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IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

**INCOME TAX APPEAL NO.2251 OF 2013
WITH
INCOME TAX APPEAL NO.2360 OF 2013**

Commissioner of Income Tax 7

..Appellant

Versus

M/s. Neon Solutions Pvt. Ltd.

..Respondent

.....
Mrs. S. V. Bharucha for the Appellant.

Mr. Niraj Seth a/w B. G. Yewale for the Respondent.
.....

**CORAM: M. S. SANKLECHA &
A. K. MENON, JJ.**

DATE : 5TH APRIL, 2016

PC.:

1. These two Appeals under Section 260A of the Income Tax Act, 1961 (the Act) challenges the order dated 30th April, 2013 passed by the Income Tax Appellate Tribunal (the Tribunal). The impugned orders relates to Assessment Years 2007-08 and 2009-10.

2. Although numerous questions had been raised in the memo of Appeal, the only question which arises for our consideration is:-

“Whether on the facts and in the circumstances of the case and in law, the Tribunal was justified in holding that inspite of following a mercantile system of accounting, the Respondent-

Assessee was entitled not to bring the notional interest on debentures subscribed by it to tax?"

3. The Respondent-Assessee had in 2003 subscribed to 2% non-convertible unsecured debentures of Rs.42 crores issued by one of its group companies viz. M/s. Marketing & Brand Solutions (I) Pvt. Ltd. On 20th May, 2004 M/s. Marketing & Brand Solutions (I) Pvt. Ltd. in response to a demand for interest from the Respondent-Assessee requested waiver of interest on the debentures as it were facing financial difficulties. In fact on 31st May, 2004 at a meeting of debenture holders waiver of interest on the debentures till 31st March, 2010 was approved. Consequent to the above, the Board of Directors of the Respondent-Assessee on 8th June, 2004 also passed a Resolution to waive interest on the debentures of M/s. Marketing & Brand Solutions (I) Pvt. Ltd. upto 31st March, 2010 and also duly informed the same to M/s. Marketing & Brand Solutions (I) Pvt. Ltd.

4. In the two assessment years under consideration, the Assessing Officer made addition of Rs.84 lakhs each being 2% interest on Rs.42 crores of debentures by Assessment Orders passed under Section 143(3) of the Act. This on the ground that waiver of interest for the six year period (2004 to 2010) by board resolution as produced is not believable.

5. In appeal the Commissioner of Income Tax (Appeals) upheld the orders of the Assessing Officer for both the subject assessment years.

6. On further appeal, the Tribunal by the impugned order takes into account the fact that even in mercantile system of accounting an item would be regarded as accrued income only if there is certainty of receiving it and not when it has been waived. The Tribunal has in the impugned order very succinctly set out the principles to be applied while recovering income in following the mercantile system of accounting:-

“(A) that merely because assessee was following mercantile system of accounting, it could not be held that income had accrued to it.

(B) earning of the income, whether actual or notional, has to be seen from the viewpoint of a prudent assessee. If in given facts and circumstances the assessee decides not to charge interest in order to safeguard the principal amount and ensure its recovery, it cannot be said that he has acted in a manner in which no reasonable person can act.

(C) The guidance note on accrual of income on accounting issued by the ICAI lays down that where the ultimate collection with reasonable certainty is lacking, the revenue recognition is to be postponed to the extent of uncertainty involved. In terms of the guidance note, it is appropriate to recognize revenue in such cases only when it becomes

reasonably certain that ultimate collection will be made.

(D) Non-recognition of income on the ground that the income had not really accrued as the realisability of the principal outstanding itself was doubtful, is legally correct under the mercantile system of accounting, when the same is in accordance with AS-I notified by the Government.

(E) It is one of the fundamental principles of accounting that, as a measure of prudence and following the principle of conservatism, the incomes are not taken into account till the point of time that there is a reasonable degree of certainty of its realization, while all anticipated losses are taken into account as soon as there is a possibility, howsoever uncertain, of such losses being incurred.

(F) The provisions of Section 145(1) are subject to, inter alia, mandate of AS-I which also prescribes that 'Accounting policies adopted by an assessee should be such so as to represent a true and fair view of the state of affairs of the business, profession or vocation in the financial statements prepared and presented on the basis of such accounting policies.' In the name of compliance with Section 145(1), it cannot be open to anyone to force adoption of accounting policies which result in a distorted view of the affairs of the business. Therefore, even under the mercantile method of accounting, and, on peculiar facts of instant case, the assessee was justified in following the policy of not recognizing these

interest revenues till the point of time when the uncertainty to realize the revenues vanished.”

The Tribunal further referred to the fact that the various resolutions which were passed by the company as well as the communication exchanged between the parties would establish on facts that interest has been waived. Further on facts it holds that there is no reason to disbelieve the resolution passed by the Respondent-Assessee waiving interest. The Tribunal further adverted to the fact that subsequently, M/s. Marketing & Brand Solutions (I) Pvt. Ltd. had amalgamated with the Respondent-Assessee which would also establish that the debentures issuing company was in serious financial difficulties which was incidentally a group company of the Respondent. The decision rendered by the Tribunal in the impugned order is a decision on facts and nothing has been shown to us which would warrant interference by this Court on account of any finding being perverse or arbitrary.

7. We were informed at the hearing that for the Assessment years prior to A.Y. 2007-08 no addition was sought to be made by the Revenue on account of notional interest.

8. The view taken by the Tribunal in the impugned order is a possible

view. In these circumstances, the questions raised for our consideration does not give rise to any substantial question of law.

9. Accordingly both the Appeals are dismissed. No order as to costs.

(A. K. MENON, J.)

(M. S. SANKLECHA, J.)

Wadhwa