

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Judgment Reserved on: 27th August, 2012
% Judgment Pronounced on: 12th September, 2012

+ ITA 634/2009

PUNJAB AND SIND BANK Appellant
Through: Mr. Salil Kapoor, Advocate

versus

COMMISSIONER OF INCOME TAX & ANR. ... Respondent
Through: Mr. Abhishek Maratha, Advocate

+ ITA 660/2009

PUNJAB AND SIND BANK Appellant
Through: Mr. Salil Kapoor, Advocate

versus

COMMISSIONER OF INCOME TAX & ANR. ... Respondent
Through: Mr. Abhishek Maratha, Advocate

CORAM:
HON'BLE THE ACTING CHIEF JUSTICE
HON'BLE MR. JUSTICE SURESH KAIT

SURESH KAIT, J:

The appellant is a statutory banking corporation, a wholly owned Government of India undertaking. It had filed its income tax return for the assessment year 1996-97 declaring a loss of Rs.53,69,87,409/-. The assessment was completed under Section 143(3) of the Income Tax Act,

1961 (hereinafter referred to as 'the Act') vide orders dated 29th January, 1999 at a total income of Rs.13,59,89,900/-. In the process, the Assessing Officer (AO) had made various disallowances and also certain additions which included the following:

- (a) The AO disallowed the claim of Rs.36,65,55,222/- on account of depreciation on investment. The assessee had claimed deduction on account of depreciation of current (trading) investments. The depreciation to the aforesaid extent was not allowed on the ground that these 'investments' were held as 'stock in trade'.
- (b) The AO also disallowed a sum of Rs.63,34,793/- on account of amortization of premium paid on purchase of securities. This amount was claimed on the ground that these were permanent securities which were intended to be held till maturity. However, the AO was of the view that it was a notional loss and was, therefore, not allowable.
- (c) The AO also made an addition of Rs.15.61 Crores on account of reverse entry made of interest paid to sellers of securities for the period 1.4.1993 to 31.3.1994. However, thereafter order was passed under Section 154 of the Act reducing the addition on account of reverse entry by Rs.13.52 Crores giving disallowance to the extent of Rs.2.09 Crores.

The aforesaid three disallowances and additions have been maintained by the Commission of Income Tax (Appeal) as well as Income Tax Appellate Authority in the impugned order. The assessee has, therefore, filed ITA No.634/2009 challenging the orders dated 28th September, 2007 passed by the ITAT.

2. Second appeal, i.e. ITA No.660/2009 raises the identical issues which pertain to the assessment year 1997-98, only the amounts are different. In fact, the decision of the ITA is common in respect of both the appeals. This will show that the issues in both the appeals perhaps are also common and for this reason, following two common questions of law were framed vide orders dated 27th August, 2010:

“(i) Whether the Tribunal is right in not allowing the deduction on account of depreciation of investments valued at the close of the year and held as stock in trade?

(ii) Whether the Tribunal is correct in not allowing the deduction on account amortization of premium paid towards purchase of securities, shown as permanent investments, spread over the remaining period of securities, particularly when the income and interest from such securities is assessed as Business Income?

In ITA 634/2009: Additional question

(iii) Whether the Tribunal is correct in not allowing the deduction of Rs.2.09 Crores wrongly added by the A.O. when the amount debited to the Profit and Loss Account is Rs.13.52 Crores and not Rs.15.61 Crores?”

3. We have heard Mr. Salil Kapoor, advocate for the assessee and Mr.Abhishek Maratha, advocate for the revenue. We have also gone through the records and the orders of the authorities below. We now proceed to decide these questions of law.

Re Question No.1

4. In so far as this question is concerned, as already pointed out above, the assessee had claimed deduction for assessment years 1996-97 and 1997-98 on account of depreciation on 'investments'. It was submitted by the assessee that being an authorized bank, the appellant is governed by the Banking Regulation Act and the balance sheet is required to be maintained in the statutory format. The current investments are shown in the balance sheet as 'investments', whereas these are in the nature of 'stock in trade' and it is open to the applicant to value to the same at cost or market value, whichever is lower. It was the case of the assessee that depreciation on investment was denoted by net depreciation in the value of current investments of the bank. This was represented by difference between the surplus and the deficit of other approved securities as per the statement of market value or securities enclosed with return. The AO has not held that securities shown as 'investments' are not 'stock in trade'. The disallowance has been made on the ground that it is notional loss. While dealing with the case for the Assessment Year 1995-96, the Tribunal held as under:

“We have perused the aforesaid order of the Tribunal. In that year, the issue before the Tribunal was whether the assessee was entitled to claim the loss resulting on account of the valuation of securities as on the last date of accounting year on the basis of cost or market value, whichever is lower. The Tribunal decided the issue in favour of the assessee. In our view, the argument of the learned counsel has to be accepted in so much that the principle to be applied for the present dispute will be the same. In that case, the loss arising on account of depreciation on investments was allowed by the Tribunal.

In the present case, the premium paid by the assessee has been amortized over the remaining period of the securities. We see no difference between the two situations and therefore, delete the addition of Rs.1,54,31,255/-. It may be noted that the assessee is not claiming the premium in a single year but in amortizing the same over the remaining period which in our opinion is quite fair and reasonable.”

5. Therefore, the moot question is as to whether the securities are ‘investments’ or these are to be treated as ‘stock in trade’. As per the assessee, the real nature of the securities is ‘stock in trade’ and these are shown as ‘investment’ due to the format of balance sheet prescribed by the Reserve Bank of India which is mandatorily followed but that should not be a determinative factor and while deciding the issue, it is the provisions of the Act which are to be taken into consideration.

6. The submission of Mr.Kapoor, learned counsel appearing for the assessee was that ITAT was not correct in holding these securities are held as ‘investment’ and not as ‘stock in trade’. According to him, the admitted fact was that income from sale of such securities on sale or on its maturity had been assessed as “business income”. It was also pointed out that the Tribunal while deciding the issue of “broken period interest” in para 9 has clearly held that income from the securities is to be assessed as ‘business income’. These admitted facts clinchly prove that the securities were ‘stock in trade’. Reliance was placed on the judgment of the Supreme Court in the case of ***United Commercial Bank v. CIT, 240 ITR 355 (SC)*** to support this submission.

7. Learned counsel additionally pointed out that in the earlier assessment years, the revenue had accepted these securities as 'stock in trade' and the loss, if any, on account of depreciation in the value of such security is allowable loss. For this purpose, he referred to the ITAT order for the assessment year 1975-76 and 1986-87. So much so, the Committee on Dispute (COD) did not even allow the revenue to challenge these very findings recorded in respect of Assessment Year 2005-06.

8. Learned counsel also relied upon the judgment of *Commission of Income Tax v. The Nedungadi Bank Ltd.*, 264 ITR 545 (Kerala) in which the High Court, after following various judgments of the Supreme Court, held that securities held by the bank constituted their 'stock in trade' and consequently the notional loss claimed by the assessee bank on valuation of such securities at the close of the year is allowable deduction. Learned counsel also submitted that the special leave petition filed against the aforesaid decision was dismissed by the Supreme Court.

9. Learned counsel for the revenue, on the other hand, justified the decision of the ITAT on the ground that while treating these securities as 'investment' the Tribunal had followed its own decision in the preceding year, i.e. Assessment Year 1995-96 and no appeal could be filed by the bank thereagainst as COD declined the approval to the assessee.

10. He also submitted that in so far as order of the ITAT in respect of Assessment Year 1975-76 is concerned, the Tribunal had only held that change in the method of accounting to comply with the RBI directives was bona fide. Therefore, mere fact that income arising from securities held by

the assessee are being assessed as 'business income' would be of no consequence. To support this plea, reliance was placed on the judgment of the Supreme Court in the case of *Southern Technology Ltd. v. Joint Commissioner of Income Tax*, [2010] 187 Taxman 346 (SC).

11. We have considered the respective submissions of the learned counsel for the parties. From the facts noted above, it becomes clear that in the year 1975-76, the Tribunal had approved the method of accounting adopted by the assessee to comply with the RBI directives as bona fide. It is also interesting that when in the earlier assessment years, deduction was allowed treating these investments as 'stock in trade', COD had not granted permission to the revenue to file appeals whereas for the year 1995-96 when the Tribunal held these securities to be 'investment', it is the assessee bank which was denied permission by the COD to file the appeal. In the years in question, the ITAT has simply relied upon its own order in respect of Assessment Year 1995-96. In such a situation, we are of the opinion that it becomes an open question to be examined viz. the true nature of these securities, more particularly when in this year, even the COD has granted permission to the assessee to file the appeal thereby implying that the issue needs consideration.

12. In the instant case, we would like to convey that in so far as the books of account are concerned, namely, the balance sheet, the assessee was supposed to follow the mandate of the Reserve Bank of India and, therefore, that by itself would not be a ground to label the securities as 'investment'. One will have to see the real nature of these securities. In *Southern Technologies Ltd.* (supra), the assessee which was a non banking

financial corporation (NBFC) had claimed deduction of certain amount under Section 36(1)(vii) of the Act being provision for NPAs in terms of NBFC's Prudential Norms (Reserve Bank) Directions, 1998 on the ground that it had to debit the said amount to Profit and Loss Account in terms of para 9(4) of the said RBI directions reducing its profits, contending it to be write off. It was the contention of the assessee that it was bound to follow the method of accounting prescribed by the RBI and as per the method followed, provisions for NPAs actually represented depreciation in the value of assets and consequently, it was deductible under Section 37(1) of the Act. The Supreme Court did not accept this contention holding that directions issued by the Reserve Bank deal only with the presentation of NPAs provisions in the balance sheet of NBFC and they had nothing to do with the computation or taxability of provisions under the Act and no deduction under the Act could be allowed on that basis. Thus, irrespective of the treatment given to this transaction in the balance sheet by virtue of RBI directions, one is to discern the true character of the securities.

13. Significantly, the AO has not held that security shown as 'investment' are not 'stock in trade'. The disallowance is made on the ground that it is notional loss. Case of the assessee is that Tribunal has proceeded on the presumption that depreciation is claimed on "permanent investments" whereas claim of deduction was towards depreciation on "current (trading) investments". However, as per the Revenue, under Section 6 of the Banking Regulation Act, 1949, a bank is entitled to hold securities either as 'stock in trade' or as 'investment' and there is no bar against trading by the bank. It was further argued by the Revenue that fluctuation in valuation of investments cannot be allowed as deduction for

computing business income and that the onus to establish that the said securities were held as 'stock in trade' was on the assessee which has not been discharged inasmuch as no trading account has been maintained by the assessee and value of opening and closing stock of securities etc. did not find place in income and expenditure account. The learned counsel also stressed that the admitted case of the assessee is that the balance sheet is maintained in the statutory format to meet the requirements of the Banking Regulation Act and, therefore, it was binding on the assessee.

14. In so far as ITAT is concerned, it has held the securities to be 'investment' by observing as under:

“We have heard both the parties and perused the material available on record. The issue for consideration relates to allowance of depreciation on investments kept in permanent category. These investments are held till the maturity date. Therefore, the investments are not held by the bank as stock-in-trade which should be valued as per market price or cost price. The assessee has valued the permanent investments at a lower price as per guidelines issued by RBI. The investment held not as stock in trade cannot be valued at the year end for the purposes of income tax. When the investments are sold whatever may be capital or loss will be determined as per the provisions of Income Tax Act. Hon'ble Madras High Court in the case of TN Power Financial & Infrastructure Development Corporation Ltd. v. Joint CIT 280 ITR 491 held that RBI guidelines cannot over-ride statutory provisions of Income Tax Act, 1961. Therefore, contention of assessee that assessee's cases is covered by ITAT order for assessment year 1975-76 is no longer applicable. Moreover, in assessment year 1975-76 it was held that change in the method of valuation of stock and security to comply with the directive of the Reserve Bank

of India could not be said that the change was not bonafide. The valuation of stocks and securities held as stock in trade has to be valued on market price or cost price which ever is lower. However, where stocks & securities are held as investments, the valuation cannot be made for the purposes of income tax as per RBI guidelines.”

15. The assessee has countered the aforesaid reasoning by relying upon the judgment of the Supreme Court in *United Commercial Bank* (supra), a reading whereof will show that the Court held as under:

“(1) That for valuing the stock, it is open to the assessee to value it at the cost or market value, whichever is lower;

(2) In the balance sheet, if the securities and shares are valued at cost but from that no firm conclusion can be drawn. A taxpayer is free to employ for the purpose of his trade, his own method of keeping accounts, and for that purpose, to value stock-in-trade either at cost or market price;

(3) A method of accounting adopted by the taxpayer consistently and regularly cannot be discarded by the Departmental authorities on the view that he should have adopted a different method of keeping accounts or of valuation;

(4) The concept of real income is certainly applicable in judging whether there has been income or not, but in every case, it must be applied with care and within their recognized limits;

(5) Whether the income has really accrued or arisen to the assessee must be judged in the light of the situation;

(6) Under s.145 in a case where accounts are correct and complete but the method employed is such that in the opinion of the ITO, the income cannot be properly reduced therefrom, the computation shall be made in such manner and on such basis as the ITO may determine.”

16. The matter needs to be examined from the aforesaid perspective. However, there is no determination in this manner by any of the authorities. We, thus, are of the opinion that matter needs to be remanded back to the AO to ascertain the true character of the securities on the basis of material produced to arrive at a finding as to whether this can be treated as ‘investment’ or ‘stock in trade’.

Re Question No.2

17. The assessee had claimed amortization of expense incurred in respect of premium paid by the assessee in purchase of securities. This was disallowed on the ground that the securities are held as ‘investment’ and, therefore, whenever such securities are transferred, the profit or loss arising therefrom would be computed after taking into account the cost of the acquisition. Since we have remanded the issue about nature and character of securities to the AO and the outcome of this issue would depend upon the said determination, this issue also stands remanded back to the AO.

Re Question No.3

18. Out of the total disallowance made by the AO originally on account of interest paid to sellers for the period from 1.4.1990 to 31.3.1994 was subsequently reduced to Rs.2.10 crores. The entry made by the assessee for Rs.15.61 crores as on 31.3.1996 in terms of RBI directives was reversed by

debiting provisions in contingency and crediting investments. The CIT (Appeals) confirmed the disallowance of Rs.2.10 crores on the ground that the assessee had offered for taxation an amount of Rs.13.52 crores and accordingly the same was disallowed to the above extent. In absence of any arguments by the assessee, disallowance was confirmed. The order passed by the CIT (Appeals) was further upheld on the ground that interest paid to sellers on purchase of investment was a capital expenditure which was capitalized by the assessee itself. The argument of Mr. Kapoor, learned counsel for the assessee, was that the entire order proceeded on the fact which was factually incorrect. According to him, in fact Rs.15.61 crores was debited in PLL account and not Rs.13.52 crores and the matter can be examined by the AO in this behalf. Learned counsel for the respondent, during arguments, himself suggested that this can be verified by the AO. For this reason, this issue is also remanded to the AO and the deduction shall be allowed subject to verification.

19. The appeals are disposed of in the aforesaid terms with no order as to costs.

**SURESH KAIT
(JUDGE)**

ACTING CHIEF JUSTICE

SEPTEMBER 12, 2012
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