IN THE HIGH COURT OF HIMACHAL PRADESH, SHIMLA

ITA Nos.82 & 83 of 2018.
Reserved on : 24th November, 2022.
Date of Decision : 7th December, 2022.

ITA No.82 of 2018.

Pr. Commissioner of Income Tax ……Appellant

Versus

The Kangra Central Co-op Bank Ltd. ……Respondent

ITA No.83 of 2018.

Pr. Commissioner of Income Tax ……Appellant

Versus

The Kangra Central Co-op Bank Ltd. ……Respondent

Coram:

The Hon'ble Ms. Justice Sabina, Judge
The Hon'ble Mr. Justice Sushil Kukreja, Judge.

Whether approved for reporting?[1]

For the appellant(s) : Mr. Vinay Kuthiala, Senior Advocate with Ms. Vandana Kuthiala, Advocate.

For the respondent(s) : Mr. Vishal Mohan & Mr. Rakesh Kumar Thakur, Advocates.

Sabina, Judge. (Oral)

Vide this order, above mentioned two appeals would be disposed of as they involved common issue.

2. Appellant-revenue has filed the appeals challenging the order dated 31st January, 2018, passed by the Income Tax Appellate Tribunal,

[1] **Whether reporters of Local Papers may be allowed to see the judgment?**

Division Bench 'A', Chandigarh, whereby the appeals filed by the revenue were dismissed.

3. At the time of admission of the appeals, following substantial questions of law were framed in ITA No.82 of 2018:-

> *"(1) Whether on the fact and in the circumstances of the case, the Hon'ble ITAT, Chandigarh is justified in deleting the addition of Rs.27,78,47,640/ made by the AO on account of interest accrued on non performing assests by ignoring the decision of the Hon'ble supreme Court in the case of State Bank of Travancore (158 ITR 102"*
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> *(2) Whether on the facts and in the circumstances of the case, the Hon'ble ITAT erred in applying Section 43D to a cooperative society even though the same is specifically excluded under Explanation (ii) to clause (vii a) of Section 36 (1)*
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> *(3) Whether on the fact and in the circumstances of the case, the Hon'ble ITAT has erred in following the decision in the case of CIT vs. Punjab State Co-op Bank Ltd. Of A.Y. 2007-08, 2008-09 reported in 143 ITD 571 (Chd) as the Punjab State Co-op Bank Ltd. is a scheduled Bank whereas the Kangra Central Co-op Bank Limited is not a scheduled Bank.*"

4. Similar substantial questions of law were framed in ITA No.83 of 2018, with difference in the amount concerned.

5. The question involved in the present appeals is as to whether the assessee was liable to pay tax on interest accrued on loans categorized as non-performing assets (NPA)/sticky loans on receipt basis

as claimed by the assessee or on accrual basis as calculated by the revenue.

6. The assessee is a non-scheduled bank. The assessing officer noted that the assessee had not credited/recognized interest on NPAs, although, it was following mercantile system of accounting.

7. Notice was issued to the assessee with regard to the assessment years 2012-13 and 2013-14. The assessee was asked to explain as to why the interest on loans had not been added to its income. The case of the assessee was that the amount of interest had not been shown as income because the same had become NPA and the bank was not certain about the recovery of principal amount/interest. Hence, the bank had not made any entries in its books of account for the years in question with regard to interest due on NPA accounts. The assessing officer held that the assessee was required to show the interest on NPAs as income and consequently the income of the assessee was recomputed by the assessing officer by including the interest, which was liable to accrue on the loans etc. Assessee filed appeals before the Commissioner of Income Tax Appeals and the appeals were allowed by the appellate authority.

8. Aggrieved against the orders passed by the appellate authority, the revenue approached the Tribunal by way of appeals. Appeals with regard to assessment years 2012-13 and 2013-14 were

clubbed and were dismissed by the Tribunal vide impugned order dated 31st January, 2018.

9. Learned counsel for the appellant-revenue has submitted that the assessee was a non-scheduled bank and was following mercantile system of banking. Hence, the assessee was required to credit the income of NPA or sticky loans and could claim the same as bad debt in the next year. The assessee could not draw any benefit under Section 43D of the Income Tax Act, 1961. Learned counsel has further submitted that para (xii) of CBDT instruction No.17/2008, dated 26th November, 2008, instructed that under Section 145 of the Act, Income under the heads 'profit and gains of business' or 'income from other sources' is required to be computed in accordance with either cash or mercantile system of accounting, regularly employed by the assessee. Under the RBI Guidelines and the Indian Companies At, 1956, Banks have to follow the mercantile system of accounting and prepare accounts on accrual basis. The Assessing Officers should ensure that this system is strictly followed by the Banks in respect of all sources of income. Learned counsel has further submitted that the said instructions were binding on the department. Learned counsel has further submitted that the assessee had not maintained any suspense account and had to only follow mercantile system of banking.

10. In support of his arguments, learned counsel for the appellant has placed reliance on the judgment of Hon'ble Supreme Court

in ***State Bank of Travancore*** *Versus* ***Commissioner of Income Tax, Kerala, (1986) 2 Supreme Court Cases, 11,*** wherein it has been held as under:-

> *"64. In CIT v. Motor Credit Co. Pvt. Ltd., the assessee, a private company, was carrying on business as financier for purchase of motor vehicles on hire purchase. It advanced under hire purchase agreements monies to two firms which were plying buses. The routes of these two firms having been taken over by a State Transport Corporation following nationalisation, the firms defaulted in making payment of the hire purchase instalments, and consequently the buses were seized. As the assessee-company was advised that there was no prospect of recovering even the principal amount, the assessee-company did not credit the interest on the outstandings from the two companies even though it was adopting the mercantile system of accounting. The Income-tax Officer, however, included a sum of Rs. 56,163 by way of accrued interest on the amounts outstanding against these two firms. There in fact no interest accrued in view of the facts because there was hire purchase and the State transport corporation had taken over the firms. Therefore, there was no question of paying any hiring charges or interest. In that view it was considered to be unrealistic that income accrued. If the actuality of situation or the reality of a particular situation makes an income not to accrue, then very different considerations would apply. But where interest has accrued and the assessee has debited the account of the debtor the difficulty of the recovery would not make the accrual non-accrual of interest.*

65. In CIT v. Devi Films (P) Ltd., the Madras High Court held that the regular mode of accounting only determined the mode of computing the taxable income and the point of time at which the tax liability was attracted. It would not determine or affect the range of taxable income or the ambit of taxation. It was further held that where no income had resulted, it could not be said that income had accrued merely on the ground that the assessee had been following the mercantile system of accounting. Even if the assessee made a credit entry to that effect still no income could be said to have accrued to the assessee according to the Madras High Court. If no income had materialised, it was pointed out, there could be no liability to tax on any hypothetical accrual of income based on the mercantile system of accounting followed by the asessee that had to be taken into account, but what should be considered was whether the income had really materialised or resulted to the assessee. The question whether real income had materialised to the assessee had to be considered with reference to commercial and business realities of the situation. In that case the assessee company had entered into an agreement with M who was producing a Kannada film. The film was in the process of production and the producer wanted finance to complete the picture and approached the assessee and offered the exclusive distribution rights of the picture in certain areas in Karnataka State. The assessee agreed to advance a sum of Rs. 2,80,000. Under the agreement the assessee as distributor could deduct the commission and appropriate the balance towards the discharge of the amount advanced to the producer and after the advance was completely adjusted, the distributor had to remit to the producer the realisations after deducting the commission.

The distribution commission was to be calculated at 35% of the net realisation on the picture. The producer undertook to complete and deliver the prints for the release of the picture failing which the producer under took to pay damages together with interest for the amount received at 12% per annum from the date of default to the date of delivery of the prints and also provided certain sum for certain contingency. It is not necessary to set out in detail the further facts. It was held that the assessee was in a position to realise only Rs. 3,47,000 approximately during the three years in question as against a total sum or Rs. 4,37,828 incurred as the cost of production. The Tribunal was justified in the High Court's view that having regard to the terms of the agreement entered into between the parties and in the light of the entries contained in the accounts, the commission could not be said to have accrued in favour of the assessee, as commission could be earned only after the entire advance had been realised. The decision, as is apparent from its tenor rested upon the peculiar facts. As the advances could not be realised because of the contingencies that happened in that case, the commissions did not accrue or could not be said to have actually accrued. As mentioned before, the concept of real income may have to be given precedence in computation of income in a particular case but accrued income cannot be waived as not having accrued to the assessee. Sethuraman, J. who delivered the judgment of the bench noted the distinction between the James Finlay's case and the case before him in the Madras High Court. Dealing with the Calcutta case, Sethuraman, J. observed at page 395 that the waiver of interest would be inconsistent with the entries in the books, since the interest had been credited to the

suspense account. As in the instant case before us in these appeals the learned judges of the Madras High Court also referred to Morvi Industries Ltd. where affirming the Calcutta High Court decision, it was found that the relinquishment by the assessee of its remuneration after it had become due was of no effect and that the amount was liable to be taxed. The Madras High Court felt that this Court had considered only in the light of the system of accounting followed by the assessee and further observed that this Court in the aforesaid decision had not been referred to the notion of real income. It is unfortunate that the High Court chose to side-track a binding decision of this Court on a wholly untenable ground."

11. Learned counsel for the appellant has also placed reliance on the decision of the Hon'ble Supreme Court in ***Kerala Financial Corporation*** *versus* **Commissioner of Income Tax**, ***(1994) 4 Supreme Court Cases, 375***, wherein it has been held as under:-

"15. The result is that we follow and affirm the view taken by the majority by this Court in State Bank of Travancore case and hold that the interest which had accrued on the sticky advance has to be treated as income of the assessee and as such taxable. We would add that if ultimately it would be established by the assessee that the advance has taken the shape of bad debt refund of the tax paid on the interest would become due and the same can be claimed by the assessee in accordance with law"

12. Learned counsel for the appellant has also placed reliance on the decision of the Hon'ble Supreme Court in ***Gem Granites*** v*ersus*

Commissioner of Income Tax, T.N. (2005) 1 Supreme Court Cases, 289, wherein it has been held as under:-

> *"18. The 1994 and 1995 notifications both relate to the interpretation of Item (x) in the Twelfth Schedule read with Section 80-HHC as amended in 1991. They are confined to an exposition of the phrase of "cut and polished" used in Item (x) and do not seek to interpret the word 'minerals' in general. The 1994 circular clarified that the phrase 'cut and polished' minerals meant exactly that and could not be extended to any other process. The 1995 circular modified the rigour of the 1994 circular to the extent that it recognized some other processes as falling within the phrase 'cut and polished'. Both circulars clearly state that benefit of Section 80 HHC was available to cut and polished granite only with effect from 1.4.91 by virtue of insertion of Item (x) in the Twelfth Schedule to the Act.*
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> *19. Doubtless, the Customs Tariff Act and the Central Excise Tariff Act both draw a distinction between minerals and processed minerals. For example in Chapter 27 of the Customs Tariff, a distinction has been drawn between mineral fuels, mineral oils and mineral products. However a classification which is relevant for the purpose of determination of rate of duty cannot be imported into the Income tax Act which makes no such distinction.*
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> *20. Consequently, even if the concession of the appellant before the High Court is ignored, the benefit of Section 80-HHC cannot be granted to the appellant for the Assessment Year in question. The appeal is accordingly dismissed without any order as to costs."*

13. Learned counsel for the respondent, on the other hand, has opposed the appeals and has submitted that the Tribunal has rightly dismissed the appeals filed by the revenue. Admittedly, respondent Assessee is a non-scheduled bank. Suspense account is required to be created by each bank as per Reserve Bank of India Instructions. There was no justification in the assessee paying tax with regard to the sticky loans and then claim it as a bad debt in the next year. Section 43D of the Income Tax Act was substituted by Finance Act 1999 (27 of 1999) w.e.f. 1st April, 2000, whereas, it had been earlier inserted by Finance Act 1991 w.e.f. 1st April, 1991. Initially the said Section was applicable to scheduled bank, but thereafter, it was amended and was also made applicable to co-operative bank w.e.f. 1st April, 2018. A perusal of the objects at the time of addition of co-operative banks in Section 43D reveals that the same was done with an intention to cure the defect.

14. In support of his arguments, learned counsel for the respondent has placed reliance on the judgment of Hon'ble Supreme Court in ***Allied Motors (P.) Ltd.*** *versus* ***Commissioner of Income-Tax, (1997) 224 ITR 677,*** wherein it has been held as under:-

> *Section 43B was inserted in the Income-tax Act, 1961 with effect from April 1, 1984. The section, as it originally stood, did not contain the two provisos. The first proviso has been set out above. The proviso was inserted by the Finance Act of 1987 which came into effect from April 1, 1988. Explanation 2 has been added subsequently by the Finance Act of 1989 but with retrospective effect from*

April 1, 1984. In these References and appeals we are concerned with the application of Section 43B as it stood before the provisos were added.

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In the case of Goodyear India Ltd. v. State of Haryana and Anr. (1991) 188 ITR 402, this court said that he rule of reasonable construction must be applied while construing a statute. Literal construction should be avoided if it defeats the manifest object and purpose of the Act.

Therefore, in the well known words of Judge learned Hand, one cannot make a fortress out of the dictionary; and should remember that statutes have some purpose and object to accomplish whose sympathetic and imaginative discovery is the surest guide to their meaning. In the case of R.B. Jodha Mal Kuthiala v. CIT (1971) 82 ITR 570, this Court said that one should apply the rule of reasonable interpretation. A proviso which is inserted to remedy unintended consequences and to made the provision workable, a proviso which supplies an obvious omission in the section and is required to be read into the section to give the section a reasonable interpretation, requires to be treated as retrospective in operation so that a reasonable interpretation can be given to the section as a whole.

This view has been accepted by a number of High Courts. In the case of CIT v. Chandulal Venichand [1994] 209 ITR 7, the Gujarat High Court has held that he first proviso to section 43B is retrospective and sales-tax for the last quarter paid before the filing of the return for the assessment year is deductable. This decision deals with assessment year 1984-85. The Calcutta High Court in the case of CIT v. Sri Jagannath Steel Corporation [1991] 191

ITR 676, has taken a similar view holding that the statutory liability for sales-tax actually discharge after the expiry of accounting year in compliance with the relevant stature is entitled to deduction under Section 43B. The High Court has held the amendment to be clarificatory and, therefore, retrospective. The Gujarat High Court in the above case held the amendment to be curative and explanatory and hence retrospective. The Patna High Court has also held the amendment inserting the first proviso to be explanatory in the case of Jamshedpur Motor Accessories Stores v. Union of India and Ors. [1991] 189 ITR 70., It was held that amendment inserting first proviso to be retrospective. The special leave petition from this decision of the Patna High Court was dismissed. The view of the Delhi High Court, therefore, that the first proviso to section 43B will be available only prospectively does not appear to be correct. As observed by G.P. Singh in his Principles of statutory Interpretation, 4th Edn. Page 291, "It is well settled that if a statute is curative or merely declaratory of the previous law retrospective operation is generally intended." In fact the amendment would not serve its object in such a situation unless it is construed as retrospective. The view, therefore, taken by the Delhi High Court cannot be sustained."

15. Learned counsel for the respondent has also placed reliance on the judgment of Hon'ble Supreme Court in ***UCo Bank*** *versus* ***Commissioner of Income-Tax (1999) 237 ITR 889,*** wherein it has been held as under:-

" We have to consider whether interest on a loan whose recovery is doubtful and which has not been

recovered by the assessee-bank for the last three years but has been kept in a suspense account and has not been brought to the profit and loss account of the assessee, can be included in the income of the assessee for the assessment year 1981-82. It is the case of the assessee that in respect of loans which are advanced by it to various customers, recovery of some loans is very doubtful. It is doubtful whether even the interest on the loans advanced will be recovered from the customer. In such cases, the interest calculated on the loan amount is credited in a suspense account. This amount is not brought to the profit and loss account of the assessee-bank because these are amounts which are not likely to be realised by the bank. Hence they do not form a part of the real income of the bank. If and when any such amount or a part of it is recovered, it is included in that assessment year in the total income of the assessee for the purpose of payment of income-tax.

The method of accounting which is followed by the assessee-bank is mercantile system of accounting. However, the assessee considers income by way of interest pertaining to doubtful loans as not real income in the year in which it accrues, but only when it is realised. A mixed method of accounting is thus followed by the assessee-bank. This method of accounting adopted by the assessee is in accordance with accounting practice. In Spicer and Pegler's Practical Auditing the relevant passage occurring at page 186-187 has been reproduced in the minority judgment of this Court in State Bank of Travancore v. Commissioner of Income-tax, Kerala [(1986) 158 ITR 102 at p.120]. It is as follows:

"Where interest has not been paid, it is sometimes left out of account altogether. This prevents the possibility of irrecoverable interest being credited to revenue, and distributed as profit. On the other hand, this treatment does not record the actual state of the loan account, and in the case of banks and other concerns whose business it is to advance money, it is usual to find the interest is regularly charged up, but when its recovery is doubtful, the amount thereof is either fully provided against or taken to the credit of an Interest Suspense Account and carried forward and not treated as profit until actually received."

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Under Section 145 of the Income-Tax Act, 1961, income chargeable under the head "profits and gains of business or profession or income from other sources" shall be computed in accordance with the method of accounting regularly employed by the assessee; provided that in a case where the accounts are correct and complete but the method employed is such that in the opinion of the Income- tax Officer, the income cannot properly be deduced therefrom, the computation shall be made in such manner and on such basis as the Income-tax Officer may determine. In the present case the method employed is entirely for a proper determination of income.

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The question whether interest earned, on what have come to be known as "sticky" loans, can be considered as income or not until actual realization, is a

question which may arise before several income tax officers exercising jurisdiction in different parts of the country. Under the accounting practice, interest which is transferred to the suspense account and not brought to the profit and loss account of the company is not treated as income. The question whether in a given case such "accrual" of interest is doubtful or not, may also be problematic. If, therefore, the Board has considered it necessary to lay down a general test for deciding what is a doubtful debt, and directed that all income tax officers should treat such amounts as not forming part of the income of the assessee until realized, this direction by way of a circular cannot be considered as travelling beyond the powers of the Board under Section 119 of the Income Tax Act. Such a circular is binding under Section 119. The circular of 9th of October, 1984, therefore, provides a test for recognising whether a claim for interest can be treated as a doubtful claim unlikely to be recovered or not. The test provided by the said circular is to see whether, at the end of three years, the amount of interest has, in fact, been recovered by the bank or not. If it is not recovered for a period of three years, then in the fourth year and onwards the claim for interest has to be treated as a doubtful claim which need not be included in the income of the assessee until it is actually recovered.

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In the premises the majority decision in the State Bank of Travancore v. CIT (1986) 158 ITR 102 (SC) cannot be looked upon as laying down that a circular which is properly issued under Section 119 of the Income-tax Act for proper administration of the Act and for relieving the rigour of too literal a construction of the law for the benefit of the assessee in certain situations would

not be binding on the departmental authorities. This would be contrary to the ratio laid down by the Bench of five judges in Navnitlal C. Javeri v. K.K. Sen (1965) 56 ITR 198 (SC). In fact, State Bank of Travancore v. CIT (1986) 158 ITR 102 (SC) has already been distinguished in the case of Keshavji Ravji and Co. v. CIT (1990) 182 ITR 1 (SC) by a Bench of three judges in a similar fashion. It is held only as laying down that a circular cannot alter the provisions of the Act. It being in the nature of a concession, could always be prospectively withdrawn. In the present case, the circulars which have been in force are meant to ensure that while assessing the income accrued by way of interest on a "sticky" loan, the notional interest which is transferred to a suspense account pertaining to doubtful loans would not be included in the income of the assessee, if for three years such interest is not actually received. The very fact that the assessee, although generally using a mercantile system of accounting, keeps such interest amounts in a suspense account and does not bring these amounts to the profit and loss account, goes to show that the assessee is following a mixed system of accounting by which such interest is included in its income only when it is actually received. Looking to the method of accounting so adopted by the assessee in such cases, the circulars which have been issued are consistent with the provisions of Section 145 and are meant to ensure that assessees of the kind specified who have to account for all such amounts of interest on doubtful loans are uniformly given the benefit under the circular and such interest amounts are not included in the income of the assessee until actually received if the conditions of the circular are satisfied. The circular of October 9, 1984, also

serves another practical purpose of laying down a uniform test for the assessing authority to decide whether the interest income which is transferred to the suspense account is, in fact, arising in respect of a doubtful or "sticky" loan. This is done by providing that non-receipt of interest for the first three years will not be treated as interest on a doubtful loan. But if after three years the payment of interest is not received, from the fourth year onwards it will be treated as interest on a doubtful loan and will be added to the income only when it is actually received.

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The other judgment on which reliance was placed by the Department was a judgment of a Bench of two judges of this Court in Kerala Financial Corporation V. CIT (1994) 210 ITR 129, where this Court, following the majority view in State Bank of Travancore v. CIT (1986)158 ITR 102 (SC) held that interest which had accrued on a "sticky" advance has to be treated as income of the assessee and taxable as such. It is said that ultimately, if the advance takes the shape of a bad debt, refund of the tax paid on the interest would become due and the same can be claimed by the assessee in accordance with law. For reasons set out above, we are not in agreement with the said judgment. The relevant circulars of Central Board of Direct Tax cannot be ignored. The question is not whether a circular can override or detract from the provisions of the Act; the question is whether the circular seeks to mitigate the rigour of a particular section for the benefit of the assessee in certain specified circumstances. So long as such a circular is in force it would be binding on the departmental authorities in view of the provisions of

Section 119 to ensure a uniform and proper administration and application of the Income-tax Act."

16. Learned counsel for the respondent has also placed reliance on the judgment of Hon'ble Supreme Court in ***Mercantile Bank Ltd.*** *versus* ***Commissioner of Income-Tax, (2006) 283 ITR 84 (SC),*** wherein it has been held as under:-

"7. Although the 1952 circular was withdrawn in June 1978 in view of the decision of the Kerala High Court to the contrary in State Bank of Travancore vs. CIT (1977) 110 ITR 336, the principle was reintroduced by the Central Board of Direct Taxes by another Circular dated October 9, 1984. The 1984 Circular clarified that up to the Assessment years 1978-79 the taxability of interest on doubtful debts credited to suspense account would be decided in the light of the Board's earlier Circular dated 6th October, 1952 as the said Circular was withdrawn only in June, 1978. With effect from 1979-80 the new procedure prescribed under the 1984 circular would apply. The procedure prescribed is not relevant for our purposes. But it is clear that the circular issued in 1978 was effectively set aside and rendered ineffective.

9. Therefore, the assessment year in question in this appeal should have been dealt with by the Department in accordance with the 1952 Circular under which the interest on doubtful loans could not be brought to tax.

10. The decision of the High Court on the first question, having been based on the decision in State Bank of Travancore [1986] 158 ITR 102 (SC) must be held to be

incorrect in view of the subsequent judgment of this Court in the case of UCO Bank Vs. CIT [1999] 237 ITR 889."

17. Learned counsel for the respondent has also placed reliance on the judgment of Hon'ble Supreme Court in ***Commissioner of Income-Tax*** *versus* ***Alom Extrusions Ltd. [2009] 319 ITR 306 (SC),*** wherein it has been held as under:-

"16. We find no merit in these civil appeals filed by the Department for the following reasons: firstly, as stated above, Section 43-B [main section], which stood inserted by Finance Act, 1983, with effect from April 1, 1984, expressly commences with a non-obstante clause, the underlying object being to disallow deductions claimed merely by making a Book entry based on Merchantile System of Accounting. At the same time, Section 43-B [main section] made it mandatory for the Department to grant deduction in computing the income under Section 28 in the year in which tax, duty, cess, etc., is actually paid. However, Parliament took cognizance of the fact that accounting year of a company did not always tally with the due dates under the Provident Fund Act, Municipal Corporation Act [octroi] and other Tax laws. Therefore, by way of first proviso, an incentive/relaxation was sought to be given in respect of tax, duty, cess or fee by explicitly stating that if such tax, duty, cess or fee is paid before the date of filing of the Return under the Income Tax Act [due date], the assessee(s) then would be entitled to deduction. However, this relaxation/incentive was restricted only to tax, duty, cess and fee. It did not apply to contributions to labour welfare funds. The reason appears to be that the employer(s) should not sit on the collected contributions

and deprive the workmen of the rightful benefits under Social Welfare legislations by delaying payment of contributions to the welfare funds. However, as stated above, the second proviso resulted in implementation problems, which have been mentioned hereinabove, and which resulted in the enactment of Finance Act, 2003, deleting the second proviso and bringing about uniformity in the first proviso by equating tax, duty, cess and fee with contributions to welfare funds. Once this uniformity is brought about in the first proviso, then, in our view, the Finance Act, 2003, which is made applicable by the Parliament only with effect from April 1, 2004, would become curative in nature, hence, it would apply retrospectively with effect from April 1, 1988. Secondly, it may be noted that, in the case of Allied Motors (P) Limited vs. Commissioner of Income Tax, reported in [1997] 224 I.T.R.677 (SC), the Scheme of Section 43-B of the Act came to be examined. In that case, the question which arose for determination was, whether sales tax collected by the assessee and paid after the end of the relevant previous year but within the time allowed under the relevant Sales Tax law should be disallowed under Section 43-B of the Act while computing the business income of the previous year? That was a case which related to Assessment Year 1984-1985. The relevant accounting period ended on June 30, 1983. The Income Tax Officer disallowed the deduction claimed by the assessee which was on account of sales tax collected by the assessee for the last quarter of the relevant accounting year. The deduction was disallowed under Section 43-B which, as stated above, was inserted with effect from April 1, 1984. It is also relevant to note that the first proviso which came into force with effect from

April 1, 1988 was not on the statute book when the assessments were made in the case of Allied Motors (P) Limited (supra). However, the assessee contended that even though the first proviso came to be inserted with effect from April 1, 1988, it was entitled to the benefit of that proviso because it operated retrospectively from April 1, 1984, when Section 43-B stood inserted. This is how the question of retrospectively arose in Allied Motors (P) Ltd. [1997] 224 I.T.R. 677. This Court, in Allied Motors (P) Limited [1997] 224 I.T.R. 677 held that when a proviso is inserted to remedy unintended consequences and to make the section workable, a proviso which supplies an obvious omission in the section and which proviso is required to be read into the section to give the section a reasonable interpretation, it could be read retrospective in operation, particularly to give effect to the section as a whole. Accordingly, this Court, in Allied Motors (P) Ltd. [1997] 224 I.T.R. 677, held that the first proviso was curative in nature, hence, retrospective in operation with effect from April 1, 1988. It is important to note once again that, by the Finance Act, 2003, not only the second proviso is deleted but even the first proviso is sought to be amended by bringing about an uniformity in tax, duty, cess and fee on the one hand vis-a-vis contributions to welfare funds of employee(s) on the other. This is one more reason why we hold that the Finance Act, 2003, is retrospective in operation. Moreover, the judgment in Allied Motors (P) Limited (supra) is delivered by a Bench of three learned Judges, which is binding on us. Accordingly, we hold that Finance Act, 2003, will operate retrospectively with effect from April 1, 1988 [when the first proviso stood inserted]. Lastly, we may point out the hardship and the invidious discrimination which would be

caused to the assessee(s) if the contention of the Department is to be accepted that Finance Act, 2003, to the above extent, operated prospectively. Take an example - in the present case, the respondents have deposited the contributions with the R.P.F.C. after March 31 [end of accounting year] but before filing of the Returns under the Income Tax Act and the date of payment falls after the due date under the Employees' Provident Fund Act, they will be denied deduction for all times. In view of the second proviso, which stood on the statute book at the relevant time, each of such assessee(s) would not be entitled to deduction under Section 43-B of the Act for all times. They would lose the benefit of deduction even in the year of account in which they pay the contributions to the welfare funds, whereas a defaulter, who fails to pay the contribution to the welfare fund right upto April 1, 2004, and who pays the contribution after April 1, 2004, would get the benefit of deduction under Section 43-B of the Act. In our view, therefore, the Finance Act, 2003, to the extent indicated above, should be read as retrospective. It would, therefore, operate from April 1, 1988, when the first proviso was introduced. It is true that the Parliament has explicitly stated that the Finance Act, 2003, will operate with effect from April 1, 2004. However, the matter before us involves the principle of construction to be placed on the provisions of the Finance Act, 2003.

17. Before concluding, we extract hereinbelow the relevant observations of this Court in the case of Commissioner of Income Tax, Bangalore vs. J.H. Gotla, reported in [1985] 156 I.T.R. 323, which reads as under:

> *"We should find out the intention from the language used by the Legislature and if strict literal construction leads to an absurd result, i.e., a result not intended to be subserved by the object of the legislation found in the manner indicated before, then if another construction is possible apart from strict literal construction, then that construction should be preferred to the strict literal construction. Though equity and taxation are often strangers, attempts should be made that these do not remain always so and if a construction results in equity rather than in injustice, then such construction should be preferred to the literal construction."*
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> *18. For the afore-stated reasons, we hold that Finance Act, 2003, to the extent indicated above, is curative in nature, hence, it is retrospective and it would operate with effect from 1st April, 1988 (when the first proviso came to be inserted). For the above reasons, we find no merit in this batch of civil appeals filed by the Department which are hereby dismissed with no order as to costs."*

18. At the time of extension of scope of 43D to co-operative banks, following factors were taken in consideration while passing Finance Bill 2017:-

> *"Extension of scope of section 43D to Co-operative Banks*
>
> *The existing provisions of section 43D of the Act, inter-alia, provides that interest income in relation to certain categories of bad or doubtful debts received by certain institutions or banks or corporations or companies, shall be chargeable to tax in the previous year in which it is*

credited to its profit and loss account for that year or actually received, whichever is earlier. This provision is an exception to the accrual system of accounting which is regularly followed by such assessees for computation of total income. The benefit of this provision is presently available to scheduled banks, public financial institutions, State financial corporations, State industrial investment corporations and certain public companies like Housing Finance companies. With a view to provide a level playing field to co-operative banks vis-à-vis scheduled banks and to rationalise the scope of the section 43D, it is proposed to amend section 43D of the Act so as to include co-operative banks other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank. Consequentially, as per matching principle in taxation, if the interest income on bad or doubtful debts is chargeable to tax on receipt basis, the interest payable on such bad or doubtful debts need to be allowed on actual payment. In view of this, it is proposed to amend section 43B of the Act to provide that any sum payable by the assessee as interest on any loan or advances from a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank shall be allowed as deduction if it is actually paid on or before the due date of furnishing the return of income of the relevant previous year. These amendments will take effect from 1st April, 2018 and will, accordingly, apply in relation to the assessment year 2018-19 and subsequent years."

19. In the present case, at the time of assessment years in question, Section 43D of the Act did not refer to non-scheduled banks and

only referred to scheduled banks. However, by Finance Act 2017, Co-operative banks were also included in the definition of Section 43D w.e.f. 1st April, 2018. At the time of passing of the Bill, it was specifically mentioned that the amendment will take place w.e.f. 1st April, 2018 and will accordingly apply in relation to assessment year 2018-19 and subsequent years. Hence, the learned counsel for the revenue has vehemently argued that Section 43D was not retrospective in nature, but it was to take effect w.e.f. 1st April, 2018.

20. On the other hand, learned counsel for the assessee has submitted that the amendment was to be interpreted, in terms of the objects, it sought to achieve and as the amendment was curative in nature to provide level playing field to the co-operative banks *vis-à-vis* scheduled bank and to rationalize the scope of Section 43D, the amendment was liable to be read with effect from the date when Section 43D was introduced in the Act i.e. with effect from 1st April, 2000. In this regard, the observations made by the Hon'ble Supreme Court in ***Allied Motors (P.) Limited's*** case *supra* are relevant. It has been observed by the Hon'ble Supreme Court that when any addition is made in a provision to remedy unintended consequence and to make it workable and it supplies an obvious omission, then reasonable interpretation would be that the said amendment is made retrospective in operation.

21. A perusal of the objects of amending the existing provisions of Section 43D of the Act vide Finance Bill 2017, reveals that the benefit

of the existing provision was available to scheduled bank or a public financial institution etc. With a view to provide level playing field to co-operative banks *vis-à-vis* scheduled banks and to rationalize the scope of Section 43D, it was proposed to introduce the amendment to Section 43D of the Act so as to include co-operative banks other then a primary agricultural credit society or a primary co-operative agricultural and rural development bank. The omission was sought to be corrected by bringing at par the scheduled banks and non-scheduled banks. Thus, it is evident that the amendment was brought in force with a view to cure the omission in Section 43D. Although, the amendment was sought to be made effective w.e.f. 1st April, 2018, but it was liable to be treated as retrospective in nature. In order to arrive at this view, reliance is made on the decision of Hon'ble Supreme Court in ***Allied Motors'*** case *supra.* Moreover, it serves no purpose that the assessee, which is a non-scheduled bank, should include the NPAs/sticky loans in the relevant assessment year and then claim it as a bad debt in the next assessment year. There is no quarrel with the preposition of law settled by the judgments relied upon by the learned counsel for the appellant, but in view of the decision given by the Hon'ble Supreme Court in ***Allied Motors'*** case *supra*, we are of the opinion that the view taken by the Tribunal that the assessee was required to tax the interest on the sticky loans/NPAs on receipt basis, is liable to be upheld.

22. Accordingly the appeals are dismissed. The substantial questions of law stand answered accordingly.

(Sabina)
Judge

(Sushil Kukreja)
Judge

December 07, 2022 (ps)