

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI SPECIAL BENCH `F' : NEW DELHI**

**Before Justice (Retd.) Dev Darshan Sud, Hon'ble
President, Shri G.C. Gupta, VP and Shri R.S. Syal AM**

ITA Nos.1999 & 2000/Del/2008
Assessment Years : 2001-02 & 2002-03

M/s National Agricultural
Cooperative Marketing Federation
of India Ltd.,
NAFED House, Ashram Chowk,
New Delhi.
PAN: AAACN0172F

Vs. Joint Commissioner of
Income Tax,
Range-32,
New Delhi.

(Appellant)

(Respondent)

Assessee By : Shri Hiren Mehta &
Shri Sanjeev Kwatra, CAs
Department By : Smt. Sulekha Verma, CIT, DR

Date of Hearing : 15.10.2015
Date of Pronouncement : 16.10.2015

ORDER

PER R.S. SYAL, AM:

The Hon'ble President of the Income-tax Appellate Tribunal, on a reference made by a Division Bench, has constituted this Special Bench by posting the following question for our consideration and decision:-

“Whether on the facts and circumstances of the case, where claim of damages and interest thereon is disputed by the assessee in the court of law, deduction can be allowed for the interest claimed on such damages while computing business income?”

2. The assessee has raised similar grounds in both the captioned appeals against the confirmation of disallowance of interest on damages amounting to Rs.7,92,52,013 and Rs.8,44,34,983 for the A.Ys. 2001-02 and 2002-03 respectively. Since the facts and circumstances of making addition by the Assessing Officer (AO) and then its echoing by the Id. Commissioner of Income-tax (Appeals) [CIT(A)] are similar for both the years, we are espousing the factual matrix relevant to the A.Y. 2001-02 for consideration and decision, which is *mutatis mutandis* similar to the other year as well.

3.1. Succinctly, the facts apropos the issue for the assessment year 2001-02 are that the assessee filed its return and the assessment was completed on 27.2.2004 u/s 143(3) of the Income-tax Act, 1961 (hereinafter also called ‘the Act’). During the course of assessment proceedings pertaining to the A.Y. 2003-04, a special audit u/s 142(2A) was carried out which

divulged, *inter alia*, that the assessee had claimed deduction for interest payable to M/s Alimenta SA Switzerland (hereinafter called 'Alimenta') on account of arbitration award, which was still disputed by it. The AO observed that the assessee claimed deduction of interest amounting to Rs.7.92 crore payable to Alimenta for the A.Y. 2001-02. Such amount of interest was not found to have been debited to the Profit & Loss Account but directly reduced in the computation of total income. He further observed that as per the provisions of section 40(a)(i) of the Act, this amount of interest was deductible only on the deduction of tax at source and payment thereof, which was not done by the assessee. In a nutshell, the AO opined that such interest was not deductible. Notice u/s 148 was issued 22.9.2006, which was duly served on the assessee.

3.2. The AO noticed during the course of assessment proceedings that deduction for interest was not backed by any corresponding liability to pay; the liability claimed by the assessee as deduction was not acknowledged due to the ongoing litigation and proceedings for compromise; the assessee was of the view that the principal amount should be wiped off and interest should either be Nil or reduced

drastically; and even if the liability was treated as certain and otherwise eligible for deduction, no deduction was allowable due to violation of the provisions of section 40(a)(i) inasmuch as no tax was deducted at source. The assessee submitted that there was a breach of contract on its part for which the Hon'ble Delhi High court held it (NAFED) liable for the loss incurred by Alimenta and also interest @ 18% per annum from the date of award till the date of realization; the judgment delivered by the Hon'ble High Court was binding; the liability was determined and ascertained because of the decree of the Hon'ble Delhi High Court notwithstanding the assessee filing appeal against it; and the term 'interest' used in section 40(a)(i) of the Act relates to loan and does not mean compensation and, hence, such provision was not applicable. The AO refused to accept the assessee's contentions by further noticing that it had treated this liability as contingent by not debiting it to the Profit & Loss Account; the provisions of section 40(a)(i) were squarely applicable in this case; and the cases relied by the assessee were not applicable to the prevailing circumstances. In view of these reasons, the AO came to hold that no deduction was

permissible for Rs.7,92,52,013. He, therefore, made an addition for this sum. Similar is the position for the succeeding year as well.

3.3. The Id. CIT(A) observed that on identical issue, the assessee preferred appeals before the Tribunal pertaining to assessment years 1996-97 to 1998-99 and the Bench was pleased to hold that the liability for payment of such interest crystallised only in the period relevant to assessment year 2000-01 and hence no deduction was allowable in such years because the claim for interest at the end of such years was not an ascertained liability. He further took note of the view taken by him for the assessment years 2003-04 and 2004-05 in holding that the interest was not deductible. The assessee's contention about the finding of the Tribunal for the crystalization of liability on 28.1.2000 pursuant to the passing of the decree by the Hon'ble High Court against NAFED, was held by the Id. first appellate authority to be only an *obiter dicta*. He, therefore, upheld the view taken by the AO in making disallowance of interest amounting for both the years.

3.4. The assessee preferred second appeals contending that since the Tribunal in assessee's own case for the A.Ys. 2003-04 and 2004-05 had allowed deduction of interest, the same view be followed for the two A.Ys. under consideration. The Division Bench hearing the appeals for the extant years was not convinced with the reasoning given by the Tribunal in its order for the A.Ys. 2003-04 and 2004-05 in deleting the disallowance of interest and, accordingly, made a reference for the constitution of a Special Bench in terms of section 255(3) of the Act. That is how, the instant proceedings have come up before us for consideration and decision.

4. We have heard the rival submissions and perused the relevant material on record. It is undisputed that the assessee is following mercantile system of accounting and has neither paid such amount of interest nor claimed it as deduction in its books of account. Deduction was claimed directly in the computation of income. The view point of the assessee is that since it is following mercantile system of accounting, the liability to pay interest @ 18% p.a. became due by the order of the Id.

Single Judge of the Hon'ble Delhi High Court and accordingly deduction for the same is permissible.

5. Under the mercantile system of accounting, an assessee gets deduction when liability to pay an expense arises, notwithstanding its actual quantification and discharge taking place subsequently. The relevant criteria for the grant of a deduction is that the incurring of liability must be certain. If the liability itself is uncertain, it assumes the character of a contingent liability and ceases to be deductible. Thus, a deduction can be allowed only when an assessee incurs liability to pay an amount in the nature of an expense. The aspect of incurring a liability needs to be understood in a correct perspective. It is here that a distinction between a contractual and a statutory liability assumes significance. A statutory liability is incurred on a mere issuance of a demand notice against the assessee and becomes deductible at that point of time. The factum of the assessee raising a dispute against such a demand does not ruin the incurring of liability. On the contrary, a contractual liability is not incurred on a mere raising of demand by a claimant. It arises only when such a claim is either acknowledged or in a case of non-acceptance, when

a final obligation to pay is fastened coupled with the claimant acquiring a legal right to receive such an amount. Unless the claimant acquires an enforceable right to receive, it cannot be said that the first person has incurred a liability to pay such an amount. To put it simply, in the case of a contractual dispute between the parties, liability of the assessee to pay arises only when the claimant against the assessee acquires some legal right to receive the amount. In the absence of the vesting of any such right in the claimant, neither he earns any income nor the assessee incurs a corresponding liability to pay, entitling him to claim deduction for the same. Crux of the matter is that except for the assessee accepting a contractual claim, his liability to pay does not arise until some legal obligation to pay is fixed on him. A legal obligation to pay is attached on an assessee when a competent court passes order and a suit is decreed against him and not during the pendency of litigation. This difference between a contractual and a statutory liability has been recognized by the Hon'ble Delhi High Court in assessee's own case since reported as *National Agricultural Co-operative Marketing Federation of India Ltd. vs. CIT (2011) 338 ITR 36 (Del)*.

6. In order to decide the question of deductibility or otherwise of interest by the assessee to Alimenta, we need to have a look at the relevant factual details, which are as under:-

- 1979-80 (Export Policy) –NAFED was appointed canalizing agency for export of HPS Groundnut. A quota of 50,000 MTs each was released to NAFED for 1979-80 and 1980-81.
- 12.1.1980. Agreement executed between NAFED and Alimenta for export of 5,000 MTs HPS GN Kernels Jawa variety @ 765 USD PMT FOB from Saurashtra Port during January-May, 1980. Another agreement for supply of 4000 MTs HPS Groundnut Kernel jawa Variety @ USD 770 for supply during 1980-81 was executed on 3.4.1980.
- 1900 MTs shipped up to 31.5.1980. Balance could not be shipped in view of the non-declaration of vessel by the buyer.
- On 20.12.1980, NAFED informed Alimenta about restriction imposed by the Government of India on export and expressed inability to ship the balance quantity of 7100 MTs.
- 13.2.1981, Alimenta asked NAFED to submit the dispute for arbitration to Federation of Oils, Seeds and Fats Association Ltd. (FOSFA) arbitrators at London.

- An award was made against NAFED on 14.11.89. Appeal was filed before the Board of Appeal of FOSFA, which also upheld the award, the details of which are as under:-
45.26 lakh USD – Principal amount + 48.81 lakh USD (interest @ 11.25% w.e.f. 13.2.1981 to 14.9.1990, being the date of award)
- August 1993. Alimenta filed this award for Enforcement under Foreign Award (Recognition and Enforcement) Act, 1961. *The ld. Single judge of the Hon'ble Delhi High Court vide its judgment dated 28.1.2000 made the award a rule of the court and further ordered that Alimenta shall be entitled to interest @ 18% p.a. from the date of the award till the date of realization. Decree was accordingly passed on the same date, that is, 28.1.2000.*
- NAFED filed appeal against the judgment and decree of the ld. Single judge. On 28.2.2001, the *Division Bench stayed the execution of judgment and decree dated 28.1.2000* on furnishing of Bank Guarantee of equivalent amount.
- Alimenta filed SLP against the order passed by the Hon'ble Delhi High Court on 28.2.2001 granting full stay. The Hon'ble Supreme Court, without entering into the merits of the contentions raised before it and without expressing any opinion as to the maintainability of appeal to the Division Bench, vide its order dated 5.4.2002, modified the stay order passed by the

Division Bench of the Hon'ble Delhi High Court, directing the NAFED to furnish either bank guarantee or proper security for the principal amount decreed within eight weeks, failing which the order of stay granted by the Hon'ble Delhi High Court was to be vacated.

- This order of the Hon'ble Supreme Court was later on modified by the Hon'ble Supreme Court on 8.1.2003 mandating that in case the assessee furnishes bank guarantee for the entire principal amount within four weeks, the execution proceedings should remain stayed.
- In the mean time, the assessee's appeal against the *Id.* Single judge's order dated 28.1.2000 came up for hearing before the Hon'ble Delhi High Court. Pursuant to difference of opinion, *the Id. third Hon'ble Judge vide his order dated 6.9.2010 came to hold that that a letters patent appeal is not maintainable against the judgment dt. 28.1.2000 of the Id. Single Judge.*
- The assessee filed SLP against this judgment of the Hon'ble Delhi High Court. Vide its order dated 25.10.2010, issuing notice, an interim stay was granted against the judgment dt. 6.9.2010 subject to the deposit of the amount due.
- A modification application was filed by the assessee, which was disposed of by the Hon'ble Supreme Court on 24.1.2011.

- One more modification application was filed, which was also disposed of by the Hon'ble Supreme Court on 7.4.2011 staying the execution of decree.
- On 17.1.2012, the Hon'ble Supreme Court rejected the prayer for interim relief and gave liberty to the respondent to enforce decree dated 28.1.2000 passed by the Id. Single Judge of the Hon'ble Delhi High Court.
- In the mean time, Alimenta filed petition for rectification of the decree order passed by the Id. Single judge dt. 28.1.2000. Vide its order dated 21.08.2014, certain clerical errors were corrected.

7. We can summarize the position germane to the issue before us from the above events-chart that the Id. Single Judge of the Hon'ble Delhi High Court vide his judgment and decree dated 28.1.2000 directed, *inter alia*, the payment of interest to Alimenta at 11.25% up to the date of award as allowed by FOSFA and at 18% from the date of award till the date of realization. It is undisputed that no payment of the principal amount of damages or interest has so far been finally made, except for furnishing bank guarantees etc. to some extent. The assessee filed a letters patent appeal against the judgment and decree of the Id. Single Judge. The

Division Bench, during the pendency of such an appeal, vide its interim order dated 28.2.2001 stayed the execution of the judgment of Id. Single Judge. Certain interim orders were passed by the Hon'ble Supreme Court and the Hon'ble Delhi High Court, but the stay on the order and decree of the Id. Single Judge was not disturbed, which continued till the Id. third Judge (on a difference of opinion between the two Id. Judges who heard the appeal) finally decided the appeal of the assessee vide its judgment dated 6.9.2010 holding that a letters patent appeal is not maintainable against the judgment dt. 28.1.2000 of the Id. Single Judge. A consequential judgment was passed in September, 2010. Effect of this judgment is that the stay order of the Division Bench passed on 28.2.2001 got vacated and the judgment and decree of Id. Single Judge dt. 28.1.2000 again came to be revived. On 17.1.2012, the Hon'ble Supreme Court rejected the prayer of the assessee for interim relief and gave liberty to Alimenta to enforce decree dated. 28.1.2000 passed by the Id. Single Judge of the Hon'ble Delhi High Court. This sequence of events transpires that the legally enforceable liability against the assessee to pay interest at the rate of 18% to Alimenta, which was created by the decree of the Id. Single

Judge dated 28.1.2000, remained suspended from the date of stay granted by the Division bench of the Hon'ble High Court on 28.2.2001. It is only on the passing of the consequential judgment and decree by the Hon'ble Delhi High Court in September, 2010, subject to certain stays etc. granted against the operation of this judgment, that the assessee incurred a legally enforceable liability to pay such interest to Alimenta.

8. Now the moot question is whether the assessee is entitled to deduction for interest at the rate of 18% decreed by the Id. Single Judge of the Delhi High Court in the computation of income for the years under consideration. The answer will be in affirmative if the assessee had any legal obligation to pay such interest during the years in question and *vice versa*. We can do this by ascertaining if any legally enforceable liability existed against the assessee to pay interest in the years under consideration. Per contra, was Alimenta legally entitled to receive such interest income during the years in question? It is patent that the stay order against the judgment and decree of the Id. Single Judge was passed by the Division Bench on 28.2.2001, which is well within the financial year relevant to the assessment year 2001-02 under consideration and remained

operative in subsequent years including the immediately succeeding year in appeal. This shows that the assessee did not have any legal obligation to pay interest during these two years. The hitherto obligation which was created by the judgment of the Id. Single judge against the assessee was eclipsed and frustrated by the later judgment of the Division bench and such obligation ceased to exist for the time being.

9. At this juncture, it will be apposite to consider the judgment dated 3.6.2011 rendered by the Hon'ble Delhi High Court in assessee's own case for the A.Ys. 1996-97 to 1998-99 as referred to in para 5 of this order *supra*. The assessee claimed deduction for interest in these three years, which the AO refused to allow. The Tribunal upheld the view of the AO. When the matter finally came up before the Hon'ble High Court, Their Lordships took up the question whether the liability could be said to have accrued to the assessee to pay this interest before the passing of the order by this Court on 28th Jan., 2000. Rejecting the assessee's contention, it was held that on the last date of all the three assessment years, namely, 1996-97, 1997-98 and 1998-99, there was no legal liability on the part of

the appellant to pay interest and that liability was crystallized only on 28th Jan., 2000 (i.e., asst. yr. 2000-01) when decree was passed by the Delhi High Court and was hence deductible only when it got crystallized into a certain liability, which event took place only on the passing a decree and awarding interest after the date of the award till the date of realization.

10. This judgment in assessee's own case has laid down that liability to pay interest arose on the ld. Single Judge passing decree on 28.1.2000 and till then there was no obligation to pay any interest and hence the assessee could not claim deduction of interest in the computation of income for the earlier years. The principle is that deduction becomes available only on coming into existence of a liability to pay and the liability to pay arises when it flows from a legally enforceable order. In such a situation, the period to which the expense originally pertained, loses its relevance. Since the decree in this case was passed by the ld. Single judge on 28.1.2000, which also covered interest for the periods relevant to the A.Ys. 1996-97 to 1998-99, the deduction of interest for such three years was held to be available not in these years but on crystallization of liability on 28.1.2000.

Albeit this judgment has been rendered on 3.6.2011, but the fact that the order and decree dt. 28.1.2000, which created liability to pay interest against the assessee, was stayed on 28.2.2001, appears not to have been brought to the notice of the Hon'ble High Court as it does not find mention anywhere in the judgment. Though this factor is otherwise crucial for our purpose, but does not have any material bearing on the conclusion about the non-deductibility of interest for the three years before the Hon'ble High Court inasmuch as the liability to pay such interest did not crystallize at the end of those three years *de hors* the stay on the judgment of the Id. Single Judge dated 28.1.2000. Be that as it may, the *ratio decidendi* of the judgment, which is not marred even by non-mentioning by the parties about the stay of the Id. Single Judge's order, is that deduction for interest can be allowed only when an enforceable liability to pay the same arises irrespective of the consideration that it relates to earlier years.

11. This view of the Hon'ble High Court accords with the one taken by the Hon'ble Supreme Court in *CIT vs. A. Gajapathy Naidu (1964) 53 ITR*

114 (SC), laying down the law in relation to accrual of income in the following terms : "When an ITO proceeds to include a particular income in the assessment, he should ask himself, inter alia, two questions, namely : (i) what is the system of accountancy adopted by the assessee, and (ii) if it is the mercantile system, subject to the deeming provisions, when has the right to receive accrued ? If he comes to the conclusion that such a right accrued or arose to the assessee in a particular accounting year, he should include the said income in the assessment of the succeeding assessment year. *No power is conferred on the ITO under the Act to relate back an income that accrued or arose in a subsequent year to another earlier year, on the ground that that income arose out of an earlier transaction.*" Applying the same principle to expenses, a deduction can be allowed only in the year in which the liability to pay them finally arises, irrespective of the year to which they actually relate.

12. Reverting to the point, unless there is a specific contrary provision, deduction for an expense can be allowed in the year in which liability to pay finally arises. Once a person has not voluntarily accepted a

contractual obligation and further there subsists no legal obligation to pay *qua* such contractual claim at a particular time, it cannot be said that the person incurred any liability to pay at that point of time so as to make him eligible for deduction on that count. Notwithstanding the fact that obligation relates to an earlier year, the liability to pay arises only in the later year, when a final enforceable obligation to pay is settled against that person. In our considered opinion, there is no qualitative difference between the two situations, viz., first, in which no enforceable liability to pay is created in the first instance, and second, in which though the enforceable liability was initially created but the same stands wiped out by the stay on the operation of such enforceable liability. In both the situations, claimant remains without any legal right to recover the amount and equally the opposite party without any legal obligation to pay the same. Neither any income accrues to the claimant, nor any deduction is earned by the opposite party. We are instantly confronted with the second type of situation in which the obligation created against the assessee by the judgment of the Id. Single Judge on 28.1.2000 was stayed by the judgment of the Division Bench on 28.2.2001, which position continued till the

decree on the judgment dt. 6.9.2010 reviving the judgment of the Id. Single Judge, became enforceable. Even though the crystallization of liability of the assessee to pay interest pursuant to the developments after 6.9.2010 also covers earlier years including the years under consideration, but such liability of the assessee became due only on the acquisition of right by Alimenta to enforce the decree issued on the advent of the judgment dated 6.9.2010. Consequently, the assessee can claim deduction for such interest only at such a later stage and not during the years under consideration.

13. Our view about non-availability of deduction for the years in question is further fortified by the judgment of the Hon'ble Supreme Court in the case of *CIT vs. Hindustan Housing & Land Development Trust Ltd. (1986) 161 ITR 524 (SC)*. The assessee in that case was dealing in land and maintained its accounts on mercantile basis. Some plots of the assessee were requisitioned by the Government and, subsequently, the land was acquired. Certain sum was awarded as compensation. The assessee preferred appeal before the arbitrator, who made the award fixing

higher amount of compensation. The State Government appealed to the High Court and, during the pendency of the appeal, the assessee was permitted to withdraw the amount on furnishing security. The AO brought to tax the difference between the amount paid to the assessee in terms of the award and the amount already paid. This amount was treated as liable to tax on the ground that the income accrued to the assessee on the date of the award. When the matter finally came up before the Hon'ble Apex Court, Their Lordships held that no income accrued to the assessee as there was no absolute right to receive the amount at that stage inasmuch as the arbitrator's award enhancing compensation for acquisition of the assessee's land was put in jeopardy by the State Government on filing an appeal against that very right and nothing would be due if the appeal was decided against the assessee. Noticing that there was no absolute right to receive the amount at that stage, the Hon'ble Summit Court held that: `There is a clear distinction between cases such as the present one, where the right to receive payment is in dispute and it is not a question of merely quantifying the amount to be received, and cases where the right to receive

payment is admitted and the quantification only of the amount payable is left to be determined in accordance with settled or accepted principles.’

14. Presently, we are also dealing with an almost similar situation in which Alimenta’s right to receive interest was in serious dispute at the end of the years under consideration because the corresponding liability of the assessee to pay stood stayed by the order of the Division Bench on 28.2.2001. By no standard, the assessee can be said to have incurred any liability for payment of interest to Alimenta at the end of the these two years.

15. The Id. AR has vehemently relied on the order passed by the Tribunal for the A.Y. 2003-04 in which a view in its favour has been taken. It is the same order, which the succeeding Bench could not agree with and referred the matter for constitution of Special bench. We have gone through this order of the tribunal, a copy of which has been placed in the paper book. It can be observed that the Tribunal, in deciding this issue in favour of the assessee, has been swayed by the fact that the Id. Single Judge passed the order/decreed against the assessee on 28.1.2000. There is no reference

whatsoever in this order dated 18.7.2008 to the later development, being the order passed by the Division Bench on 28.2.2001 staying the operation of the earlier judgment and decree of the Id. Single Judge. This crucial fact of paramount importance was not brought to the notice of the Tribunal and it is on these half presented facts that the Tribunal allowed deduction of interest.

16. The Id. AR has relied on certain judgments of the Hon'ble jurisdictional High Court to bolster the deductibility of interest. We find such reliance as completely misplaced. The first judgment is *R.C. Gupta vs. CIT (2008) 166 Taxmann 191 (Del)*. The facts of the case are that the assessee therein made certain purchases from company 'H' in the year 1975 and the amount was payable, but, there was dispute on the liability to pay. The assessee claimed deduction for the said amount in its computation of income for the A.Y. 1979-80. The AO disallowed it on the ground that: 'the said amount did not relate to any purchases made during the previous year relevant to the assessment year in question.' The Hon'ble High Court eventually allowed deduction for the said amount.

We do not find any parallel between the facts of that case and the case under consideration. In that case, an undisputed fact prevailed that the liability was incurred as the goods were in fact purchased by the assessee and the only dispute was of the timing of deductibility. On the contrary, we are confronted with a situation in which no liability, as such, has been incurred by the assessee, for which a deduction is sought.

17. The next case relied by the ld. AR is *Jasjeet Films (P) Ltd. Vs. CIT (2007) 165 Taxmann 599 (Del)*. The assessee in this case constructed a cinema building on a plot of land allotted to it on lease by Delhi Development Authority (DDA). Construction of the said building was completed in August, 1970. On 9.9.1980, the DDA issued a letter to the assessee, wherein demand was raised for ground rent and also towards interest charges for belated payment of such ground rent. The assessee debited the amount in its Profit & Loss Account for the assessment year 1981-82. The AO disallowed the amount of interest pertaining to earlier years on the ground that the said liability could not be construed to have accrued during the relevant previous year. Reversing the view taken by

the AO, the Hon'ble High Court held that such amount of interest pertaining to earlier years was deductible in the year in question because the liability to pay such interest accrued on the issuance of letter by the DDA on 9.9.1980. We fail to comprehend as to how this case supports the assessee's contention. We are dealing with a situation in which the liability to pay interest did not exist at all at the end of the years in question because the judgment and decree of the Id. Single Judge was stayed by the Division Bench of the Hon'ble Delhi High Court vide its order dated 28.1.2001. This judgment rather supports the Revenue's contention that the deduction can be claimed only when the liability is incurred. Going by the *ratio decidendi* of the judgement in *Jasjeet Films (P) Ltd. (supra)*, we find that the assessee can claim deduction for interest only when the liability to pay such interest finally got crystallized on the passing of decree by the Hon'ble Delhi High Court in September, 2010, subject to certain stays etc. granted against the operation of this judgment and not the years in question when such liability to pay was absent at the respective year endings.

18. Similarly, we find that the case of *CIT vs. Industrial Finance Corporation of India Ltd. (2009) 185 Taxmann 296 (Del)*, relied by the Id. AR is not germane to the issue. In that case, the assessee entered into a forward contract for purchase of foreign currency on a future date at a pre-determined rate and the difference between forward contract rate and exchange rate on the date of entering into the contract was recognised as deduction, which the AO refused to allow by treating it as a contingent liability. The Hon'ble Delhi High Court overturned the view taken by the AO and finally held that this is an ascertained and definite liability in terms of contract and, hence, eligible for deduction. In our considered opinion, this judgment has no relevance to the facts under consideration.

19. We consider it paramount to mention that the assessee has adopted diagonally opposite stands in civil proceedings and income-tax proceedings in so far as the question of interest liability is concerned. While dealing with one of the petitions filed by the assessee assailing its liability to pay interest to Alimenta, the Hon'ble High Court has recorded in para 17 of its order dated 16.4.2015, that the assessee filed an

application for the modification of the order dt. 25.10.2010 passed by the Hon'ble Supreme Court, reading as under : -

“17.NAFED filed an application for modification of the order dated 25th October, 2010 passed by the Supreme Court of India in SLP (Civil) No.28325 of 2010 affirming as follows:-

“The applicant submits that the *aforesaid directions in the decree are not in accordance with and in fact in excess of the award as would be seen* from page 117 of the SLP paper book has only directed payment of US\$ 11.25% p.a. from February 13, 1981 to date of award i.e. September 14, 1990 and costs and expenses of appeal amounting to U.K. Pound 9344.55 and no other amount. It has not granted any interest from the date of award till payment.

(Emphasis supplied)”

20. Thus it is palpable that while on one hand the assessee in civil proceedings is seriously contesting its liability to pay interest, on the other hand, when the same question comes up in the income-tax proceedings, it has taken a transversely opposite stand that it has incurred liability towards interest payment and the same be allowed as deduction.

There is an absolute mismatch between these two inconsistent stands taken by the assessee in income-tax and civil proceedings. Similar position is prevailing insofar as the assessee's understanding and reflection of such interest liability in its annual accounts is concerned. It has been brought to our notice by the Id. DR that the assessee in its Annual report for the year 2012-13 has claimed the amount payable to Alimenta as a contingent liability on the ground of the same being *sub judice*. Similarly, in the Notes and explanatory statements, the assessee has given the reason for not providing this contingent liability in the books of account, on page 79 of its Annual report, that the award is under challenge before the Hon'ble Apex Court and based on expert legal advice, the assessee considers the disputed case likely to be decided in its favour. Though the deductibility or otherwise of an expenditure in the income-tax proceedings depends on the appreciation of the correct legal position under the Act and not what the assessee claims under any proceedings or its treatment as contingent liability in the books of account, the idea behind incorporating these facts in the order is to accentuate the incongruous stand of the assessee on the same issue.

21. Now, we espouse the alternative view point canvassed by the AO for disallowing interest, being the making of claim by the assessee directly in the computation of income without routing it through its Profit and loss account. It is trite that entries in the books of account are not conclusive of accrual of income or deductibility of expenses. If an entry is passed in the books of account for a deduction which is otherwise not available as per law, it does not make the claim *per se* deductible. In the like manner, if a claim is otherwise deductible, but no entry has been passed in the books of account, then there can be no denial of such a claim. Essence of the matter is the deductibility or otherwise as per law and not the passing of entries in the books of account. In our considered opinion, entries in books are not conclusive of accrual of income or deductibility of expenses. On the contrary, it is the incurring of liability or accrual of income by means of a legally enforceable right, which decides about the deductibility of an expense or earning of income. Our view gets strength from the judgment of the Hon'ble Supreme Court in *CIT vs. SMIFS Securities Ltd. (2012) 348 ITR 302 (SC)*, which reiterates similar view taken in several earlier judgments including *CIT vs. Shoorji Vallabhdas & Co. (1962) 46 ITR 144*

(SC). As such, we jettison this contention advanced on behalf of the Revenue as a reason for sustaining the disallowance of interest.

22. We sum up our conclusion on the point that the assessee did not incur any liability for payment of interest to Alimenta as at the end of the years under consideration. Since no legally enforceable liability existed against the assessee, the deduction has been rightly denied.

23. Now we take up the AO's alternative point of view that the deduction, if at all permissible, is also hit by the provision of section 40(a)(i). In this regard, we find that this provision with marginal note of - 'Amounts not deductible' - applies to disallow the otherwise allowable deductions in the computation of income of the payer under the head "Profits and gains of business or profession", if any sum chargeable to tax under the Act is payable outside India; or in India to a non-resident, not being a company or to a foreign company, on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid during the previous year, or in the subsequent year before the expiry of the time prescribed under sub-section (1)

of section 200. Conversely, if deduction is otherwise not allowable under the head 'Profits and gains of business or profession', then there cannot be any further disallowance in the computation of income for want of deduction of tax at source etc. In view of our decision as to the non-incurring of liability for interest by the assessee and the resultant non-availability of deduction of interest in the computation of income for the years under consideration, section 40(a)(i) of the Act becomes inapplicable, as the underlying condition for its applicability, being the otherwise eligibility of deduction for expense, becomes wanting.

24. In view of the foregoing reasons, we answer the question posted before this Special bench in negative by holding that in the facts and circumstances of the case, where claim of damages and interest thereon is disputed by the assessee in the court of law, deduction can't be allowed for the interest claimed on such damages in the computation of business income.

25. Now the instant appeals are directed to be placed before the Division Bench for disposal having regard to the decision of the special bench on the question raised before it.

The order pronounced in the open court on 16.10.2015.

Sd/-

Sd/-

Sd/-

[JUSTICE (RETD.) DEV DARSHAN SUD]
PRESIDENT

[G.C. GUPTA]
VICE PRESIDENT

[R.S. SYAL]
ACCOUNTANT MEMBER

Dated, 16th October, 2015.

dk

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT (A)
5. DR, ITAT

AR, ITAT, NEW DELHI.

		Date	Initial	
1.	Draft dictated on	15.10.2015		Sr.PS
2.	Draft placed before author	15.10.2015		Sr.PS
3.	Draft proposed and placed before the Hon'ble President	16.10.2015		
4.	Draft proposed and placed before the Hon'ble Vice President.	16.10.2015		
5.	Draft discussed/approved by Hon'ble President	16.10.2015		
6.	Draft discussed/approved by Hon'ble V.P.	16.10.2015		JM/AM
7.	Approved Draft comes to the Sr.PS/PS	16.10.2015		Sr.PS/PS
8.	Kept for pronouncement on	16.10.2015		Sr.PS
9.	File sent to the Bench Clerk			Sr.PS
10.	Date on which file goes to the Head Clerk.			
11.	Date of dispatch of Order.			

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