

**IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "B", PUNE**

**BEFORE SHRI SHAILENDRA KUMAR YADAV, JUDICIAL MEMBER
AND SHRI G.S. PANNU, ACCOUNTANT MEMBER**

**ITA No.495/PN/2012
(Assessment Year : 2008-09)**

The Solapur District Central Co-op.
Bank Ltd.,
207-209, Gold Finch Peth,
Solapur.

PAN : AAATT9561B Appellant

Vs.

Asstt. Commissioner of Income Tax,
Circle- 2, Solapur. Respondent

Assessee by : Mr. Sunil Ganoo &
Mr. S. N. Puranik
Department by : Mr. A. K. Modi
Date of hearing : 30-07-2014
Date of pronouncement : 29-09-2014

ORDER

PER G. S. PANNU, AM

The captioned appeal by the assessee is directed against an order of the Commissioner of Income Tax (Appeals)-III, Pune dated 28.10.2011 which, in turn, has arisen from an order dated 20.12.2010 passed by the Assessing Officer u/s 143(3) of the Income-tax Act, 1961 (in short "the Act"), pertaining to the assessment year 2008-09.

2. In this appeal, assessee has raised the following Grounds of Appeal :-

"1. CIT (A) has erred in confirming the addition of Rs.47,01,85,366/- in respect of interest on NPA A/cs same may please be deleted.

2. CIT (A) has erred in confirming rejection of method of Accounting of NPA interest, it may be held that method followed by Assessee is mercantile correctly recognizing NPA interest income on realization.

3. Without prejudice to Ground No. 2 above and if assessee fails to succeed on Ground No. 2, the amount already included in credit to Profit & Loss A/c being interest actually received on NPA A/cs. Same may please be excluded.

4. CIT (A) has erred in confirming addition of interest on Agricultural Stabilization Fund Rs.52,24,988/- and Rs.13,97,158/- interest on Corpus

Fund. This being over riding charge over profit of Bank, addition may please be cancelled.

5. *Assessing Officer has erred in disallowing excess provision for Bonus Rs.60,500/- Same may please be cancelled. As per notified AS 2 u/s 145 same cannot be disallowed.*

6. *Assessing Officer has erred in charging interest u/s 234 B,C and withdrawing interest u/s 234D. Same may please be cancelled.*

7. *Assessee denies liability to interest u/s 234 A,B and C.*

8. *Appellant prays for just and equitable relief.*

9. *Appellant prays to add, alter, modify, clarify, amend and/or withdraw the ground/s as the occasion may demand."*

3. The appellant before us, is a Co-operative Society incorporated under the provisions of the Maharashtra Co-operative Societies Act, 1960 and is carrying on banking business as a Co-operative Bank. For the assessment year 2008-09, it filed a return of income on 18.09.2008 declaring a loss of Rs.1,30,78,739/- which was subject to scrutiny assessment by the Assessing Officer. In the assessment order passed u/s 143(3) of the Act dated 20.12.2010 the assessed income has been determined at a positive figure of Rs.46,57,41,910/- after making certain additions/disallowances as against the reported loss of Rs.1,30,78,739/-. The additions/disallowances made by the Assessing Officer were carried in appeal before the CIT(A), who has allowed partial relief. Not being satisfied with the order of the CIT(A), assessee is in further appeal before us on the aforestated Grounds of Appeal.

4. The first dispute is in terms of Grounds of Appeal No.1 to 3 which relate to an addition of Rs.47,01,85,366/- on account of interest on Non Performing Assets (in short "NPAs"). As noted earlier, assessee is a co-operative bank carrying on banking business in terms of a license issued by Reserve Bank of India (RBI). Therefore, assessee is governed by the Circulars and Guidelines issued by the RBI, in particular relating to Prudential Norms, Income Recognition, Asset Classification, Provisioning and other related matters. In terms of such Prudential Norms of RBI, assessee asserts that it did not recognize interest income on account of NPAs i.e. the loans/advances to

customers which have been classified as NPAs following the Prudential Norms of RBI. The pertinent dispute in the Grounds of Appeal No.1 to 3 relates to non-recognition of income of Rs.47,01,85,366/- in respect of advances/loans to customers, which have been classified as NPAs.

5. The controversy with respect to non-recognition of income on accrual basis relating to the NPAs is no longer *res integra* but the same has already been adjudicated in favour of the assessee by the decision of the Pune Bench of the Tribunal in the case of ACIT vs. The Omerga Janta Sahakari Bank Ltd. vide order dated 31.10.2013 and also other subsequent decisions of the Pune Bench of the Tribunal. Apart therefrom, the Hon'ble Bombay High Court in the case of CIT vs. M/s KEC Holdings Limited vide Income Tax Appeal No.221 of 2012 dated 11.06.2014 has also approved the proposition that the interest income on NPAs is not recognizable on accrual basis. The aforesaid matrix is not challenged by the Revenue also. So however, in the present case, the case setup by the Revenue is that assessee had indeed credited such income in its Profit & Loss Account and there is an equivalent amount of Provision made by the assessee by way of debit in the Profit & Loss Account. In essence, the stand of the Revenue is that the impugned income, though relating to NPAs, is deemed to have accrued since assessee has credited it in its Profit & Loss Account, and the corresponding debit in the Profit & Loss Account is only a Provision for overdue interest and it is not an allowable deduction.

6. In the above background, we have considered the rival stands. The assessee has also furnished an affidavit on oath dated 05.10.2013 enumerating the various factual aspects and in response the Revenue has also furnished its say in terms of written comments dated 18.11.2013 by the Assistant Commissioner of Income Tax, Circle-2, Solapur, the Assessing Officer in this case. Before dwelling on the rival arguments on the objections

raised by the Revenue we consider it appropriate to briefly cull out the necessary facts having regard to the orders of the authorities below as well as the material on record.

7. The assessee is registered as a co-operative society and is carrying on the banking business. For the financial year 2007-08 corresponding to the assessment year under consideration it filed a return of income which was accompanied by, inter-alia, audited Balance-Sheet and Profit & Loss Account. In the consolidated Profit & Loss Account for the financial year under consideration, a copy of which is at page 51 of the Paper Book, on the credit side under the heading 'Interest Received', interest from Society Loan and from Individual Loans have been reflected at Rs.167,02,91,981/- and Rs.13,66,79,692/- respectively. It has been explained that the aforesaid interest income credited in the Profit & Loss Account include Rs.46,30,12,177/- and Rs.71,73,189/- on account of Society Loans and Individual Loans respectively which are relatable to loans/advances to customers classified as NPAs as per RBI norms. Similarly, on the debit side of the Profit & Loss Account under the heading 'Interest Paid', sums of Rs.46,30,12,177/- and Rs.71,73,189/- are put under sub-headings 'Overdue interest from Society Loans' and 'Overdue interest from Individual Loans' respectively. Similarly, on the Liabilities side of the Balance-Sheet an entry of Rs.82,81,68,339/- styled as 'Overdue Interest Reserve' appears. It has been explained that the term Reserve has been mistakenly used and in-fact the said amount reflects a contra entry for Interest Receivable on NPAs, which is appearing on the 'Assets side' on the Balance-Sheet under the heading 'Interest Receivable', with sub-headings 'On Society Loans' and 'On Individual Loans'.

8. Due to the aforesaid depiction in financial statements, the case of the Revenue is that the interest on NPAs have been credited in the Profit & Loss

Account and thus its accrual has been accepted by the assessee; and that the contra entry by way of debit in the Profit & Loss Account is to be understood as a mere Provision and, since a Provision is not an allowable deduction, the amount of Rs.47,01,85,366/- has been added to the total income.

9. The claim of the assessee is that it is incorrect to say that it has created a Reserve/Provision in respect of the Overdue Interest on NPAs. It is explained that instead of netting of the interest on loans, the bank has shown the gross interest on credit side of the Profit & Loss Account and on the debit side of the Profit & Loss Account the amount of interest on NPAs has been separately shown. It is further pointed out that amount on the debit side of the Profit & Loss Account is not appearing as a Provision. Further, even in the Balance-Sheet, it is pointed out that amount of Rs.82,81,68,339/- on the 'Liabilities' side of the Balance-Sheet does not appear under the head 'Reserve and Other Funds' but is separately disclosed as 'Overdue Interest Reserve'. It is also pointed out that the treatment in the financial statement of the assessee would show that it has never created in a Provision or a Reserve in respect of Overdue Interest on NPAs as sought to be made out by the income-tax authorities. In this context, the following averments in the affidavit are relevant :-

"3. It is respectfully submitted that in the Balance Sheet as on 31/03/2008 [in English copy] on the Liability side there appears an entry for Rs.82,81,68,339.10 styled as Overdue Interest Reserve. The bank submits that the term Reserve is mistakenly used and is erroneous and in fact it is a Contra Entry for Interest Receivable on N.P.A. which is appearing on Asset side of the Balance Sheet under the heading Interest Receivable and sub heading On Society Loans and On Individual Loan. The bank submits that the said amount of Rs.82,81,68,339.10 is not appearing on Liability side of the Balance Sheet under the heading Reserves and Other Funds but is separately disclosed as Overdue Interest. Similarly in the Profit and Loss Account the amount of Rs.47,01,85,366.04 [being the interest on N.P.A. during the year] is not appearing under the heading Provisions but is debited under the heading Interest Paid as overdue interest on loans of Societies and Individuals as a contra entry.

4. The bank most respectfully submits that a careful and dispassionate study of the final accounts of the bank would reveal that it has never

created any provision or reserve in respect of Overdue Interest on N.P.A. as alleged by the tax authorities. The entries as appearing in the Profit and Loss Account and the Balance Sheet for the F.Y. 2007-08 appear to have created some confusion in the minds of the learned Assessing Officer. It is false and incorrect to say that the bank has created a Reserve/ Provision in respect of the overdue interest on N.P.A. which has been treated as Interest accrued in the books of account of the bank for the relevant year.

5. *The bank most respectfully submits that instead of netting of the interest on loans, the bank has shown the gross interest on credit side of the Profit and Loss Account and simultaneously shown on debit side of the Profit and Loss Account the amount of interest on N.P.A. which is in accordance with the Accounting Standard [AS] 9 issued by the I.C.A.I.*

6. *The bank most respectfully submits that as on 31/03/2008 it had 214 branches. At the time of preparation of consolidated Profit and Loss Account and Balance Sheet as on 31/03/2008 [the copies of which are filed before the various tax authorities] solely with a view to make a disclosure of Gross Interest that would have been received by the bank, the interest on N.P.A. is disclosed on credit side of the Profit and Loss Account and a contra entry is made on debit side under the head Interest Paid. This accounting treatment does not by any logic convert the interest on N.P.A. in to interest accrued within the meaning of the provisions of the I.T. Act 1961 or cannot be called as recognition of income by the bank.*

7. *The interest on N.P.A. advances can never be recognized as income accrued to the bank merely by placing reliance in isolation on the presentation of Profit and Loss Account and dehors of entries in the Balance Sheet which show that the same is simultaneously debited to Interest Receivable on N.P.A. Account [on Asset side] and a contra credit entry is made in Overdue Interest Account [on Liability side]*

8. *The bank most respectfully submits that the aforesaid factual position was explained by it to the learned Assessing Officer during the assessment proceedings as well as to the learned C.I.T.[A] during the appellate proceedings. However both the authorities have failed to appreciate the facts in the proper perspective.*

9. *The bank most respectfully submits that entries made while presentation of final accounts to the shareholders for better understanding of the various issues shall not convert the true character and nature of income.”*

10. Apart therefrom, it has also been pointed out that the gross interest reflected on the credit side of the Profit & Loss Account and the Overdue Interest on NPAs shown on the debit side of the Profit & Loss Account is as per the requirements of section 65 of the Maharashtra Co-operative Societies Act, 1960 which prescribes the manner in which the net profit or loss is required to be computed in the financial statement. It was therefore contended that presentation in the Annual financial statements would not justify the income-tax authorities to treat the claim of the assessee differently than an assessee who would have netted the interest on loans.

11. We have carefully considered the rival submissions. As noted earlier, the crux of the controversy is with regard to assessee's claim that income with respect to the Interest on NPAs classified as per RBI norms is not assessable on accrual basis but is liable to be taxed as and when received. As per the Revenue, in the present case, assessee has credited gross interest in its Profit & Loss Account which is inclusive of the interest relatable to the NPAs, and crediting of such interest in the Profit & Loss Account shows that assessee has perceived such income to have been accrued, because assessee is following the mercantile system of accounting.

12. Undisputedly, the assessee bank is following the mercantile system of accounting. However, with regard to the recognition of income on NPAs, it has applied the RBI guidelines which say that such income is not to be recognized on accrual basis but is to be recognized as income only when it is actually received. The RBI guidelines also prescribe the manner in which the interest in relation to NPAs is to be shown in the Annual financial statements. In terms of the Master Circular on Income Recognition, Asset Classification, Provisioning & Other Related Matters issued by the RBI on 4th July, 2004 in chapter 4 of 'Income Recognition' in para 4.5.1 it is advised that the accrued interest in relation to NPAs should be computed and shown separately, though not accounted as income of the bank for the relevant period. Further, in para 4.5.3, with a view to ensuring uniformity in accounting the accrued interest in respect of both the performing and non-performing assets, the RBI guidelines inter-alia, prescribe that interest accrued in respect of NPAs should not be debited to borrowal accounts but shown separately under 'Interest Receivable Account' on the 'Property and Assets' side of the Balance-Sheet and corresponding amount shown under the 'Overdue Interest Reserve Account' on the 'Capital and Liabilities' side of the Balance-Sheet. In-fact, as a preface in para 4.5.3 the RBI has laid down that the aforesaid guideline be adopted notwithstanding the existing provisions in the respective State Co-operative

Societies Act. Notably, the Balance-Sheet format prescribed under the Third Schedule to the Banking Regulation Act, 1949 (as applicable to Co-operative Societies) specifically requires the banks to show 'Overdue Interest Reserve' as a distinct item on the 'Capital and Liabilities' side of the Balance-Sheet. Thus, it is evident that 'Overdue Interest Reserve Account' cannot be regarded as a 'reserve' or a part of the owned funds of the bank, as it is not created out of the real income received by the bank.

13. As a compliance to the aforesaid RBI guidelines, we find that the assessee has not debited the interest on NPAs to the accounts of the respective borrowals but it has been shown separately under 'Interest Receivable Account' on the 'Property and Assets' side of the Balance-Sheet. and corresponding amount has been shown under 'Overdue Interest Reserve Account' on the 'Capital and Liabilities' side of the Balance-Sheet. Thus, the depiction in the Balance-Sheet is in adherence to the prescription contained in the Banking Regulation Act, 1949 (as applicable to Co-operative Societies), a statute under which assessee is bound to carry out its banking business.

14. Now, we may come to the plea of the Revenue with reference to the depiction of impugned interest on NPAs in the Profit & Loss Account prepared by the assessee. As has been succinctly noted by us in the earlier paras, assessee has credited its Profit & Loss Account with gross interest which, inter-alia, includes the impugned interest on NPAs. On the debit side, assessee has shown the impugned interest on NPAs under the heading 'Interest paid' and sub-headings 'Overdue Interest from Society Loans' and 'Overdue Interest from Individual Loans'. The assessee is a society registered under the Maharashtra Co-operative Societies Act, 1960 and it is also governed by the Maharashtra Co-operative Societies Rules, 1961. Section 65 of the Maharashtra Societies Act, 1960 deals with Ascertainment and appropriation of profits by a society. Sub-section (1) of section 65 of the Maharashtra Co-operate Societies Act, 1960 lays down that a society shall

construct its relevant annual financial statements to arrive at its consequent net profit or loss in the manner prescribed. Such manner in relation to the calculation of net profits has been prescribed in Rule 49-A of the Maharashtra Co-operative Societies Rules, 1961. Rule 49-A prescribes that a society shall calculate “the net profits by deducting” from the gross profits for the year the Items (i) to (xvi) prescribed therein. For our purpose, it would suffice to examine Item (i) of the amounts deductible, which reads as under :-

“(i) all interest accrued and accruing on amounts of overdue loans (except in overdue amounts of loans against fixed deposit, gold, etc.)”

15. The aforesaid would show that while constructing its Profit & Loss Account to arrive at its net Profit or Loss, a Co-operative Society is required to show interest accrued/accruing on amounts of Overdue Loans separately. This is precisely what has been done by the assessee in the present case. The aforesaid requirement of the manner of construction of Profit & Loss Account, prescribed under the Rules of the Maharashtra Co-operative Societies Act, 1960, has prompted the assessee to draw up its Profit & Loss Account in the manner we have noted above qua the interest on NPAs. Therefore, it cannot be accepted that the manner or presentation of account which ostensibly is in compliance with the statutory provisions governing the assessee, can be a factor to evaluate assessability or otherwise of an income. In our considered opinion, it would inappropriate to be merely guided by a presentation in the annual financial statements to infer assessee’s perception that an income had accrued, without considering the entries made in the financial statements in *toto*. In the present case, it is quite clear that assessee has drawn up its annual financial statement in compliance with the requirements of the statutes under which it functions and/or is incorporated. Therefore, the issue with regard to non-recognition of income on NPAs is required to be adjudicated having regard to the relevant legal position and not on the basis of the presentation in the annual financial statements. At this

stage, we may also refer to the judgement of the Hon'ble Supreme Court in the case of CIT vs. Shoorji Vallabhdas & Co., (1962) 46 ITR 144 (SC) for the proposition that a mere book keeping entry cannot be assessed as income unless it can be shown that income has actually resulted. In the present case, the crediting of gross interest in the Profit & Loss Account, which includes interest on NPAs cannot be taken as a proof that such income has accrued to the assessee unless the statutory guidelines applicable on the said subject are ignored. Obviously, when the banking institutions following mercantile system accounting are permitted to treat the income on NPAs as assessable on receipt basis, such a position cannot be ignored in the case of present assessee merely because of a presentation in the annual financial statements. Even otherwise, we notice that the RBI guidelines permit that interest income on NPAs be parked in a suspense account and it is not necessary that it has to be brought to the Profit & Loss Account by the assessee. However, in the present case, as seen earlier, assessee has credited the gross amount of interest on credit side of the Profit & Loss Account and simultaneously shown on the debit side of the Profit & Loss Account, the amount of interest on NPAs. In other words, instead of netting of the interest the two amounts have been shown separately one on the credit side and other on the debit side. The net effect of the said presentation is the same. Therefore, in our view, the lower authorities have misguided themselves in rejecting the claim of the assessee for non-recognition of interest income on NPAs.

16. In view of the aforesaid, we set-aside the order of the CIT(A) and direct the Assessing Officer to delete the addition of Rs.47,01,85,366/-. Thus, on Grounds of Appeal No.1 and 2 assessee succeeds. The Ground of Appeal No.3 is only an alternative Ground raised, in case assessee does not succeed on Grounds of Appeal No.1 and 2. Since assessee has succeeded on Grounds of Appeal No.1 and 2, Ground of Appeal No.3 is dismissed as infructuous.

17. In Ground of Appeal No.4, assessee has challenged the addition of Rs.52,24,988/- and Rs.13,97,158/- on account of interest on Agricultural Stabilization Fund and on Corpus Fund respectively. At the time of hearing, the learned counsel has submitted that assessee bank does not wish to press the addition of Rs.13,97,158/- relating to interest on Corpus Fund. Accordingly, the same is dismissed as 'Not Pressed'.

18. The surviving dispute is of Rs.52,24,988/- which represents interest on Agricultural Stabilization Fund, the relevant facts thereof are as follows. It is explained that the Fund has been created pursuant to a the Govt. Resolution, Agriculture and Co-operation Department No.CCR4 1869/22948-C-1 dated 27th February 1971, utilization of which was governed by the Rules laid down by the State Government. It is stated that the assessee has been paying interest @ 3% on the Fund balance as per stipulation in the Rules and accordingly, an amount of Rs.52,24,988/- was credited to the balance of the fund at on the end of the year. The aforesaid amount was claimed as a deduction while computing the taxable income. The Assessing Officer held that the aforesaid amount could not be deducted because it was not an actual outgo. Accordingly, the interest debited in the Profit & Loss account in this regard amounting to Rs.52,24,988/- was disallowed and added back to the income of the assessee. The CIT(A) has also affirmed the stand of the Assessing Officer on this aspect and the operative part of the order of the CIT(A) in this regard reads as under :-

"6.3 The submissions of the appellant are carefully considered with reference to the income & expenditure account and the relevant rules for establishment and use of agricultural credit (Stabilization) Fund as provided in the Govt. Resolution No.CCR4 1869/22948-C-1 dated 27th February 1971. As stated in para 3 of the Rules, the resources for establishment and maintenance of funds are as follows:-

(a) Annual appropriation of 40% of annual profits of the District Central Cooperative Bank to be divided between the Reserve Fund and the Agricultural Credit (Stabilization) Fund in such a way that the

contribution to the stabilization fund alone in no case is reduced below 15% of the net profit;

(b) Transfer of amount of dividend payable on the share holding of the Government in District Central Cooperative Bank over and above 3%;

(c) Credit of interest at 3% per annum on the balance to the credit of the fund as at the commencement of the year.

6.3.1 *The objects of the fund as stated in the Scheme are as under :-*

"The object of constitution of agricultural credit stabilization fund at the Apex and District Central Cooperative Banks' levels is to facilitate the conversion of short terms loans for agricultural purposes into medium terms loans and to provide conversion facilities to the installments of medium term loans for agricultural purposes in circumstances in which total or partial failure of crops resulting from natural calamity renders the repayment of such short term loans or installments of medium term loans impossible without dislocation of the credit structure and without hardship to individual agriculturalists. The principles and procedures set out below shall govern the establishment and utilization of the stabilization fund at various levels."

6.3.2 *The resources for the establishment of the fund clearly indicate that the fund was created out of appropriation of profits of the appellant bank and therefore, even the credit of interest @ 3% on the balance at the beginning of the year is also an appropriation of profit to meet the exigencies as mentioned in the aims and objects of the fund and the interest cannot be a charge to the profit & loss account. The claim of the appellant that the fund was utilized for its business purposes and therefore* the interest is business expenditure cannot be accepted. It is only an appropriation of profit towards a specific purpose and the same does not constitute business expenditure of the appellant. The same is the position with the interest on Corpus fund, which is meant for weaker sections of the society and it is only an appropriation of the profit and cannot be a charge to the income & expenditure account. Accordingly, the additions made by the Assessing Officer on this ground do not call for any interference and the ground raised by the appellant in this regard stands rejected."*

19. Before us, the learned counsel for the assessee has submitted that assessee was required to pay to the fund interest @ 3% and therefore the said amount was allowable as an expense.

20. On the other hand, the learned Departmental Representative has opposed the plea of the assessee by pointing out that assessee was in control of the investment of the fund and any income therefrom is permitted to be credited in assessee's Profit & Loss Account. In this context, a reference has been made to the Rules For The Establishment AND USE OF

AGRICULTURAL CREDIT (STABILISATION) FUND, a copy of which has been placed at pages 65 to 79 in the Paper Book.

21. We have carefully considered the rival submissions. In our considered opinion, no fault can be found with the order of the CIT(A) on this count as it has been justifiably concluded by him that the impugned interest is only an appropriation of profits towards specific purpose and it does not constitute a business expenditure of the assessee. The constitution of the Agricultural Credit (Stabilization) Fund per the resolution of the Government of Maharashtra reflects that it is created by appropriation of the profits of the assessee bank, and the yearly credit of interest @3% on the balance to the credit of Fund, is not a charge against the Profit & Loss Account. The order of the CIT(A) is hereby affirmed and assessee fails on this Ground. Thus, Ground of Appeal No.4 is dismissed.

22. The Ground of Appeal No.5 relating to excess provision for Bonus of Rs.60,500/- has not been pressed and is accordingly, dismissed.

23. The only other Ground relates to the chargeability of interest u/s 234A, B and C which is consequential in nature and does not require any specific adjudication.

24. In the result, appeal of the assessee is partly allowed.

Order pronounced in the open Court on 29th September, 2014.

Sd/-
(SHAILENDRA KUMAR YADAV)
JUDICIAL MEMBER

Sd/-
(G. S. PANNU)
ACCOUNTANT MEMBER

Pune, Dated : 29th September, 2014.

Sujeet

Copy of the order is forwarded to: -

- 1) The Assessee;
- 2) The Department;
- 3) The CIT(A)-III, Pune;

- 4) The CIT-III, Pune;
- 5) The DR "B" Bench, I.T.A.T., Pune;
- 6) Guard File.

By Order

//True Copy//

Assistant Registrar
I.T.A.T., Pune