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Tvs Finance and Services Ltd., Jayalakshmi Estates Vs. the Joint Commissioner of Income Tax Special Range - Xi

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Court : Chennai

Decided On : Feb-09-2009

Reported in : (2010)228CTR(Mad)546; [2009]318ITR435(Mad)

Judge : Prabha Sridevan and ;K.K. Sasidharan, JJ.

Acts : [Income Tax Act, 1961](#) - Sections 18, 28, 36, 36(1), 36(2), 115JA and 145(1); Reserve Bank of India Act; Companies Act; Companies Rules - Rule 7(2)

Appeal No. : T.C. (Appeal) Nos. 107 to 110 of 2002 and T.C.M.P. Nos. 175 to 178 of 2003

Appellant : Tvs Finance and Services Ltd., Jayalakshmi Estates

Respondent : The Joint Commissioner of Income Tax Special Range - Xi

Advocate for Def. : Pushya Sitaraman, Sr. Standing Counsel

Advocate for Pet/Ap. : P.J. Pardiwala, Sr. Counsel for ;K. Venkataraman, Adv.

Judgement :

Prabha Sridevan, J.

1. The appeals have been admitted on the following substantial questions of law:

In T.C.(A). No. 107 of 2002:

(i) Whether order of the Income Tax Appellate Tribunal rejecting the Appellant's method of accounting income from discounting of bills and holding that the whole of the income from bill discounting accrues at the time of discounting bill and not over the period of discount is correct in law?

(ii) Whether the order of the Income Tax Appellate Tribunal in reversing the decision of the Commissioner of Income Tax (Appeals) in allowing the claim for 100% depreciation in respect of asset leased to M/s. Lord Furnace and restoring the matter to the file of the Assessing Officer is correct in law?

In T.C.(A) No. 108 of 2002:

(i) Whether the provision of Rs. 27,41,000/- made pursuant to the prudential norms towards Non-Performing Assets (NPAs) prescribed by the directions of Reserve Bank of India is an allowable deduction under the Income Tax Act?

(ii) Whether the Tribunal ought to have considered the claim as allowable as a business loss Under Section 28 of the Income Tax Act, if not as a bad debt Under Section 36(1)(vii) of the [Income Tax Act, 1961](#)?

(iii) Whether order of the Income Tax Appellate Tribunal rejecting the Appellant's method of accounting income from discounting of bills and holding that the whole of the income from bill discounting accrues at the time of discounting bill and not over the period of discount is correct in law?

(iv) Whether the Income Tax Appellate Tribunal is right in holding that Rs. 3,99,62,960/- towards lease equalisation charge made as per Institute of Chartered Accountants of India's guidance note is contingent in nature and therefore includible in computing 'book profit' Under Section 115-JA of the Income Tax Act?

In T.C. No. 109 of 2002:

(i) Whether the provision of Rs. 59,35,318 made pursuant to the Prudential Norms towards Non-Performing Assets (NPAs) prescribed by the directions of Reserve

Bank of India is an allowable deduction under the Income Tax Act?

(ii) Whether the Tribunal ought to have considered the claim as allowable as a business loss Under Section 28 of the Income Tax Act, if not as a bad debt Under Section 36(i)(vii) of the [Income Tax Act, 1961](#)?

(iii) Whether order of the Income Tax Appellate Tribunal rejecting the Appellant's method of accounting income from discounting of bills and holding that the whole of the income from bill discounting accrues at the time of discounting bill and not over the period of discount is correct in law?

(iv) Whether the order of the Income Tax Appellate Tribunal that the claim for depreciation in respect of asset leased to M/s Vatan Dye Chem Export Limited is correct in law?

In T.C(A) No. 110 of 2002:

(i) Whether the provision of Rs. 50,95,991 made pursuant to the Prudential Norms towards Non-Performing Assets (NPAs) prescribed by the directions of Reserve Bank of India is an allowable deduction under the Income Tax Act?

(ii) Whether or not Chapter III-B of the RBI Act has an overriding effect over other laws inclusive of the [Income Tax Act, 1961](#)?

(iii) Whether order of the Income Tax Appellate Tribunal rejecting the Appellant's method of accounting income from discounting of bills and holding that the whole of the income from bill discounting accrues at the time of discounting bill and not over the period of discount is correct in law?

(iv) Whether in computing the book profit Under Section 115JA, the provision of Rs. 50,95,991 towards NPA and Rs. 5,52,40,154 debited to PRL towards lease equalisation changes should be excluded?

2. The question relating to bills discounting facility arises in T.C(A) Nos. 107 to 110 of 2002 and will be dealt with by a common order. Similarly the question relating to write off of bad debts arises in T.C(A) Nos. 108 to 110 of 2002 and will be dealt with by a common order and finally the question relating to lease equalization

charges arises in T.C(A) Nos. 108 and 110 of 2002 and will be dealt with by a common order.

3. The assessee is a non-banking finance company engaged in lease, hire purchase, bills discounting and mortgage loans. According to the assessee, it is required to comply with the RBI guidelines which includes recognition of issues and provisions for NPA. The assessee is aggrieved with regard to the additions made in view of the change in the method of accounting with regard to this discounting facility and disallowances of its claim relating to bad debts and lease equalization charges. Mr. P.J. Pardiwala, learned Senior Counsel made his submissions on behalf of the assessee and Mrs. Pushya Sitaraman, learned Senior Standing Counsel on behalf of the respondent. Written submissions were also filed on behalf of both the parties. Submissions advanced were mainly with regard to the questions relating to bill discounting, lease equalization charges and write off of bad debts.

4. Bills discounting

Bill discounting is one amongst the various modes viz., financing, engaged in by the assessee. We are concerned with the addition made on account of changing the method of accounting adopted by the appellant during the year under consideration. The Assistant Commissioner rejected the assessee's claim for change in the method of accounting and brought to tax what he termed as additional finance charges and as additional income by way of bills discounting charges. These amounts will vary for the respective assessment years. According to the assessing officer, the appellant had been following the accrual basis in respect of discounting charges for and upto the assessment years 1994-95 and there was no justification for switching over to mercantile system of accounting on receipt basis. The assessee contended that the bill is discounted for a specific period and at the end of the period the customer should pay the amount referred to on the bill. The assessee is under an obligation to repay that portion of the front-end discounting charges in case the customer settled the amount before the due date. This is the reason for the switch in system of accounting. The CIT (Appeals) held that in view of the uncertainty involved in this type of income accrual, the

appellant's claim should succeed and that the re-adaptation of the method of accounting was bona fide. The Department appealed against this. The Tribunal held in favour of the Revenue.

5. The learned Senior Counsel submitted that when it is accepted that the assessee could change the method of accounting and had done so and when the CIT(Appeals) had found that the system had been changed only to bring it in line with the Accounting Standards then the assessee's claim must be accepted. He also submitted that if the income received by the assessee on the bills is compensation for use of money then it must be spread over the entire period. He also submitted that income accrues to the assessee only when the assessee receives the bill value at the end of the period of bill or earlier and that Accounting System 9.4 is mandatory and there would be certainty only at the date of discount. The learned Senior Standing Counsel submitted that the discounting of bills is not equal to encashment of the bill and bill discounting is a separate transaction and what is received by the assessee on the date of purchase of the bill alone should be considered.

6. According to the assessee, as the recognition of the income in its entirety at the stage of acquisition did not reflect the true profits, the appellant changed its accounting policy of recognizing this income with effect from the previous year. The appellant is following the mercantile method of accounting and it must be accepted unless the revenue makes out a case that the accounts are not correct and complete or that the method employed is such that the true profits cannot be determined. Income accrues only when the assessee acquires an indefeasible right to receive the income. It is the case of the assessee that on the date when the bill of exchange is acquired, there is no such indefeasible right. What the assessee obtains is only an inchoate right to receive the face value of the bill on its maturity date, if the appellant continues to be the holder of the bill on such maturity date. According to the assessee, income cannot arise only from the purchase of the commodity, which is when the bill is transferred and if the bill is rediscounted prior to the maturity date, then what the appellant receives is sale proceeds and the appellant's right to receive the sale proceeds would accrue on the date the rediscounting is done. It changed its method of accounting in accordance with the

Accounting Standards issued by the Institute of Chartered Accountants of India. It cannot be said that the accounts are not correct. According to the assessee, if the income is assessed on the date when the bill is acquired, it may distort the true profits as such assessment is based on the presumption that the bill will be held to maturity and the entire difference will be earned by the appellant for which presumption there is no certainty. They referred to the following decisions:

(i) CIT v. Tamil Nadu Mercantile Bank Limited 291 ITR 137

(ii) CIT v. M.G.F. India Ltd. : [2005]272ITR191(Delhi)

(iii) British Bank of Middle East v. CIT : [1998]233ITR251(Bom)

(iv) CIT v. Bank of Tokyo 71 Taxman 85

7. On the side of the Department, it is stated that in the case of bill discounting only the date of discount is certain. The assessee takes the interest amount upfront when he discounts the bill by way of 'front end discount'. The income accrues at that point in time. It is not a case of purchase of goods for sale at a later date. Since there are many uncertainties after the date of discounting according to the assessee, such as whether the bill is to be rediscounted, and if so at what point in time and whether the assessee will hold it till its due date, etc., the only certainty is the point of discount, and as such, when there is no dispute that the discounted amount is a taxable receipt in the hands of the assessee, it is the point of discounting at which it should be taxed, as that is the point at which he becomes entitled to it. As held by the Tribunal, the transaction of discounting of a bill is completely different from the encashment thereof, as the encashment could be from and by different persons altogether than the person who originally discounted the bill, and the person who received the amount. It was also submitted that in the cases cited by the assessee, the instruments were bonds, debentures and the other interest on securities as also guarantee commission and they cannot be relied on in this question.

8. The relevant Accounting Standards are extracted below:

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.

6.1 A key criterion for determining when to recognize revenue from a transaction involving the sale of goods is that the seller had transferred the property in the goods to the buyer for a consideration. The transfer of property in goods, in most cases, results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. However, there may be situations where transfer of property in goods does not coincide with the transfer of significant risks and rewards of ownership. Revenue in such situations is recognised at the time of transfer of significant risks and rewards of ownership to the buyer. Such cases may arise where delivery has been delayed through the fault of either the buyer or the seller and the goods are at the risk of the party at the fault as regards any loss which might not have occurred but for such fault. Further, sometimes the parties may agree that the risk will pass at a time different from the time when ownership passes.

8. The Use by Others of Enterprise Resources Yielding Interest, Royalties and Dividends

8.2 Interest accrues, in most circumstances, on the time basis determined by the amount outstanding and the rate applicable. Usually, discount or premium on debt securities held is treated as though it were accruing over the period to maturity.

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 by others of enterprise resources is reasonably determinable. When such consideration is not determinable within reasonable limits, the recognition of revenue is postponed.

9. In Circular No. 2/02, the Tax treatment of Deep Discount Bonds and Strips, the relevant section is as follows:

5. Transfer before maturity

Where the bond is transferred at any time before the maturity date, the difference between the sale price and the cost of the bond will be taxable as capital gains in the hands of an investor or as business income in the hands of a trader. For computing such gains, the cost of the bond will be taken to be the aggregate of the cost of which the bond was acquired by the transferor and the income, if any, already offered to tax by such transferor (in accordance with para 4 above) upto the date of transfer.

10. In (2007) 291 ITR 137 (cited supra), the question was,

Whether, on facts and circumstances of the case, the Tribunal was right in law in holding that interest on securities is taxable only on specified dates when it became due for payment and not on accrued basis?

On appeal, the High Court held, dismissing the appeal, that even though Section 18 of the Act was deleted, the assessee was taxable for interest on securities only on specified dates when it became due for payment, in view of the third proviso to Section 145(1) of the Act, which was in force during the relevant assessment years.

11. In 71 Taxman 85 (cited supra), the assessee, a banking company had shown in its accounts deferred guarantee commission receivable in the accounting year relevant to assessment year in question, it made provision for unexpired portion of guarantee and submitted that the guarantee commission receivable in respect of future period should not be taxed in said year, since it was following mercantile system of account.

12. The Calcutta High Court held that the Tribunal was justified in holding that the income from deferred guarantee commission did not accrue or arise in the year when the guarantee agreements were entered and that the same should be spread over the period to which the guarantee commission related and should be assessed proportionately. According to the appellant, this decision would clearly apply to their case with regard to bills discount.

13. In 44 ITR 32 (Indo-commercial Bank Ltd. v. Commissioner of Income-tax, Madras) this Court held that the assessee was carrying on a banking business held securities and shares as part of its stock-in-trade or circulating capital, which were all along valued in its accounts maintained on the mercantile system. There was an abnormal fall in the securities in 1951-52 and the Reserve Bank of India allowed the Schedule Banks like the assessee to value their holdings of securities at the current market prices and adjust the resulting loss against the current profits or against the amounts permitted to be drawn from the statutory reserves. The assessee claimed a business loss. The department did not allow the deduction on the ground that the change in the basis of valuation was highly detrimental to the Revenue and that the assessee cannot be allowed to deduct one year, the loss attributable and spread over many years and on the reference, the High Court held that,

The department was not, therefore, entitled to reject that system adopted by the assessee.

14. Now let us look at the Bills discounting facility and its nature since the Revenue had objected to any reliance being placed on the cases cited on behalf of the appellant on the ground that those instruments were different and would not apply.

(i) In Tannan's Banking Law and Practice in India 25th Edition 2005 Volume - I under Chapter 23-Employment of Funds-Reasons for the restricted use of Bills in India,, Advantages of discounting of bills by banks reads thus:

Advantages of discounting of bills by banks.- The following are the chief points in favour of the employment of funds by commercial banks, in the discounting of bills:

(a) Certainty of payment on due date.:

(b) Employment of funds for a definite period.:

(c) Liquidity.:

(d) Freedom from fluctuations in prices.:

(e) Higher yield. The yield from the discounting of bills is slightly higher than that from loans or advances when the rates charged are equal, because, in the case of the former, the interest known as discount is deducted at the time of discounting the bills, whereas, in the latter case, it becomes payable only when the principal falls due or is payable quarterly, half-yearly or yearly. The following table below shows the difference in return, per cent year between interest on loans and discount on bills:

Interest cent	By Discount	Per cent	By Interest Per cent	By Discount Per cent	By Interest Per cent
-----1				1.0101	6
6.3829-----2				2.0408	7
7.5268-----3				3.0927	8
8.6956-----4				4.1666	9
9.8901-----5				5.2631	10
11.1111-----				(f) New accounts. -- ..	

PRECAUTIONS IN DISCOUNTING BILLS.

Customer's account credited.-- When a banker decides to discount a bill, he will proceed to credit his customer's current or overdraft account with the amount of the bill, less discount charged. The bill is then entered in the Bills Receivable Book, and its date of maturity noted in the Bills Receivable Diary.

Therefore, the Tribunal was right in holding that the transaction of discount is complete at the moment, the customer is given 90% of the value of the bill. The discount is equivalent to the interest. What can be seen from the extracts of Tannan's Banking is that the accrual of this is certain and arises on the date of discount itself. The Tribunal was right in concluding that the uncertainty regarding the discharge of the bill or rediscounting has no relevance and on that ground the income cannot be postponed or spread over the period of discount, because that is a separate transaction. 71 Taxman 85 (cited supra) cannot apply since there the payability of the guarantee commission was a tentative right to receive the commission for the unexpired period and the right became perfected and crystallize only with the expiry of the unexpired period and the date for the entire

amount would arise only when the whole guarantee period is made in the complete round. But here, while discussing the advantages of bills discounting it is seen from the above that in the case of bills discounting the yield is at the time of discounting and it is higher than loans or advances. The question Nos. (i), (iii), (iii) , (iii) in T.C. Nos. 107 to 110 of 2002 respectively are answered against the assessee.

22. Write off of Bad Debts:

With regard to the write off of bad debts, the assessee claims that according to the prudential norms the Non Banking Financial Companies (NBFCs) should classify the loans and advances into four broad groups and how provisions should be made against the sub-standard assets, doubtful assets and loss assets. According to the assessee these provisions had been made 'as per the RBI norms' and the balance sheets for the relevant assessment years have also been produced. The balance sheet reads that 'provisions as per RBI norms'. The Assessing Officer held that this deduction cannot be allowed since there is no actual write off. The assessee had simply indicated that it was as per the RBI norms and there is no indication with reference to the write off of debts. The Tribunal held that the explanation to Section 36(1)(vii) was clear and unambiguous and therefore, the provision for bad and doubtful debts is not to be treated as write off of bad debts in part or in full and that the provisions of the Income Tax Act would have to be applied over the RBI norms. The appellant is aggrieved because when the appeal to the Tribunal was only made for the restoration of the issue, the Tribunal ought not to have put the appellant in a worse position than where he was before the order of the Tribunal. According to them, since the appellant has debited the same to his Profit and Loss Account, there is a write off as contemplated in the Section and they referred to CIT v. Jwala Prasad Tiwari : [1953]24ITR537(Bom) and Vithaldas Bardhanwala v. CIT : [1981]130ITR95(Guj) wherein this Court has held that a debt is said to be written off as irrecoverable when it is denied to the profit and loss account and it was immaterial as to what account is credited.

24. According to the assessee, the view expressed by this Court in CIT v. Micromax Systems Pvt. Ltd. : [2005]277ITR409(Mad) was on a factually incorrect

premise. He has further submitted that since the amount written off as bad debt represented money lent to the business of banking or money lending that was carried on by the assessee, it cannot be disputed that this advance would not fulfill the condition provided for in the first part of Clause (i) of Section 36(2) and therefore, it has to be allowed as a deduction. According to the assessee, the Explanation on which the Tribunal placed reliance would have no application when there is specific provision for compliance with the RBI directions. He also submitted that even if we assume that the Explanation covered a case such as the present case, having regard to the fact that the account debited is the 'Bad Debt written off account' and that the said amount has been reduced from the value of the relevant assets in the balance sheet, the Explanation would in no manner militate against the claim of the assessee. According to him, in the alternative, it should be allowed as a loss arising in the course of the business and must not be on capital account and relied on *Devi Films Private Limited v. CIT* : [1970]75ITR301(Mad) .

25. On the side of the respondent, it was submitted that the assessee had admitted that the amount shown as bad debts representing the write off made on the principal portion as per RBI norms on asset classification and provisioning, and hence has not been shown as income in the earlier year. It was submitted that though the assessee had debited the Profit and Loss Account it had not been written off and therefore, what was made was only a provision. It was submitted that deduction on the basis of bad and doubtful debts is allowed by the statute only for banks and public financial institutions and not the non-banking finance company like the appellant and other assesseees are entitled to write off only when the bad debt is written off as irrecoverable. It was submitted that we have to see whether under Section 36(2)(i) permits the assessee to write off the bad and doubtful debts, even though they have not been offered to tax in this year or any other earlier year, or whether it 'represents money lent in the ordinary course of the business of banking or money lending which is carried on by the assessee.' Section 36(2)(i) of the [Income Tax Act, 1961](#) reads thus:

(2) In making any deduction for a bad debt or part thereof, the following provisions shall apply:(i) no such deduction shall be allowed unless such debt or part thereof

has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year, or represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee;

Since the assessee is neither doing the business of banking nor money lending and since the assessee had not offered the amounts to tax this year or any other year, the assessee cannot claim write off.

26. According to the learned Senior Standing Counsel, the judgment reported in : [1981]130ITR95(Guj) (Vithaldas H Dhanjibhai Bardanwala v. CIT) will not apply since that was a case which arose under the old Section 36(2) wherein it was held that posting of debit entries in profit and loss account and credit entries in the bad debt reserve account will suffice to claim deduction and after the introduction of the explanation, it is no longer possible to claim deduction unless there is an actual and total write off. Further it was submitted that the Bombay High Court dealt with a case where there was a factual finding that the debt had indeed become bad.

27. According to the learned Senior Standing Counsel Micromax Systems P. Ltd., : [2005]277ITR409(Mad) would apply and also Ahmedabad Electricity Co. Ltd., : [2003]262ITR97(Guj) wherein it was held that, 'a debt must be both bad and actually written off before any deduction can be claimed under Section 36(1)(vii) read with Section 36(2).'

The writing off a trade debt as bad requires judgment on the part of the person carrying on the business taking into consideration all circumstances of the debt as to the likelihood and cost of its recovery before a decision is taken to write off the debt.

28. In : [2005]277ITR409(Mad) (cited supra) it was held thus:

In the present case, it can be seen that the assessee did not write off the debt in question as irrecoverable in his accounts for the previous year. Hence on the plain language of Section 36(1)(vii) of the Act the debt cannot be allowed as a 'bad

debt'. It may be that the assessee committed an inadvertent mistake, but we cannot go by notions of equity in tax matters. Making a provision is not the same thing as writing off a debt a irrecoverable.

This is squarely applicable to the facts on hand. In the present case, the debts are shown as written off on the basis of the formula given by the Reserve Bank of India. Writing off of the debt as bad requires judgment on the part of the person carrying on the business but in the present case, the debts evidently have been 'written off' merely on the basis of the RBI norms and nothing more. As far as the alternate submission that it should not be allowed as a trading loss, it was contended that there was no loss for the assessee as on date.

29. In T.C.(A) No. 141 of 2007(Sundaram Finance Ltd. v. Assistant Commissioner of Income-tax), dated 27-02-2007, wherein the following substantial questions of law were raised,

(i) Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that the appellant is not entitled to deduction of the 'provision' made in respect of Non Performing Assets which are considered irrecoverable?

(ii) Whether the Appellate Tribunal was justified in not appreciating that the provision made in respect of Non Performing Assets if not allowable as a bad debt is allowable as a business loss?

this Court rejected the appellant's contention placing reliance on : [2006]280ITR491(Mad) (T.N. Power Finance and Infrastructure Development Corporation Ltd., v. Joint Commissioner of Income-tax) wherein it is held that merely because the Reserve Bank of India has given a direction to the assessee to provide for non-performing assets (NPA in short) the same cannot override the mandatory provisions of the Act as the provisions of NPA are predominately capital in nature, and held that, there was no substantial question of law that arose for consideration.

30. In Commissioner of Income-tax v. Ahmedabad Electricity Co. Ltd. : [2003]262ITR97(Guj) the Gujarat High Court held that 'the debt in question had become a bad debt and whether the deduction was admissible in the context of Section 36(1)(vii) and Sub-section (2) of Section 36 of the Act and held that in most cases the debt is a bad debt should suffice, when there are circumstances or material to indicate the reasonableness of the decision. But to support the claim for deduction it is not enough that the debt is bad. The bad debt must also be actually written off and necessary book-keeping steps must be taken to record that the debt has been determined and writing off a trade debt as bad requires judgment on the part of the person carrying on the business taking into consideration all circumstances as to the likelihood and cost of its recovery before a decision is taken to write off the debt and that, for a bad debt to be properly written off, it must be bona fide written off and that the evidence should establish that.

31. In Vithaldas H. Dhanjibhai Bardanwala v. Commissioner of Income-tax : [1981]130ITR95(Guj) the Gujarat High Court held,

Under Section 36 of the I.T. Act of 1961, it is clear that before any claim for allowance for a bad debt is held established by the ITO it must appear that the concerned bad debt was written off as irrecoverable in the account books of the assessee for the relevant previous years. This requirement has become a condition for the grant of claim for bad debt allowance. To that extent, there is a clear departure from the scheme in the earlier Act. Still, so far as the exact requirement of the writing-off of the concerned debt as irrecoverable in the account books of the assessee is concerned, the language used in both the Acts, viz., the Act of 1922 and the Act of 1961, is almost identical. The only requirement of Section 36(2)(i)(b) is that the concerned bad debt must have been written off as irrecoverable in the accounts of the assessee. If the debit entries posted by the assessee indicate the said fact the requisite statutory condition has got to be treated as fully complied with. Once the assessee has posted entries in the profit and loss account and corresponding entries are posted in the bad debt reserve account that would be sufficient compliance with the provisions of the statutory requirement for writing off as irrecoverable the concerned debt in the books of the

assessee. No further requirement can be spelt out from the express language used by the Legislature. It is not necessary that the assessee must also post corresponding entries in the ledger account of the concerned parties and should close those accounts.

Section 36(1)(vii) reads thus:

subject to the provisions of Sub-section (2), the amount of any bad debt or part thereof which is written off as irrecoverable in the account of the assessee for the previous year;

Provided that in the case of an assessee to which Clause (viiia) applies, the amount of the deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under that clause:

Explanation.-For the purposes of this clause, any bad debt or part thereof written off as irrecoverable in the accounts of the assessee shall not include any provision for bad and doubtful debts made in the accounts of the assessee.

32. In Commissioner of Income-tax v. Micromax Systems P. Ltd. : [2005]277ITR409(Mad) , this Court held,

(i) that the provisions of Section 36(1)(viiia) of the Income-tax Act, 1961, were not applicable to the assessee since the assessee was admittedly not a bank or a public financial institution. It was only a company manufacturing control systems and equipment. Therefore, only Section 36(1)(vii) would apply to the assessee and not Section 36(1)(viiia).

(ii) That since the assessee did not write off the debt in question as irrecoverable in its books of account for the previous year relevant to the assessment year 1997-98, the debt could not be allowed as bad debt on the plain language of Section 36(1)(vii).

In view of the above, the question Nos. (i) & (iii) in T.C.(A). Nos. 108 to 110 /02 are answered against the assessee.

33. Lease Equalization Charges:

As far as lease equalization is concerned, the Assessing Officer held that the provision for lease equalization charges was to be added back and that since the Act does not recognize the concept of these lease equalization charges, the CIT(Appeals) confirmed the decision of the Assessing Officer with regard to lease equalization charges. The Tribunal also upheld the contention of the Revenue. According to the assessee, the lease rentals that accrue under financial leases should be disclosed separately to the credit of the profit and loss account for the relevant period, and a finance lease is one where the lessor recovers the entire cost of the leased assets over the period of the lease along with a return by way of interest on the amount financed. Therefore, the Institute of Chartered Accounts of India had recommended that every year as against the lease rentals taken to the credit of the Profit and Loss Account, a matching lease annual charge shall be debited to the profit and loss account and this charge should represent a recovery of the net investment made by the lessor for the acquisition of the leased assets over the lease term and the annual lease rentals are to be calculated by reducing from the lease rentals the interest income earned for the year. Reliance was placed on (2002) 252 ITR 273 (Apollo Tyres Ltd. v. Commissioner of Income-Tax) show that in determining the book profits the assessing officer is bound by the accounts adopted for the purposes of the Companies Act and the only adjustment that he is permitted to make are those referred to in the various clauses of the Explanation. He has also referred to 2008 (305) ITR 409 (SC) (Commissioner of Income-Tax v. HCL Comnet Systems and Services Ltd.) and contended that having regard to the nature of the lease equalization charge it cannot be treated as a provision for a liability but it is really an amount debited to the Profit and Loss Account to match the revenues and costs so that the true profits can be accounted for.

34. According to the Revenue, the authorities below did not consider the possibility that it may be a 'reserve' and had all along held that 'lease equalization charges' is a provision for liability other than ascertained liability. The Revenue also relied on : [1981]132ITR559(SC) (Vazir Sutan Tobacco Co. Ltd.,) and : [1986]161ITR741(SC) (Saran Engineering Co. Ltd.,) where the Supreme Court

had highlighted the difference between a provision and a reserve. In part III of Schedule VI to the Companies Act, Rule 7(2) says 'Where (a) any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, not being an amount written off in relation to fixed assets before the Commencement of this Act; or (b) any amount retained by way of providing for any known liability is in excess of the amount which in the opinion of the directions is reasonably necessary for the purpose, the excess shall be treated for the purposes of this Schedule as a reserve and not as a provision.'

35. According to the appellant, the lease equalization charge has been made on the basis of the Reserve Bank Guidelines and on the basis of the opinion of the Directors. As a sample we extract the treatment of lease equalization charge in the Books as follows:

Year Lease Income Recovery Bank Lease Profit

Rentals A from Lease towards Depreciation Equalization before tax

Principal in @ charge 1-2

EMI A-B=1 13.91%WDV 2

SUMMARY

Lease Rentals 17,200,000

Cost of Asset 10,000,000

Depreciation charged to Profit and Loss a/c

as per books during the lease period(A) 4,889,000

Lease Equalization Charges accounted

during the Lease period (B) 5,111,000

Cost of the Asset (A+B) 10,000,000

36. This is in accordance with the Guidance Norms on Accounting for leases. The department concedes that the amount of lease equalization charges over the period of lease is equal to the difference between the quantum of principal recovered and the residual value. But hypothetically justifies its treatment as a reserve on the ground that there will be some years when the quantum of the provision is more than necessary. When the lease equalization charges is debited as per the guidelines and when the Department also admits the above, we cannot appreciate the stand of the Department that it should be treated as a reserve which stand that it is taking for the first time on the ground that there may be some years when the quantum of the provision is more than necessary.

37. From this, it is clear that in accordance with the guidance note the appellant had debited the same on account of depreciation and lease equalization charges before determining the profits and in this kind of lease, the lessor recovers the entire cost of the leased assets over the period of lease along with the interest on the amount financed.

38. In HCL Comnet Systems case the Supreme Court held that a provision made 'to cover the diminution made in the value of the asset' cannot be said to be 'a provision for a liability' and held that 'the Assessing Officer could not add back the said provision under Clause (c) of the Explanation to Section 115JA of the 1961 Act.' The fourth question in T.C.(A) Nos. 108 and 110 of 2008 are answered in favour of the assessee.

39. The learned Senior counsel, Mr. P.J. Pardiwala, submitted that as far as question (ii) in T.C.(A) No. 107 of 2002 is concerned since the matter was restored to the file of the Assessing Officer and no order has been passed, the question is purely academic and therefore, the assessee is not pressing this question. With regard to question No. (iv) in T.C.(A) No. 109 of 2002, it is admitted that the

question is purely academic and in fact, no arguments were advanced to the effect. Hence these questions are not answered.

40. The tax case appeals are ordered as above.

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