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Chief Justice's Court
Case :- INCOME TAX APPEAL No. - 88 of 2014

Appellant :- Commissoner Of Income Tax (Ii) Kanpur
Respondent :- M/S. Shivam Motors (P) Ltd.
Counsel for Appellant :- Shambhu Chopra

Hon'ble Dr. Dhananjaya Yeshwant Chandrachud,Chief Justice
Hon'ble Dilip Gupta,J.

This appeal under Section 260-A of the Income Tax Act, 1961 arises from a decision of the Lucknow Bench of the Income Tax Appellate Tribunal dated 12 November 2013. The Assessment Year to which the appeal relates is AY-2008-09. Three questions have been framed by the Revenue in this appeal of which, the following two, as submitted by the learned counsel, would be sufficient to cover the controversy:

> "1. Whether on the facts and in the circumstances of the case and in law, the Income Tax Appellate Tribunal was justified in upholding the decision of CIT (A) in allowing the interest of Rs.1,72,78,000/- of earlier years in the A.Y. 2008-09 on the basis of a supplementary agreement without considering that liability for such payment flowed from the original agreement with NEL and as per the system of accounting followed by the assessee was payable in years in which it accrued.
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> 3. Whether on the facts and in the circumstances of the case and in law, the Income Tax Appellate Tribunal was justified in upholding the decision of CIT(A) in deleting the disallowance of Rs.2,03,752/- u/s. 14A ignoring the fact that there is difference of opinion of various courts on the view taken by the ITAT that in the absence of tax free income, no disallowance u/s 14A is permissible."

The assessee is a dealer of Tata Motors for the territory of Bilaspur and surrounding districts. The vehicles of the Company were being supplied to the assessee on credit of 45 days. The assessee would make payment to

the Company when the sale proceeds were realised. Eventually the balance due and outstanding remained unpaid.

On 30 March 2000, an agreement was entered into by which a financial arrangement was made between the assessee, Tata Motors Ltd. (TML) and a Company by the name of Niskalp Investments & Trading Company Ltd. Under the arrangement, a loan of Rs.4.80 crores was provided to the assessee by Niskalp on an interest of 12% per annum. The loan was utilized by the assessee to pay the outstanding dues of TML. Under the financial arrangement, the assessee was to pay interest at 12% per annum. The assessee did not, at any point of time, pay the amount of interest under the agreement dated 30 March 2000. On the contrary, as the Tribunal noticed, the assessee was agitating the issue as regards the rate of interest. The notes of account to the balance-sheet contained a specific observation of the auditors of the assessee that no provision has been made in the accounts in respect of interest on dues relating to supply of vehicles which had been converted into a term loan from Niskalp, which had resulted in understating the loss by the same amount. The issue as regards the payment of interest by the assessee to Niskalp was eventually resolved by a supplementary agreement dated 12 April 2007. Under the supplementary agreement, the rate of interest was reduced from 12% to 6% on a reducing balance method with effect from 1 April 2000.

The relevant part of the agreement which has been extracted in the order of the Tribunal reads as follows:

> "G. In or about March 2007, the Borrower approached the Lender and requested the Lender to grant additional concessions and reliefs in respect of the amounts payable in respect of the Loan Agreement. Accordingly, the Borrower has requested the Lender to grant relief and concessions as set out hereinunder:
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> (i) to reduce interest rate @6% per annum on reducing balance method with effect from 1st April, 2000.
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> (ii) All the payments made after 1st April 2000 against the Finance Facilities to adjust against principal amount.
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> (iii) To waive penal/additional interest.
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> (iv) To accept the repayment in Revised Monthly Installments ("RMIs") towards repayment of the outstanding dues in 36 monthly installments of Rs.10,94,000/- each with effect from April 2007 till March 2010, and
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> (v) The liability in respect of the accrued interest @6% p.a. due and payable on the revised principal amount of Rs.229.32 lacs for the period starting from 1st April, 2000 till repayment of the principal amount will be paid by the Borrower in three equal installments commencing from April 2010 to June 2010. The Revised Monthly Installment (RMI) include the part of amount to be adjusted against interest payment. Accordingly, the differential amount of interest liability arising out of computation of recovery of principal amount first against RMI determined on the basis of part payment of principal amount and interest will be computed at the end of tenure or in or about April 2010 when the appropriate amount of rebate may be considered on the basis of tract record of payment of RMI on stipulated dates till March 2010."

On the basis of the agreement, the assessee debited interest amount of 1.72 crores under the head of interest in Schedule 17 to the profit and loss account. The Assessing Officer made a disallowance of a claim of interest of 1.72 crores on the ground that the assessee had followed the mercantile system of accounting and hence, the liability in terms of payment of interest could be quantified and made in the corresponding assessment year. The CIT (A) deleted the disallowance observing that the liability to pay interest

to Niskalp was not a statutory liability but a contractual liability; there was a serious disagreement between the assessee and Niskalp regarding the rate of interest and to resolve it, a meeting had been held on 10 May 2002 by the Directors of the Company and the Management of the Tata Group. This impasse continued till 2007 when a fresh agreement was entered into on 12 April 2007. The CIT(A) held that liability to pay interest was crystallized only upon the execution of the agreement on 12 April 2007. This view has been affirmed by the Tribunal which has observed as follows:

> "12. Turning to the facts of the case, we find that in the instant case the liability was not statutory liability. Admittedly, it was a contractual liability. Though it accrued at the time of execution of first agreement through which loan was obtained by the assessee but that liability was disputed by the assessee by raising a dispute with regard to rate of interest through various correspondences and auditors notes attached to the balance sheet. Finally the dispute was resolved in the impugned assessment year through a supplementary agreement through which the rate of interest was reduced from 12% to 6% per annum besides other terms of payments. Therefore, the contractual liability is finally accrued on its crystallization in the impugned assessment year, and on the basis of the said agreement the assessee has made debit entry to the profit & loss account. Since the contractual liability has been crystallized in the impugned assessment year, the entries passed by the assessee in its accounts is in accordance with law and no disallowance can be made on the ground that the assessee has been following mercantile system of accounting and the debit entries are to made in corresponding assessment years. We have carefully examined the order of CIT(A) and we find that he has adjudicated the issue in right perspective following the judicial pronouncements rendered on the subject. Since we find no infirmity in his order, we confirm the order of CIT(A)."

The contention of learned counsel appearing on behalf of the Revenue is that the liability of the assessee, which had followed the mercantile system

accounting, to pay interest had arisen under the agreement dated 30 March 2000.

Both the CIT(A) and the Tribunal have noted that initially an agreement was entered on 30 March 2000 under which the outstanding dues of the assessee to TML in the amount of Rs.4.80 crores was squared off by the grant of a loan from Niskalp to the assessee for that purpose. However, the issue as regards the payment of interest remained unresolved because though the contractual agreement stipulated interest of 12% per annum, the assessee had disputed this amount consistently and no interest was paid. Eventually, it was only on the execution of a supplementary agreement on 12 April 2007 that the liability to pay interest @6% per annum was agreed upon and in pursuance whereof, the assessee debited an amount of Rs.1.72 crores towards interest in the year in question.

In this view of the matter, we do not find any reason to interfere with the order of the Tribunal. The judgment of the Supreme Court in **Rotork Controls India P. Ltd. Vs. Commissioner of Income Tax**[1] upon which reliance was placed by the learned counsel appearing on behalf of the Revenue involved a situation where the assessee had issued a warranty. For the assessment year in question, the provision for warranty was disallowed by the Assessing Officer on the ground that it was merely a contingent liability. The Supreme Court held that the present value of a contingent liability, like the warranty expenses, if properly ascertained on accrual basis, could be an item of deduction under Section 37. Though, the principle of

1 [2009] 314 ITR 62 (SC)

estimation of the contingent liability is not a normal rule, it would depend on the nature of the business, the nature of sales, the nature of the product manufactured and sold and the scientific method of accounting adopted by the assessee.

This decision will really not carry the case of the department any further. In the present case, it was not a statutory liability of the assessee but a contractual dispute with the assessee under the agreement dated 30 March 2000 which eventually was resolved and the liability was crystallized only when the subsequent agreement dated 12 April 2007 was made. Consequently, there is no reason to interfere with the order of the CIT(A) and of the Tribunal.

As regards the second question, Section 14A of the Act provides that for the purposes of computing the total income under the Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under the Act. Hence, what Section 14A provides is that if there is any income which does not form part of the income under the Act, the expenditure which is incurred for earning the income is not an allowable deduction. For the year in question, the finding of fact is that the assessee had not earned any tax free income. Hence, in the absence of any tax free income, the corresponding expenditure could not be worked out for disallowance. The view of the CIT(A), which has been affirmed by the Tribunal, hence does not give rise to any substantial question of law. Hence, the deletion of the disallowance of Rs.2,03,752/- made by the Assessing Officer was in order.

No substantial question of law would hence arise. For these reasons, we are of the view that the appeal by the Revenue does not give rise to any substantial question of law.

The appeal shall, accordingly, stand dismissed.

Order Date :- 5.5.2014
NSC

(Dr. D.Y. Chandrachud, C.J.)

(Dilip Gupta, J.)