IN THE INCOME TAX APPELLATE TRIBUNAL
"A" BENCH : BANGALORE

BEFORE SHRI GEORGE GEORGE K., VICE PRESIDENT
AND
SHRI LAXMI PRASAD SAHU, ACCOUNTANT MEMBER

ITA No.282/Bang/2023
Assessment year : 2018-19

Mahalasa Exports, 75-1A & 3B, Rajaji Road, Bommarabettu, Udupi – 576 113. **PAN: AAEFM 4143Q**	Vs.	The Income Tax Officer, Ward 1 & TPS, Udupi.
APPELLANT		RESPONDENT

Appellant by	:	Shri Sandeep Chalapathy, CA
Respondent by	:	Shri Nischal B., Addl.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	11.07.2023
Date of Pronouncement	:	17.07.2023

O R D E R

Per Laxmi Prasad Sahu, Accountant Member

This appeal by the assessee is against the DIN & Order No.ITBA/NFAC/S/250/2022-23/1049570428(1) dated 9.2.2023 of the CIT(Appeals), National Faceless Assessment Centre, Delhi [NFAC], Delhi passed u/s 250 of the Act. for the assessment year 2018-19 on the following grounds:-

"1. That the order of the learned Commissioner of Income-tax (Appeals) in so far it is prejudicial to the interests of the

appellant is bad and erroneous in law and against the facts and circumstances of the case.

2. That the learned Commissioner of Income-tax (Appeals) ought to have deleted the addition of Rs.1,50,265/- made by the learned assessing officer by considering the fact that the same is taxed subsequently in the A.Y 2019-20.

3. That the learned Commissioner of Income-tax (Appeals) ought to have held that the duty drawback is offered to tax on receipt basis by the appellant which is allowed as per ICDS-VII and hence, the addition made by the learned assessing officer is not valid.

4. Without prejudice to the above grounds, the learned Commissioner of Income-tax (Appeals) ought to have held that the Duty Drawback of Rs.1,50,265/- has to be reduced from the income declared for F.Y 2018-19 relevant to A.Y 2019-20 otherwise, the same will amount to double taxation.

5. That the learned Commissioner of Income-tax (Appeals) ought to have allowed the appellant to deduct the interest paid on refund of excess Duty Drawback claimed amounting Rs.3,30,674/- as deductible expenses while calculating the taxable income for the A.Y 2018¬19.

6. That the learned Commissioner of Income-tax (Appeals) ought to have allowed the interest paid on refund of excess Duty Drawback claimed by the appellant amounting Rs.3,30,674/-u/s.37 of the Act as deduction while calculating the income under the head "Profits and Gains from Business or Profession" by treating the same as compensatory in nature.

7. That the learned Commissioner of Income-tax (Appeals) ought to have allowed the 1 appellant to reduce an amount Rs.8,200/- while calculating income under the head Profits and Gains from the Business or Profession on recrediting the excess Duty Drawback claimed during the A.Y 2018-19.

Each of the above grounds are without prejudice to one another, the appellant seeks the leave of the Hon'ble Income Tax

> Appellate Tribunal, Bangalore to add, delete, amend or modify otherwise each or any of the grounds of appeal either before or at the time of hearing this appeal."

2. At the outset, the ld. AR submitted that grounds No.3 & 7 are not pressed. Accordingly these two grounds are dismissed as not pressed.

3. Now effectively two issues remain before us. The brief facts of the case are that the assessee filed its return of income on 22.10.2018 disclosing an income of Rs.2,81,88,000. Return was processed and case was selected for scrutiny. Thereafter other statutory notices were issued to the assessee. During the course of assessment proceedings, the assessee was asked to furnish the details of duty drawback in specified format. In this regard, the assessee furnished the details and submitted that duty drawback and service tax was received in FY 2017-18 relating to FY 2016-17 as per Annexure-4 of Rs.22,93,878 and received in FY 2017-18 relating to FY 2017-18 of Rs.1,10,38,338. Further, Rs.15,422 and Rs.8200 was refunded and refund of export benefits enjoyed of Rs.38,95,350 as per Annexure-6 towards draw back wrongly claimed @ 1% under 0801A instead of 0.15% under 0801B on 22.3.2018. Accordingly, there was net duty drawback & service tax received in FY 2017-18 of Rs.94,13,224.

4. The AO noticed that there was a duty drawback received of Rs.103,95,889 and service tax of Rs.7,92,714 totalling to Rs.1,11,88,603. However, in the computation of the assessee, the duty drawback and service tax received was shown at Rs.1,10,38,388 with a

difference of Rs.1,50,215 which was received in subsequent year, but the assessee has not offered it to tax in the impugned assessment year. The AO has not disputed that the difference amount has been offered for taxation in the subsequent assessment year. The AO observed that following cash system of accounting for receipt of duty drawback instead of mercantile system of accounting the difference of Rs.1,50,215 should be taxed in the year of accrual i.e. FY 2017-18.

5. Further the AO observed from the computation of duty drawback & service tax, the assessee refunded in the relevant year Rs.38,95,350 being excess duty drawback claimed @ 1% instead 0.15%. Resultantly the assessee paid interest of Rs.3,30,674 on the excess amount of refund claimed. The AO noted that interest against duty drawback received is not correct as interest is not part of duty drawback and interest was paid for the period for which the assessee was benefited by the excess amount received. Thus by claiming interest against duty drawback, the assessee has shown less duty drawback by an amount of Rs.3,30,674 which cannot be adjusted towards duty drawback refund. Similarly assessee claimed deduction of Rs.8,200 being re-credit of duty drawback which was repaid on 27.2.2018 and since amount was recredited no deduction was to be claimed from the income. Accordingly, Rs.3,38,674 (3,30,674+8200) interest was added back to the total income of assessee.

6. Aggrieved, the assessee filed appeal before the CIT(Appeals). The CIT(A) confirmed the order of the AO on the addition of Rs.1,50,215. He further observed that interest payment of Rs.3,30,674 on excess refund received is not allowable expenditure u/s. 37 of the Act. The nature of interest is not of duty drawback, but is regular/normal interest whereas drawback is a special facility by Government and hence interest cannot be said to be part of duty drawback wrongly paid and cannot be adjusted to show less duty thereafter. Accordingly, the interest cannot be allowable u/s 37. The CIT(Appeals) dismissed the appeal of the assessee. Aggrieved by the order of the CIT(Appeals), the assessee is in appeal before us.

7. The ld. AR submitted in respect of ground No. 2 that the assessee has followed mercantile system of accounting, but right to receive the refund of duty drawback is received in the subsequent year, therefore the amount has not been offered in the impugned assessment year and it has been offered for taxation in the subsequent year He further submitted that both the authorities below are not justified since they have followed dual policy. The assessee received duty drawback and service tax for FY 2016-17 in the FY 2017-18 which has been offered for taxation and accepted by the revenue authorities. However, the refund amount of duty drawback of Rs.1,50,215 which was received in the subsequent financial year pertaining to the impugned financial year has not been accepted by the AO. If the claim of the assessee is not accepted, then the amount received of Rs.22,93,878 cannot be taxed in the impugned assessment year because it relates to

prior year. He further submitted that the amount of Rs.1,50,215 has been offered for taxation in the following assessment year. He relied on the judgment of the Hon'ble jurisdictional High Court in the case of *CIT v. Asea Brown Boveri Ltd (117 Taxman 447)* and *CIT v. Sriyansh Knitters (P) Ltd. (336 ITR 235)*.

8. The ld. AR further submitted in respect of ground Nos.5 & 6 that the assessee wrongly claimed excess refund in which the assessee obtained interest. There was no malafide intention of the assessee for claiming excess refund, but it was inadvertent mistake of the assessee. The interest paid to the Government is compensatory in nature which could be allowed as a deduction u/s. 37 of the Act. He further submitted that as per Rule 17 if any person is paid erroneously or excess payment of drawback, then he has to pay interest on the excess amount which is not penal in nature. The Rule itself has provided for payment of interest, therefore the assessee has not violated any provisions of the Act and it is not in the nature of penalty. He relied on the following judgments:-

- Velankini Information Systems Ltd. v. DCIT, 173 ITR 19
- Lachmandas Mathuradas v. CIT, 122 Taxman 828
- CIT v. Catholic Syrian Bank Ltd., 130 Taxman 447
- CIT v. Dhanalakshmi Bank Ltd., 69 taxmann.com 284

9. On the other hand, the ld. DR relied on the orders of the lower authorities and submitted that the assessee is following hybrid system of accounting which is not permissible. The refund of duty drawback is due when the bills are submitted to the respective authorities and the

assessee was knowing the amount of claim of duty drawback and therefore the amount accrued for the year. Therefore the assessee has to offer the accrued income in the impugned assessment year & should pass the necessary entry as receivables in the books of account. He further submitted that in respect of interest paid on excess duty drawback received, the assessee had got undue benefit and it was in the nature of penal interest and it cannot be adjusted from refund of duty drawback. He submitted that the lower authorities have rightly held that it is wrongly deducted from the total refund of duty drawback.

10. After hearing both the sides, perusing the entire material on record and the orders of the lower authorities, we notice that during the course of assessment proceedings the AO has added back the duty drawback of Rs.1,50,215 which has been received in the subsequent assessment year 2019-20 but pertains to the relevant current assessment year 2018-19. The ld. AR of the assessee submitted that the right to receive occurred in the subsequent year 2019-20 when the customs authority granted the refund of duty drawback, therefore the amount has been offered as income in the subsequent assessment year 2019-20. On going through the reconciliation statement submitted by the assessee before the AO, we note that the refund for FY 2016-17 has been offered as income in the impugned FY 2017-18 which has been accepted by the revenue. On the one hand, the revenue authorities have considered duty drawback & service tax of Rs.22,93,878 as income in the current assessment year which was received by the assessee in the impugned AY 2018-19 whereas it

pertained to previous FY 2016-17 relevant to AY 2017-18. On the other hand, the amount of duty drawback and service tax refund of Rs.1,50,215 has been received in the subsequent year, but considered as income in the current FY 2017-18. The amount of Rs.1,11,88,603 has been arrived by the AO as under:-

Refund for FY 2017-18 received in the same year:		Rs.1,10,38,338
Refund for FY 2017-18 received in FY 2018-19	:	Rs. 1,50,215
Total		Rs.1,11,88,603

For the refund of duty drawback the assessee accounts the same when it gets the right to receive the duty drawback which is nothing but mercantile system of accounting. This fact has not been disputed by the revenue authorities in any of the previous years as submitted by the ld. AR. In the peculiar facts and circumstances of the present case, we conclude that the income would be receivable only when the income accrues to the assessee and income would accrue to the assessee only when the assessee gets such a right to receive the income. The assessee would get a right to receive only when it is sanctioned to the assessee by the custom authorities and not when the assessee makes a claim of the same. This view is supported by the judgment of High Court in the case of *CIT v. Asea Brown Boveri Ltd (117 Taxman 447)* and *CIT v. Sriyansh Knitters (P) Ltd. (336 ITR 235).* Ground No.2 raised by the assessee on this issue is allowed. Accordingly the alternative ground No.4 does not require any adjudication.

11. Ground No.5 & 6 is in respect of interest payment of Rs.3,30,674 on excess claim of refund which has been adjusted against the duty drawback for the period for which the assessee benefitted on the excess amount of duty drawback @ 1% instead of 0.15%. The lower authorities have not accepted that the interest paid is part of duty drawback. The ld. AR in this regard referred to Rule 17 which governs the repayment of erroneous or excess payment of drawback and interest which is as under:-

> "**17.** Where an amount of drawback and interest, if any, has been paid erroneously or the amount so paid is in excess of what the claimant is entitled to, the claimant shall, on demand by a proper officer of customs repay the amount so paid erroneously or in excess, as the case may be, and where the claimant fails to repay the amount, it shall be recovered in the manner laid down in sub-section (1) of section 142 of the Customs Act, 1962 (52 of 162) ".

The above Rule provides refund of excess claim and interest thereon, but it is not in the nature of penalty or fine where the Rule itself provides for payment of principal as well as interest. Hence, in our considered opinion, it should not be considered as penalty or fine. Therefore, the assessee has not violated the provisions of Explanation 1 to section 37(1) of the I.T. Act. A similar issue has been decided by the Hon'ble High Court of Delhi in the case of *Principal Commissioner of Income-tax v. Attire Designers (P.) Ltd. [2022] 145 taxmann.com 188 (Delhi)* in which it has been held as under:-

"**10.** As far as the second issue raised by the Appellant is concerned, this Court finds that the Appellate Authorities below have recorded that assessee had received incentive of Rs. 1,68,00,331/- from Custom Department Authority on export of 'technical textile'. However, later on, Deputy DGFT asked the assessee to refund the incentive received, as certain exports did not fall in 'technical textile' category for which the incentives were payable. The Appellate Authorities below noted that in the letter directing the assessee to refund the incentive, nowhere it was stated that assessee had committed any offence under foreign trade regulation.

11. The Appellate Authorities below further recorded that the Revenue has not placed any material on record to point out that interest paid by the assessee was on account of any act of assessee which is prohibited by law and to demonstrate that the payment is hit by *Explanation 3*7(1) of the Act.

12. This Court in the case of *CIT* v. *Enchante Jewellery Ltd.* [2013] 40 taxmann.com 216/[2014] 220 Taxman 8 (Mag.) (Delhi) has held as follows:

'2. The facts are that the assessee used to manufacture and trade in gold jewellery. Its return for the assessment year 2001-02 was selected for scrutiny and notice under section 143(2) was issued and served upon the assessee. During the assessment proceedings the Assessing Officer disallowed Rs. 1,04,000/- paid by the assessee as interest on customs duty demand. The assessee contended that he used to import jewellery manufacturing machinery under Export Promotion Capital Goods Scheme (EPCG Scheme) at a concessional rate with an export obligation which it could not fulfil and was required to pay interest @ 24% per annum to DGFT. The Assessing Officer after considering the contentions of the assessee held that the interest paid by the assessee cannot be allowed as deduction as it was penal in nature and, therefore, fell within the mischief of *Explanation* below section 37(1) of the Act. The assessee appealed to the Commissioner (A) who ruled in favour of the assessee in the following terms:-

"3.2 During the course of appellate proceedings it has been submitted by the appellant counsel the interest is on late payment of customs duty and is not a penalty. The penalty was to surrender the special import licences equivalent to thrice the value of import license. Therefore, the A.O. has wrongly disallowed the amount. It was further submitted if any interest is paid for purchase of capital asset after commencement of the business the same is allowable as a business expenditure.

3.3 On going through the letter placed on record by the appellant counsel it is observed in the letter it is clearly mentioned that the entire duty saved along with interest @ 24% is to be deposited. It is also mentioned that SIL equivalent to thrice the value of import license is also required to be surrendered as penalty. Therefore, from this letter it is clear that the interest paid is not in the nature of penalty. It is also a fact that, the business of the appellant has already commenced and even the interest paid on purchase of machinery is an allowable business expenditure. Therefore, the addition made by the A.O. is deleted."

3. The Revenue's appeal before the Tribunal was that the disallowance directed to be set aside by the CIT (A) was not justified since the amount paid was penal in nature. The Tribunal considered the submissions and held that there was no infirmity in the order of the CIT (A) and the amount paid was not penal in nature as much as it was as per the declared policy of the government and occasioned by the failure of the assessee to meet its obligations. *The amount being interest was compensatory and not penal according to the Tribunal.*

4. The counsel for the Revenue attacked the reasoning of the Tribunal contending that since the assessee availed the facility without having fulfilled the obligations, there was a violation of the terms of the scheme, doing something that is prohibited by law.

5. *The Revenue, in the opinion of the Court, has been unable to establish that the assessee's conduct was an offence or that it did anything that was prohibited by law*. The Assessing Officer has not pointed out which provision of law was violated by the assessee. *Even if in any adjudicatory proceedings under Customs Act the word "penalty" is used, that cannot be determinative of*

> *the nature of the payment, nor can the Assessing Officer conclude that the assessee did something that was an offence or was prohibited by law*. There is nothing brought on record by the Revenue to show that the payment was hit by the *Explanation* below section 37(1) of the Act."
>
> (*Emphasis Supplied*)

12. Respectfully following the above judgment, we hold that the interest paid by the assessee towards excess claim of refund of duty drawback is not penal in nature. Therefore, Explanation 1 to section 37 will not apply and assessee is eligible for claiming it as expenditure. Since the assessee has adjusted the interest paid from the refund of export benefit, it will not affect the profitability of the company. Accordingly, this issue raised by the assessee is allowed.

13. In the result, the appeal by the assessee is partly allowed.

Pronounced in the open court on this 17th day of July, 2023.

Sd/-	Sd/-
(GEORGE GEORGE K.) VICE PRESIDENT	(LAXMI PRASAD SAHU) ACCOUNTANT MEMBER

Bangalore,
Dated, the 17th July, 2023.

/*Desai S Murthy /*

Copy to:

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

By order

Assistant Registrar
ITAT, Bangalore.