IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH : H : NEW DELHI

BEFORE SHRI I.P. BANSAL, JUDICIAL MEMBER
AND
SHRI SHAMIM YAHYA, ACCOUNTANT MEMBER

ITA No. 2337/Del/2008
Assessment Year : 2005-06

Dy. Commissioner of Income Tax, Circle 4 (1), New Delhi.	Vs.	M/s Umang Dairies Ltd. (formerly JK Dairy & Foods Ltd.), 3rd Floor, Gulab Bhawan, 6A, BSZ Marg, New Delhi. PAN : AAACJ1322R
(Appellant)		(Respondent)

Assessee by : Shri Pramod Jain, CA
Revenue by : Shri N.K. Chand, Sr. DR

ORDER

PER I.P. BANSAL, JUDICIAL MEMBER:

This is an appeal filed by the revenue. It is directed against the order of the CIT (A) dated 30th March, 2008 for Assessment Year 2005-06. Grounds of appeal read as under:-

1. The order of the Ld. CIT (A) is erroneous & contrary to facts & law.

2. On the facts and in the circumstances of the case, the learned CIT (A) has erred in deleting disallowance of interest of Rs.1,24,76,750/- ignoring

a) the various decisions as mentioned by AO in his assessment order & also the decision in the case of Standard Tea Exports vs. CIT (1993) 70 Taxman 201 in respect of which SLP has also been dismissed (1993) 199 ITR (st.) 78-79 (SC) laying down that no deduction could be claimed in respect of a provision made for future interest being a

contingent liability.

b) the provision of section 40(a) (ia) as assessee has not deducted tax on the provisions of interest.

3. The appellant craves leave to add, to alter, or amend any grounds of the appeal raised above at the time of the hearing.

2. Accrued interest on debentures issued by the assessee company was claimed as expenditure in the computation of income filed for the year under consideration. The details of such accrued interest are as under:-

GIC Mutual Fund	4439250
Asman Investments Ltd.	3937500
Taurus Mutual Fund	2250000
Lazard Investment Ltd.	1850000
	12476750

3. It is an admitted position that the above interest was not covered by the provisions of Section 43-B. It is the case of the Assessing Officer that as the assessee did not accounted for such interest in its books of account, the liability was not ascertained liability and was contingent liability and it was claimed to avoid tax. The second reason given by the A.O. is that such interest could not be allowed as per provisions of Section 40(a)(ia) as assessee has not deducted tax at source on such interest.

4. For the purpose of holding that the interest liability is unascertained and contingent, the A.O. has placed reliance on the following decisions:-

i) Mysore Kirloskar Ltd. Vs. CIT (1987) 166 ITR 836 (Karn.)
ii) Escorts Agents Pvt. Ltd. Vs. CIT (1971) 80 ITR 60 (Del)
iii) CIT vs. Lachmann Das Mathura Das (1980) 124 ITR 411 (All)
iv) Shree Sajjan Mills Ltd. Vs. CIT (1985) 156 ITR 585 (SC)
v) Indian Molasses Co. vs. CIT (1959) 37 ITR 66 (SC)
vi) Swan Mills Ltd. Vs. CIT (1995) 81 Taxman 39 (Bom)

vii) Rajasthan State Mines and Minerals Ltd. Vs. CIT (1994) 208 ITR 1010

5. It is in this manner the AO has disallowed the interest claim of the assessee of Rs.1,24,76,750/-.

6. During the appellate proceedings before the CIT (A), it was contended that liability was neither contingent nor unascertainable. It was submitted that as per terms of debenture issued, interest was accruing year to year, therefore, the ascertainability of the amount of interest was never in doubt and, therefore, it was not contingent. Reference was made to the Accounting Standard 29 and it was contended that the decisions relied upon by the AO had no application on the case of the assessee as in those cases the liability was unascertained and contingent. It was submitted that the assessee is following mercantile system of accounting according to which the claims which are incidental to the business are allowable on accrual basis even though they have not actually been paid. It was submitted that expenditure in the case of the assessee is allowable as per provisions of Section 36(1)(iii) of the Income Tax Act, 1961 (the Act). Reference was made to the following decisions to contend that interest has to be allowed as per provisions of Section 36(1)(iii):-

i) CIT vs. Southern Cables and Engineering Works (2007) 289 ITR 167 (Ker);
ii) CIT vs. Delhi Toambaku Udyog (P) Ltd. (2001) 247 ITR 814 (Del); and
iii) CIT vs. Woodward Governor India Pvt. Ltd. (2007) 210 CTR 354 (Del)

7. It was further submitted that provisions of Section 193 (Chapter XVII-B) read with Section 40(a) (ia) are not applicable because the entries of the interest having not been passed in the books of account and, therefore, credit or payment of the same does not arise at all. It was submitted that non-making of entries in the books of account cannot debar the assessee to claim the expenditure and, for this purpose, reliance was placed on the following decisions:-

i) Kedar Nath Jute Manufacturing Co. Ltd. Vs. CIT (1971) 82 ITR 363 (SC)

ii) DCIT vs. Uttam Steel Ltd. (2005) 2 SOT 777 (Mum)

iii) Addl. CIT vs. Buckav Wolf New India Engineering Works Ltd. (1986) 157 ITR 751 (Bom).

8. Considering these submissions, the Ld. CIT (A) has observed that the assessee is a sick company and has filed an application with BIFR. He observed that during the course of appellate proceedings copy of debenture certificates were called and, according to those copies of debenture certificates, the debentures were in the nature of secured documents on which the interest had accrued every year. Although the payment of interest has not been made by the assessee because of its financial problems, the interest is quantified as per terms and conditions of the debentures issued to the subscribers of the company. The CIT (A) has observed that there is no provision in the Income-tax Act to stipulate that such interest expenses can be allowed only upon making payment as is in the case of financial institutions and banks such interest can be disallowed u/s 43-B on the ground of non-making of payments. It is also observed by the CIT (A) that such disallowance was not made in the past and debenture certificates clearly state that liability of interest was certain and real. Therefore, the CIT (A) has held that the liability being ascertained liability was to be allowed on the basis of accrual as per mercantile system of accounting and such liability could not be carried forward to future year. He also accepted the contention of the assessee that provisions of Section 40 (a) (ia) could not be applied as the expenditure was allowable as per decision of Hon'ble Supreme Court in the case of Kedarnath Jute Manufacturing Company Ltd. and other decisions relied upon by the assessee (supra) and it is in this manner the CIT (A) has allowed the appeal filed by the assessee and deleted the disallowance against which the revenue is aggrieved, hence, in appeal.

9. After narrating the facts, it was vehemently pleaded by Ld. DR that the interest liability was computed by the assessee on estimate basis and it was

claimed only in the computation of income without carrying the same to the Profit & Loss Account. He submitted that in this manner the assessee has adopted a modus operandi to claim the expenses only through computation of income just to avoid taxes. He submitted that liability of interest was not ascertained liability and, therefore, it could not be claimed even as per mercantile system of accounting.

10. In the alternative, it was submitted that without deduction of tax such interest could not be allowed in view of specific provisions of Section 40 (a) (ia). He submitted that no such disallowance could be made in the past as the provisions of Section 40 (a) (ia) were brought on the Statute only w.e.f. the year under consideration. He submitted that there is no dispute to the fact that on such interest the tax is deductible as the same will be income taxable in the hands of recipient. He in this regard submitted that even assessee admits its liability to deduct tax from such interest u/s 193 but liability to deduct tax during the year under consideration is denied on the ground that entry regarding accrued interest is not made in the books of account in the relevant financial year. It was submitted that if the payment of interest is liable for deduction at source, then, it will come within the purview of section 40 (a) (ia) and the assessee can get the deduction of that interest only when it makes payment of TDS. He submitted that unless assessee makes the payment of TDS, it is not entitled to get deduction in that respect. Thus, it was submitted that the CIT (A) was wrong in allowing the claim of the assessee on both the grounds, namely, (i) that the liability was ascertained liability and it has to be allowed as the assessee is maintaining its account on the basis of mercantile system of accounting and; (ii) that the provisions of Section 40 (a) (ia) were not attracted. Thus, it was submitted by Ld. DR that the order of the CIT (A) on this issue should be set aside and that of the AO be restored.

11. On the other hand, it was submitted by the Ld. AR that Ld. CIT (A) has rightly observed that the liability of the assessee is ascertained liability. He submitted that a specific finding has been given by the CIT (A) that he has gone

through the terms and conditions of the debenture and from that he found that liability of interest on debenture was specific and ascertained liability. Thus, it was pleaded by Ld. AR that according to the case law relied upon by the assessee before the CIT (A), the said liability was allowable despite the fact that whether or not the entry has been made in the books of account. He submitted that law in this regard is well settled that if an ascertained liability has accrued and it can be quantified, then, according to the mercantile system of accounting, it has to be allowed irrespective of the fact that whether the payment has been made or not. Therefore, Ld. AR pleaded that order of the CIT (A) on this issue should be upheld. He submitted that Ld. CIT (A) is also right in observing that provisions of Section 40(a)(ia) are not applicable. He submitted that according to Section 193, unless entries are passed in the books of account, there is no liability either for deduction or for making payment of TDS. He submitted that the provisions of Section 40(a) (ia) refers to the word 'deductible' under Chapter XVII-B and the said term 'deductible' refers to the factual aspect when it is deductible under the provisions of Section 193 and, thus, he pleaded that the CIT (A) was right in holding that provisions of Section 40 (a) (ia) were not attracted. He submitted that order of the CIT (A) should be upheld and departmental appeal should be dismissed.

12. We have carefully considered the rival submissions in the light of the material placed before us. Clause (ia) of Section 40(a) has been introduced by the Finance (No.2) Act, 2004 w.e.f. 01.04.2005. It will be relevant to reproduce the relevant portion of Section 40 to better understand the controversy.

> ***Amounts not deductible***
>
> *40. Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession." –*
>
> *(a) in the case of any assessee –*
> *(i)……*

……

……

(ia) any interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work), on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid, -

(A) in a case where the tax was deductible and was so deducted during the last month of the previous year, on or before the due date specified in sub-section (1) of section 139; or
(B) in any other case, on or before the last day of the previous year;

***Provided** that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted –*

(A) during the last month of the previous year but paid after the said due date; or
(B) during any other month of the previous year but paid after the end of the said previous year;
such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

The proviso originally inserted with clause (ia) was as under:-

*"**Provided** that where in respect of any such sum, tax has been deducted in any subsequent year or, has been deducted in the previous year but paid in any subsequent year after the expiry of the time prescribed under sub-section (1) of section 200, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid."*

13. The above proviso was subsequently substituted by the Finance Act, 2008 with retrospective effect from 01.04.2005 and the substituted provision as applicable from assessment year 2005-06 read as under:-

***Provided** that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted—*

(A)during the last month of the previous year but paid after the said due date; or

(B)during any other month of the previous year but paid after the end of the said previous year,

such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

14. It will also be relevant to state the object behind the insertion of sub-clause (ia) stated in the Finance (No.2) Act, 2004.

Clause 11 of the Bill seeks to amend section 40 of the Income-tax Act relating to amounts not deductible.

The proposed amendment seeks to insert a new sub-clause (ia) in clause (a) of the said section so as to provide that any interest, commission or brokerage, fees for professional services or fees for technical services, payable to a resident or amount credited or paid to a contractor or sub-contractor being a resident for carrying out any work (including supply of labour for carrying out any work), on which tax has not been deducted or, after deduction, has not been paid before the expiry of the time prescribed under sub-section (1) of section 200 and in accordance with the other provisions of Chapter XVII-B shall not be allowed as deduction in computing the income chargeable under the head "Profits and gains of business or profession". It is further proposed to provide that where in respect of any such sum, tax has been deducted under Chapter XVII-B or paid in any subsequent year, such sum shall be allowed as deduction in computing the income of the previous year in which such tax has been paid. It is also proposed to define the expressions "commission or brokerage", "fees for technical services", "professional services" and "work" used in the proposed new clause (ia).

This amendment will take effect from 1st April, 2005, and will, accordingly, apply in relation to the assessment year 2005-2006 and subsequent years.

15. It will also be relevant to mention that in the Memorandum explaining the provisions relating to direct taxes in the Finance Act, the above clause has been described under the head 'Measures to plug revenue leakages' and the relevant

portion of Memorandum Explaining the Provisions Relating to Direct Taxes is reproduced below:-

> **Enforcing compliance of provisions of TDS**
>
> Under the existing provisions of sub-clause (*i*) of clause (*a*) of section 40, failure to make deduction at source from payment of interest, royalty, fees for technical services or any other sum which is payable outside India, or in India to a non-resident or to a foreign company or failure to make payment to the account of the Central Government, attracts disallowance of such payments in the hands of the payer. Deduction of such sum is, however, allowed in the computation of income if tax is deducted, or after deduction, paid in any subsequent year in computing the income of that year.
>
> **With a view to augment compliance of TDS provisions, it is proposed to extend the provisions of section 40(*a*)(*i*) to payments of interest**, commission or brokerage, fees for professional services or fees for technical services to residents, and payments to a resident contractor or sub-contractor for carrying out any work (including supply of labour for carrying out any work), on which tax has not been deducted or after deduction, has not been paid before the expiry of the time prescribed under sub-section (1) of section 200 and in accordance with the other provisions of Chapter XVII-B. **It is also proposed to provide that where in respect of payment of any sum, tax has been deducted under Chapter XVII-B or paid in any subsequent year, the sum of payment shall be allowed in computing the income of the previous year in which such tax has been paid.**
>
> The proposed amendment will take effect from 1st day of April, 2005 and will, accordingly, apply in relation to the assessment year 2005-2006 and subsequent years. [*Clause 11*]
>
> (*Emphasis ours*)

16. A combined reading given to the provisions, object and Memorandum explaining the provision will reveal that this sub-clause has been inserted in the statute to enforce the compliance of provisions of TDS. To enforce the compliance of provisions of TDS, it has been provided in the statute that no deduction of any of the expenses mentioned in the sub-clause will be allowed unless TDS is deducted and if the TDS deducted that is paid to the Government. It is also stipulated that the said expenses will be allowed in the computation of income only if the tax is deducted and after deduction the same is paid and if it is paid in subsequent year, then, it will be allowed in the subsequent year.

Therefore, the intention of the legislature is clear that the nature of expenses mentioned in sub-clause (ia) cannot be allowed unless tax deducted has been paid thereon. It is true that if a liability is ascertained and it has been quantified and it has accrued, then, according to mercantile system of accounting, the same has to be allowed as an expenditure irrespective of the fact that whether any such expenditure has been debited to Profit & Loss Account as allowability of an expenditure will not depend upon accounting treatment given by the assessee to a particular expense. If the expenses have been incurred for the purpose of business and they are allowable otherwise, the entry in the books of account, whether it is made or not is not relevant for the purpose of considering the allowability thereof. But, here, the statute has put a bar on the allowability of such expenditure and the general proposition of allowability does not override the provision of statute whereby it has been made clear that certain expenditure described in sub-clause (ia) of Section 40(a) will be allowed only when tax deductible thereon is deducted and paid.

17. Here, the contention of Ld. AR is that the word 'deductible' referred to in Section 40(a) (ia) refers to the deductibility of tax in accordance with the provisions of Section 193 as applicable to the present case. We do not find any force in such argument as the word 'deductible' referred to in Section 40(a) (ia) refer to the nature of expenditure which inter alia include interest. If such argument of Ld. AR is to be accepted, then, proviso to Section 40(a) (ia) will become redundant, which clearly states that in cases where the tax in respect of any such sum (the nature of expenditure which inter alia include interest), has been deducted in subsequent year or has been deducted during the last month of previous year, but paid after the said due date or during any other month of previous year, but paid after the end of the said previous year, such sum shall be allowed as a deduction in computing the income of previous year in which such tax has been deducted. The proviso makes it clear that unless tax is deducted on such sum and the same is paid, no deduction is permissible to be allowed. It is not disputed even by the assessee that on interest accrued on debentures the

liability of TDS is there. It is only the case of the assessee that during the year under consideration it is not liable to deduct tax at source as no entry has been made in the books of account. The provisions of Section 40(a) (ia) are applicable irrespective of the fact that whether or not any entry has been made in the books of account as interest expenses which are claimed by the assessee in the computation of income, are liable for TDS payments. Therefore, we hold that the Ld. CIT (A) was wrong in holding that without payment of TDS, the assessee was eligible to claim interest expenditure accrued on debenture. Ld. CIT (A) has wrongly held that provisions of Section 40(a)(ia) are not applicable. From the objects stated for bringing such provision on statute, Memorandum Explaining the Provisions Relating to Direct Taxes and the provision itself, it is clear that the expenditure claimed by the assessee *inter alia* including interest can be allowed only if the assessee has paid TDS thereon. Probably, the CIT (A) has not properly understood the provisions of Section 40(a)(ia). The observations of CIT (A) that in the past no such disallowance has been made also does not have any relevance as this provision has been brought on the statute only w.e.f. Assessment Year 2005-06.

18. In view of the above discussion, it is held that expenditure claimed by the assessee as interest accrued on debentures cannot be allowed to the assessee in view of specific provisions of Section 40(a) (ia). Here, it may be mentioned that Ld. AR of the assessee had contended during the course of appellate proceedings that in case it is held that assessee is not entitled to claim such expenditure during the year under consideration, then, a direction may be given for the allowability of the same in the year in which the assessee has made the payments of TDS. For this purpose, it may be mentioned that such claim of the assessee is even recognized by the provisions of Section 40 (a) (ia) and the assessee can claim the same in accordance with law in the year in which it has made the payment of TDS.

19. In the result, the appeal filed by the Department is allowed in the manner aforesaid.

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20. The order pronounced in the open court on 04.12.2009.

[SHAMIM YAHYA]	[I.P. BANSAL]
ACCOUNTANT MEMBER	JUDICIAL MEMBER

Dated, 04.12.2009.

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Copy forwarded to: -

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

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By Order,

Deputy Registrar,
ITAT, Delhi Benches