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

BEFORE SHRI G.S. PANNU, ACCOUNTANT MEMBER
AND MS. SUSHMA CHOWLA, JUDICIAL MEMBER

ITA Nos.2220 & 2221/PN/2013
(Assessment Years : 2009-10 & 2010-11)

Asstt. Commissioner of Income Tax,
Circle- 1, Solapur. .... Appellant

Vs.

Solapur Siddheshwar Sahakari Bank Ltd.,
205, East Mangalwar Peth, 1st Floor,
Head Office, Solapur – 413 002..
PAN : AABAS6216L .... Respondent

Department by	:	Shri Mazhar Akram
Assessee by	:	Shri Pramod Shingte
Date of hearing	:	28-10-2014
Date of pronouncement	:	31-10-2014

ORDER

PER G. S. PANNU, AM

The captioned two appeals have been preferred by the Revenue belonging to the same assessee and certain issues involved are common, therefore, they have been clubbed and heard together and a consolidated order is being passed for the sake of convenience and brevity.

2. Both the appeals are directed against a common order of the Commissioner of Income Tax (Appeals)-III, Pune dated 28.10.2013 which, in turn, has arisen from two different assessment orders dated 18.11.2011 and 31.11.2012 passed by the Assessing Officer u/s 143(3) of the Income-tax Act, 1961 (in short "the Act") pertaining to the assessment years 2009-10 and 2010-11 respectively.

3. In both the appeals, Revenue has raised multiple Grounds of Appeal, but the solitary dispute relates to an addition of Rs.53,88,043/- for assessment year 2009-10 and Rs.38,36,285/- for assessment year 2010-11 respectively made by the Assessing Officer on account of interest income on Non-

Performing Asset advances. Briefly put, the controversy can be summarized as follows. The assessee is a non-scheduled Co-operative Bank carrying on banking business in terms of a license issued by Reserve Bank of India (RBI), and is thus governed by Circulars of RBI relating to Prudential Norms, Income Recognition, Asset Classification, Provisioning and other related matters. In terms of such Prudential Norms of RBI, assessee did not account for interest relating to Non-Performing Assets (NPAs) i.e. advances to customers which were classified as NPAs in terms of the RBI guidelines. The Assessing Officer was of the opinion that interest income even in relation to such NPAs was liable to be included in this year's total income, having regard to the mercantile system of accounting followed by the assessee. As per the Revenue, the provisions of section 43D of the Act, which provide that interest income relatable to NPAs classified as per the RBI guidelines shall be charged to tax in the year in which it is credited or received by the assessee, whichever is earlier, was not applicable to the assessee, since the assessee was not a scheduled bank or any other entity prescribed in section 43D of the Act. Thus, as per the Assessing Officer, interest income on NPA advances accrued to the assessee and accordingly, he brought to tax such interest income of Rs.53,88,043 for assessment year 2009-10 and Rs. 38,36,285/- for assessment year 2010-11 respectively, which is the subject-matter of dispute before us.

4. The learned CIT(A) disagreed with the Assessing Officer, and thus the Revenue is in appeal before us. At the time of hearing, it was a common point between the parties that an identical controversy has been considered by the Pune Bench of the Tribunal in the case of ACIT vs. The Omerga Janta Sahakari Bank Ltd. vide order in ITA No.350/PN/2013 dated 31.10.2013. In the said precedent, the Tribunal considered the judgement of the Hon'ble Delhi High Court in the case of M/s Vasisth Chay Vyapar Ltd., 330 ITR 440 (Del) as well as the judgement of the Hon'ble Madras High Court in the case of

CIT vs. Sakthi Finance Ltd., (2013) 31 taxmann.com 305 (Madras), which had expressed divergent views with respect to the issue of accrual of interest income on NPA advances; and, following the proposition that in the absence of any judgement of the Jurisdictional High Court, there being contrary judgements of the non-jurisdictional High Courts, a decision which was favourable to the assessee was to be followed in view of the reasoning laid down by the Hon'ble Supreme Court in the case of CIT vs. Vegetable Products Ltd., (1973) 88 ITR 192 (SC) and, thus the Tribunal decided the issue in favour of the assessee. The relevant discussion in the order of the Tribunal dated 31.10.2013 (supra) is reproduced as under :-

> "*8. We have carefully considered the rival submissions. In so far as the applicability of section 43D of the Act to the assessee is concerned, there is a convergence of opinion between the assessee and the Revenue to the effect that the same is not applicable to the assessee. Ostensibly, assessee is a Co-operative Bank carrying on banking business in terms of a license granted by RBI and is not a 'scheduled bank' included in second schedule of RBI so as to fall within the scope of section 43D of the Act. Notably, section 43D of the Act prescribes that interest income on such categories of bad and doubtful debts as prescribed by the RBI guidelines shall be chargeable to tax in the year in which such interest income is credited by the assessee in the Profit and Loss account or in the year of actual receipt, whichever is earlier. Since assessee is not an entity covered within the scope of section 43D of the Act, the present controversy cannot be adjudicated in the light of section 43D of the Act, and it is liable to be decided on general principles as to whether the impugned income has accrued to the assessee during the year under consideration.*
>
> *9. In this connection, we find that the Visakhapatnam Bench of the Tribunal in the case of The Durga Cooperative Urban Bank Ltd. (supra) has considered an identical controversy. The assessee before the Visakhapatnam Bench was a Co-operative Bank operating under a license issued by RBI but was not a 'scheduled bank' so as to fall within the scope of section 43D of the Act. The issue related to taxability of interest income relating to NPAs, which as per the Revenue was liable to be taxed on accrual basis in line with mercantile system of accounting adopted by the assessee therein. The assessee, on the other hand, contended that having regard to the guidelines issued by RBI regarding accounting of interest on NPAs, no interest income accrued in respect of NPAs and that the same was to be taxed only on receipt basis. The Tribunal observed that the question of taxability of interest on NPAs classified by RBI, was considered by the Hon'ble Delhi High Court in the case of M/s Vasisth Chay Vyapar Ltd. (supra) wherein after considering the decision of the Hon'ble Supreme Court in the case of Southern Technologies Ltd. (supra) it was held that interest income relatable to NPAs was not includible in total income on accrual basis since the same did not accrue to the assessee. The following discussion by the Visakhapatnam Bench of the Tribunal in the case of The Durga Cooperative Urban Bank Ltd. (supra) is worthy of notice :-*

"8. We have heard the rival contentions and carefully perused the record. The question of taxability of interest on NPAs has been considered by the Hon'ble Delhi High Court in the case of M/s Vasisth Chay Vyapar Ltd (Supra); wherein the Hon'ble Delhi High Court took into account the decision rendered by the Hon'ble Supreme Court in the case of Southern Technologies Ltd (Supra). In the case of M/s Vasisth Chay Vyapar Ltd, the assessee therein was a non banking financial company and it was also bound by the "Prudential norms directions" issued by the Reserve Bank of India for Income recognition and asset classification. The assessee did not include the interest income relatable to NPA assets in its total income. The Assessing Officer, however, added the said interest as the income of the assessee by holding that it had "accrued" to the assessee even it was not realized as the assessee was following mercantile system of accounting. The learned CIT (A) affirmed the order of the Assessing Officer. However, the ITAT deleted the aforesaid income. Hence the revenue preferred appeal before the Hon'ble Delhi High Court.

8.1 After hearing the rival submissions, the Hon'ble Delhi High Court took note of sec.45Q of Reserve Bank of India Act which reads as under:

> ***"Chapter IIIB to override other laws.***
>
> *45Q. The provisions of this Chapter shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law".*

The High Court took note of the fact that the provision of 45Q of Reserve Bank of India has overriding effect over any other law. Then the Hon'ble High Court also considered accounting standard "AS-9" on "Revenue recognition" and also extracted following relevant portion from the said accounting standard:

> ***9. Effect of uncertainties on Revenue Recognition***
>
> *9.1 Recognition of revenue requires that revenue is a measurable and that at the time of sale or the rendering of the service, it would not be unreasonable to expect ultimate collection.*
>
> *9.2 Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g., for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognize revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognized at the time of sale or rendering of service even though payments are made by installments.*
>
> *9.3 When the uncertainty relating to collectability arises subsequent to the time of sale or the rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.*
>
> *9.4 An essential criterion for the recognition of revenue is that the consideration receivable for the sale of goods, the rendering of services or from the use of others of enterprise resources is reasonably determinable. When such*

consideration is not determinable within reasonable limits, the recognition of revenue is postponed.

9.5 When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognized".

8.2 The Delhi High Court also considered the decision rendered in the following cases:

i) CIT vs. Elgi Finance Ltd., 293 ITR 357 (Mad)

ii) CIT vs. KKM Investments (Cal) – SLP dismissed by Supreme Court (310 ITR 4)

iii) CIT vs. Motor Credit Co (P) Ltd., 127 ITR 572 (Mad)

iv) UCO Bank vs. CIT 237 ITR 889 (SC)

v) CIT vs. Shoorji Vallabhdas & Co 46 ITR 144 (SC)

vi) Godhra Electricity Co. Ltd., Vs.CIT 225 ITR 746

vii) CIT vs. Goyal M G Gases (P) Ltd., 303 ITR 159 (Del)

viii) CIT vs. Eicher Ltd., ITA No.431/2009 dated 15.7.2009 (Del)

8.3 After considering the Accounting Standard 9 and the various case law listed above, the Hon'ble Delhi High Court held that the interest on NPA advance cannot be treated as "accrued" to the assessee.

8.4 Before the Delhi High Court, the revenue took support of the decision of the Hon'ble Supreme Court in the case of Southern Technologies Ltd (Supra). The Delhi High Court considered the said decision of Hon'ble Apex Court and explained the same as under:

"We have already held that even under the Income Tax Act, interest income had not accrued. Moreover, this submission of Mr. Sabharwal is based entirely on the judgment of the Supreme Court in the case of Southern Technology (Supra). ***No doubt, in first blush, reading of the judgment gives an indication that the Court has held that Reserve Bank of India Act does not override the provisions of the Income Tax Act.*** *However, when we examine the issue involved therein minutely and deeply in the context in which that had arisen and certain observations of the Apex Court contained in that very judgment, we find that the proposition advanced by Mr.Sabharwal may not be entirely correct.* ***In the case before the Supreme Court, the assessee a NBFC debited Rs.81,68,516 as provision against NPA in the profit and loss account, which was claimed as deduction in terms of Section 36(1) (vii)*** *of the Act. The Assessing Officer did not allow the deduction claimed as aforesaid on the ground that the provision of NPA was not in the nature of expenditure or loss but more in the nature of a reserve, and thus not deductible under section 36(i)(vii) of the Act.* ***The Assessing Officer, however, did not bring to tax Rs.20,34,605/- as income (being income accrued under the mercantile system of accounting).*** *The dispute before the Apex Court centered around deductibility of provision for NPA.* ***After analyzing the provisions of the Reserve Bank of India Act, their Lordships of the Apex Court observed that in so far as the permissible deductions or exclusions under the Act are concerned, the same are admissible only if such deductions/exclusions satisfy the relevant conditions stipulated therefore under the Act. To that extent, it was observed that the Prudential Norms do not override the provisions of the Act.*** *However, the Apex Court made a*

distinction with regard to "Income Recognition" and held that ***income had to be recognized in terms of the Prudential Norms, even though the same deviated from mercantile system of accounting and/or section 45 (sic. 145) of the Income Tax Act.*** *It can be said, therefore, that the Apex Court approved the 'real income' theory which is engrained in the Prudential Norms for recognition of revenue by NBFC".*

9. The Hon'ble Supreme Court in the case of M/s Southern Technologies Ltd (Supra) dissected the matter into two parts viz., a) Income Recognition and b) permissible deduction/exclusions under the Income Tax Act. In so far as income recognition is concerned, the Hon'ble Supreme Court held that Section 145 of the Income Tax Act has no role to play and the Assessing Officer has to follow Reserve Bank of India directions 1998, since by virtue of 45Q of the Reserve Bank of India Act, an overriding effect is given to the directions of Reserve Bank of India vis-à-vis income recognition principles in the Companies Act 1956. In so far as computation of income under the Income Tax Act is concerned, (which involves deduction of permissible deductions and exclusions) the admissibility of such deductions shall be governed by the provisions of the Income Tax Act. The relevant observations of the Hon'ble Supreme Court are extracted below:

"Applicability of Section 145

40. At the outset, we may state that in essence RBI Directions 1998 are Prudential/Provisioning Norms issued by RBI under Chapter IIIB of the RBI Act, 1934. These Norms deal essentially with Income Recognition. They force the NBFCs to disclose the amount of NPA in their financial accounts. They force the NBFCs to reflect "true and correct" profits. ***By virtue of Section 45Q, an overriding effect is given to the Directions 1998 vis-à-vis "Income Recognition" principles in the Companies Act, 1956.*** *These Directions constitute a code by itself. However, these Directions 1998 and the IT Act operate in different areas. These Directions 1998 have nothing to do with computation of taxable income.* ***These Directions cannot overrule the 'permissible deductions" or "their exclusion" under the IT Act.*** *The inconsistency between these Directions and Companies Act is only in the matter of Income Recognition and presentation of Financial Statements. The Accounting policies adopted by an NBFC cannot determine the taxable income. It is well settled that the Accounting Policies followed by a company can be changed unless the AO comes to the conclusion that such change would result in understatement of profits.* ***However, here is the case where the AO has to follow the Reserve Bank of India Directions 1998 in view of Section 45Q of the Reserve Bank of India Act. Hence, as far as Income Recognition is concerned, Section 145 of the IT Act has no role to play in the present dispute".***

10. Turning to the facts of the case before us, the assessee herein is a cooperative bank and it is not in dispute that it is also governed by the Reserve Bank of India. Hence the directions with regard to the prudential norms issued by the Reserve Bank of India are equally applicable to the assessee as it is applicable to the companies registered under the Companies Act. The Hon'ble Supreme Court has held in the case of Southern Technologies Ltd (Supra), that the provision of 45Q of Reserve Bank of India Act has an overriding effect vis-à-vis income recognition principle under the Companies Act. Hence Sec.45 Q of the RBI Act shall have overriding effect over the income recognition principle followed by cooperative banks also. Hence the Assessing Officer has to follow the Reserve Bank of India directions 1998, as held by the Hon'ble Supreme Court.

10.1 Based on the prudential norms, the assessee herein did not admit the interest relatable to NPA advances in its total income. The Hon'ble Delhi High Court in the case of Vasisth Chay Vyapar Ltd (Supra) has held that the interest on NPA assets cannot be said to have accrued to the assessee. In this regard, the following observations of Hon'ble Delhi High Court in the above cited case are relevant:

> *"What to talk of interest, even the principle amount itself had become doubtful to recover. In this scenario it was legitimate move to infer that interest income thereupon has not "accrued".*

The said decision of the Hon'ble Delhi High Court is equally applicable to the issue in our hands. Accordingly we do not find any infirmity with the decision of the learned CIT (A) in holding that the interest income relatable on NPA advances did not accrue to the assessee. Accordingly we uphold his order."

10. Following the aforesaid discussion, which has been rendered on an identical issue under similar circumstances, we find no reasons to interfere with the ultimate conclusion of the CIT(A) in deleting the impugned addition relating to interest income in respect of NPAs.

11. So, however, the learned Departmental Representative has submitted that the Hon'ble Madras High Court in the case of CIT vs. Sakthi Finance Ltd., (2013) 31 taxmann.com 305 (Madras) has differed with the judgement of the Hon'ble Delhi High Court in the case of M/s Vasisth Chay Vyapar Ltd. (supra) on a similar issue, i.e. relating to interest income on NPAs. The learned Departmental Representative further pointed out that the Hon'ble Madras High Court followed the decision of the Hon'ble Supreme Court in the case of Southern Technologies Ltd. (supra) in holding that interest on NPAs was assessable to tax on accrual basis. We have carefully considered the submissions put-forth by the learned Departmental Representative based on the judgement of the Hon'ble Madras High Court in the case of Sakthi Finance Ltd. (supra). The controversy before the Hon'ble Madras High Court related to non-recognition of interest income on NPAs by the assessee following the RBI guidelines. The Hon'ble Madras High Court took the view that the judgement of the Hon'ble Supreme Court in the case of Southern Technologies Ltd. (supra) also applied to the Income Recognition Norms provided by RBI and therefore it held the interest income on NPAs is liable to be taxed on accrual basis and not in terms of RBI's guidelines. But the Hon'ble Delhi High Court in the case of M/s Vasisth Chay Vyapar Ltd. (supra) has taken a view that Southern Technologies Ltd. (supra) case did not apply to the Income Recognition Norms prescribed by RBI. Ostensibly, there is divergence of opinion between the Hon'ble Delhi High Court and the Hon'ble Madras High Court as noted by the Hon'ble Madras High Court in its order.

12. In so far as, present case is concerned there is no judgment of the Jurisdictional High Court. We are faced with two contrary judgments of the non-jurisdictional High Court. In such a situation, we are inclined to prefer a view which is favourable of the assessee following the judgement of the Hon'ble Supreme Court in the case of CIT vs. Vegetable Products Ltd. (1973) 88 ITR 192 (SC).

13. Therefore, in view of the aforesaid discussion, we are inclined to follow the decision of our co-ordinate Bench in the case of The Durga Cooperative Urban Bank Ltd. (supra) and accordingly the order of the CIT(A) is liable to the affirmed. We hold so.

14. In the result, the appeal of the Revenue is dismissed."

5. Since it was a common point between the parties that the facts and circumstances in the present case are identical to those considered by us in the case of The Omerga Janta Sahakari Bank Ltd. (supra), following the said precedent the present claim of the assessee deserves to be upheld. Thus, the order of the CIT(A) is hereby affirmed and the Revenue has to fail on this aspect.

6. In the result, both the appeals of the Revenue are dismissed.

Order pronounced in the open Court on 31st October, 2014.

Sd/-	**Sd/-**
(SUSHMA CHOWLA)	**(G.S. PANNU)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Pune, Dated: 31st October, 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;
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By Order

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