system of accounting.

11.4 In the case of Paramjit Singh vs. ITO [2010] 236 CTR)P&H) 466, their Lordships have observed that according to provisions of the Indian Evidence Act, 1972 when terms of a contract, grant or other disposition of property have been reduced to the form of a document then no evidence is permissible to be given in proof of any such term or such grant or disposition of the property except the document itself or the secondary

evidence thereof and no oral agreement contradicting/varying the terms of a document could be offered.

11.5 In the case of CIT vs. Motors & General Stores (P.) Ltd. 66 ITR 692, their Lordships have observed that when the transaction is embodied in a document the liability to tax depends upon the meaning and content of the language used in accordance with the ordinary rules of construction.

11.6 Having carefully examined the various judicial pronouncements, we are of the considered view that wherever nature of liability is of a contractual liability, the liability of payment always accrues on its crystallization or final settlement of the dispute, if any.

12. Turning to the facts of the case, we find that in the instant case the liability was not statutory liability. Admittedly it was a contractual liability. Though it accrued at the time of execution of first agreement through which loan was obtained by the assessee but that liability was disputed by the assessee by raising a dispute with regard to rate of interest through various correspondences and auditors notes attached to the balance sheet. Finally the dispute was resolved in the impugned assessment year through a supplementary agreement through which the rate of interest was reduced from 12% to 6% per annum besides other terms of payments. Therefore, the contractual liability is finally accrued on its crystallization in the impugned assessment year, and on the basis of the said agreement the assessee has made debit entry to the profit & loss account. Since the contractual liability has been crystallized in the impugned assessment year, the entries passed by the assessee in its accounts is in accordance with

law and no disallowance can be made on the ground that the assessee has been following mercantile system of accounting and the debit entries are to made in corresponding assessment years. We have carefully examined the order of CIT(A) and we find that he has adjudicated the issue in right perspective following the judicial pronouncements rendered on the subject. Since we find no infirmity in his order, we confirm the order of CIT(A).

13. In the result, the appeal of the Revenue is dismissed.

(Order pronounced in the open court on 12/11/2013)

Sd/.	Sd/.
(SAMIM YAHYA)	(SUNIL KUMAR YADAV)
Accountant Member	Judicial Member

Dated:12/11/2013
*Singh

Copy forwarded to the:
1. Appellant.
2. Respondent.
3. CIT (A)
4. CIT
5. DR.

Assistant Registrar