Bombay High Court American Express International ... vs Cit on 25 September, 2002 Equivalent citations: (2002) 177 CTR Bom 442 Author: S Kapadia JUDGMENT S.H. Kapadia, J. The above three references are made by Tribunal, Bombay, under section 256(1) of the Income Tax Act, 1961 (hereinafter, for the sake of brevity, referred to as "the Act"). Since they raise common question of law and facts, they are disposed of by this common judgment. 2. For the sake of convenience, we are relying upon the facts in Income Tax Reference No. 346 of 1987. 2. For the sake of convenience, we are relying upon the facts in Income Tax Reference No. 346 of 1987. 3. The basic question referred to us by the Tribunal reads as follows : 3. The basic question referred to us by the Tribunal reads as follows : "Whether, on the facts and circumstances of the case, the assessee was entitled to deduct net interest paid by the assessee for the broken period to persons from whom the assessee bought Dated Government Securities while computing the assessee's business income?" This question is quoted from Income Tax Reference No. 173 of. 1983 as it involves the principal controversy in this case. This judgment deals with the scope of section 18 and section 28 of the Income Tax Act 1961. Preface : Meaning of broken period interest AssesseeAmerican Express International Banking Corporation is a nonresident banking company. In Income Tax Reference No. 346 of 1987, we are concerned with assessment year 1977-78 (accounting year ending 31-12-1976), whereas in Income Tax Reference No. 173 of 1983, we are concerned with assessment year 1974-75 and in Income Tax Reference No. 75 of 1986, we are concerned with assessment years 1975-76 and 1976-77. AssesseeAmerican Express International Banking Corporation is a nonresident banking company. In Income Tax Reference No. 346 of 1987, we are concerned with assessment year 1977-78 (accounting year ending 31-12-1976), whereas in Income Tax Reference No. 173 of 1983, we are concerned with assessment year 1974-75 and in Income Tax Reference No. 75 of 1986, we are concerned with assessment years 1975-76 and 1976-77. Before coming to the facts of the case, a short preface needs to be mentioned. This preface explains the concept of broken period interest. Every bank is required to maintain Statutory Liquidity Ratio (hereinafter referred to as "SLR"). For that purpose, every bank subscribes to Government securities. One such security is known as (hereinafter referred to as the SGL). This ledger is maintained in Public Debt Office in Reserve Bank of India. Every bank is required, as a part of banking business, to subscribe to this loan. This Loan/SGL is also transferable like any other security. In this case, for example, we are concerned with 4.75 per cent Government of India Loan, 1980, f.v. Rs. 5 lakhs. On the SGL, RBI pays half yearly interest. In the case of the said 4.75 per cent Government of India Loan, 1980, f.v. Rs. 5 lakhs, RBI was required to pay halfyearly interest on 12-5-1976, and 12-11-1976. RBI pays interest on due dates on such securities to the holders of the securities, every six months. RBI pays interest on the balance to banks, whose name appear as holders in the PDO Ledger. After subscribing to the said loans, banks were free to transfer such Loans for consideration to other banks. Consequently, RBI pays interest to the holder on the balances in a security if, in its books, the said security stood in the name of that holder on the due date for payment of interest. As stated above,

to maintain SLR levels, every bank subscribes to such loans. This is a part of banking business. However, after so subscribing, banks are free to deal in such securities like any other trader. Therefore, there are two activities involved-one activity is that of subscribing to the Loan and the other is trading. Now, if a bank purchased 4.75 per cent GOI Loan, 1980, f.v. Rs. 5 lakhs on 11-8-1976, then, on purchase, the said bank was required to lodge the transfer form with the PDO. On such lodgement, the name of the bank was entered into in PDO Ledger. Therefore, on the next due date for payment of interest, namely, 12-11-1976, the bank was entitled to receive half-yearly interest from RBI for the period 12-5-1976, upto 12-11-1976 even though it had bought the said security on 11-8-1976. Therefore, it receives interest for the entire six months, though it bought the security on 11-8-1976. In the above example, since the security was sold/transferred on 11-8-1976 (i.e. after due date for payment of interest), interest had accrued to the transferor/seller from the last due date i.e. 12-5-1976, upto 11-8-1976. Before concluding this preface, it may be pointed out that one of us (Kapadia, J.) is presiding in the special court set up under the special court (Trial of Offences Relating to Transactions in Securities) Act, 1992. That, in several cases before the special court, operation, of SGL Account is in issue and the court is familiar with operation of such accounts. In this connection, it may be mentioned that there are three types of credits which find place in SGL Account in PDO viz., credit for subscription to new Loan; credit for purchase of SGI, securities vide SGL transfer forms and lastly, credit for lodgement of physicals. This aspect is important because it indicates the difference between investment and trading. Subscription to new Loans would come under investment, whereas purchase of SGI, securities by way of transfer forms would come under trading. After subscribing, the bank trades in SGL securities. This point of difference is not spelt osut and seen by the assessing officer. It needs to be clarified that SGL account-holders operate their account by using the transfer forms prescribed by RBI. Lastly, it may be mentioned that the credit balances in the PDO Ledger are maintained in the form of face value of the security; that a folio is allocated for each security in the PDO Ledger. With this preface, we have to examine the facts of this case. Facts 4. As stated above, for the sake of convenience facts in Income Tax Reference No. 346 of 1987 are mentioned here-in-below. In the said reference, we are concerned with accounting year 1-1-1976, to 31-12-1976, corresponding to assessment year 1977-78. By order dated 25-3-1980, the assessing officer computed the total income at Rs. 5,01,20,289. against returned income of Rs. 4,32,55,680. The assessee had computed the figure of net profit as per profit & loss account, making numerous adjustments. Under the impugned adjustment, payment for broken period interest paid to the seller-bank was shown as Rs. 3,06,399. In this connection, it may be mentioned that the assessee used to deal in the Dated Government Securities. The assessee had also subscribed to the Loans as and when they were floated by Government of India/State Governments. Therefore, as stated above, the assessee used to subscribe to new loans and the assessee also used to buy and sell securities. On the subscription, interest income of Rs. 1,26,92,931 accrued. That interest income was assessed under section 18 of the Income Tax Act (See page 28 of

the paper book). In this reference, there is no challenge to the computation of interest income of Rs. 1,26,92,931. under section 18. However, interest income accrued to the assessee as the assessee traded in securities and it is the adjustment in the computation of business income, that the dispute has arisen. As stated above, assessee used to pay for broken period interest whenever the assessee bought Dated Government Securities and similarly, assessee used to receive payment for broken period interest whenever they sold such securities to the counter party bank. It is the correct treatment of the receipt and payment on account of broken period interest which is in issue in this case. During the assessment year, the impugned adjustment was made by the assessee. Under the impugned adjustment, Rs. 7,13,627 (amount paid by the assessee to the sellers for purchase of broken period interest) less Rs. 4,07,288. (amount received by the assessee from the buyers on account of broken period interest) amounting to Rs. 3,06,399 was claimed as deduction as revenue expenditure under section 37. In the earlier ten (10) years, before assessment year 1977~78, such deduction was allowed. During that period the impugned adjustment was permitted. However, in view of the judgment of the High Court the case of Vijaya Bank v. CIT 1976 TLR 524 (Karn), the impugned adjustment was not permitted. Consequently, the assessing officer brought to charge, Rs. 4,07,288 as business income. However, the adjustment claimed by the assessee of Rs. 3,06,399 was disallowed. In other words, the assessing officer taxed receipt of payment of broken period interest when the security was sold by the assessee, but he disallowed the deduction for payment made by the assessee for broken period interest when the assessee bought the securities. This was done by the assessing officer as he was of the view that the judgment of the High Court in the case of Vijaya Bank (supra) was applicable. The assessing officer took the view that outlay on purchase of income bearing assets was in the nature of capital outlay and no part of such outlay could be set off for income tax purposes as expenditure against income accruing from the asset in question. Consequently, the assessing officer added back the aforestated amount of Rs. 4,07,288. being interest received by the assessee for the broken period on sale to the net profits as per profit & loss account of the assessee, but refused deduction for interest paid for the broken period on purchase of the securities. Accordingly, the assessing officer computed taxable business income for assessment year 1977-78 at Rs. 4,75,49,351. under section 28 to which he added, inter alia, taxable interest income under section 18 amounting to Rs. 1,26,92,931 (See page 28). Being aggrieved, the assessee-bank went in appeal to Commissioner (Appeals). In that appeal, the assessee succeeded. The Commissioner (Appeals) came to the conclusion firstly that, in this case, the issue related to computation of the business income of the assessee-bank under section 28. That, the assessee-bank was entitled to claim deduction for payment made by it to the seller towards broken period interest. That, it was not open to the department to treat receipt on account of broken period interest as business income and deny deduction on payment made by the assessee for broken period interest for computing the business income under section 28. The Commissioner (Appeals) also come to the conclusion that the judgment in the case of Vijaya Bank (supra) had no application to the facts of

this case. Being aggrieved, the department carried the matter in appeal to the Tribunal which has confirmed the order passed by the Commissioner (Appeals). Hence this reference. 4. As stated above, for the sake of convenience facts in Income Tax Reference No. 346 of 1987 are mentioned here-in-below. In the said reference, we are concerned with accounting year 1-1-1976, to 31-12-1976, corresponding to assessment year 1977-78. By order dated 25-3-1980, the assessing officer computed the total income at Rs. 5,01,20,289. against returned income of Rs. 4,32,55,680. The assessee had computed the figure of net profit as per profit & loss account, making numerous adjustments. Under the impugned adjustment, payment for broken period interest paid to the seller-bank was shown as Rs. 3,06,399. In this connection, it may be mentioned that the assessee used to deal in the Dated Government Securities. The assessee had also subscribed to the Loans as and when they were floated by Government of India/State Governments. Therefore, as stated above, the assessee used to subscribe to new loans and the assessee also used to buy and sell securities. On the subscription, interest income of Rs. 1,26,92,931 accrued. That interest income was assessed under section 18 of the Income Tax Act (See page 28 of the paper book). In this reference, there is no challenge to the computation of interest income of Rs. 1,26,92,931. under section 18. However, interest income accrued to the assessee as the assessee traded in securities and it is the adjustment in the computation of business income, that the dispute has arisen. As stated above, assessee used to pay for broken period interest whenever the assessee bought Dated Government Securities and similarly, assessee used to receive payment for broken period interest whenever they sold such securities to the counter party bank. It is the correct treatment of the receipt and payment on account of broken period interest which is in issue in this case. During the assessment year, the impugned adjustment was made by the assessee. Under the impugned adjustment, Rs. 7,13,627 (amount paid by the assessee to the sellers for purchase of broken period interest) less Rs. 4,07,288. (amount received by the assessee from the buyers on account of broken period interest) amounting to Rs. 3,06,399 was claimed as deduction as revenue expenditure under section 37. In the earlier ten (10) years, before assessment year 1977~78, such deduction was allowed. During that period the impugned adjustment was permitted. However, in view of the judgment of the High Court the case of Vijaya Bank v. CIT 1976 TLR 524 (Karn), the impugned adjustment was not permitted. Consequently, the assessing officer brought to charge, Rs. 4,07,288 as business income. However, the adjustment claimed by the assessee of Rs. 3,06,399 was disallowed. In other words, the assessing officer taxed receipt of payment of broken period interest when the security was sold by the assessee, but he disallowed the deduction for payment made by the assessee for broken period interest when the assessee bought the securities. This was done by the assessing officer as he was of the view that the judgment of the High Court in the case of Vijaya Bank (supra) was applicable. The assessing officer took the view that outlay on purchase of income bearing assets was in the nature of capital outlay and no part of such outlay could be set off for income tax purposes as expenditure against income accruing from the asset in question. Consequently, the assessing officer added

back the aforestated amount of Rs. 4,07,288. being interest received by the assessee for the broken period on sale to the net profits as per profit & loss account of the assessee, but refused deduction for interest paid for the broken period on purchase of the securities. Accordingly, the assessing officer computed taxable business income for assessment year 1977-78 at Rs. 4,75,49,351. under section 28 to which he added, inter alia, taxable interest income under section 18 amounting to Rs. 1,26,92,931 (See page 28). Being aggrieved, the assessee-bank went in appeal to Commissioner (Appeals). In that appeal, the assessee succeeded. The Commissioner (Appeals) came to the conclusion firstly that, in this case, the issue related to computation of the business income of the assessee-bank under section 28. That, the assessee-bank was entitled to claim deduction for payment made by it to the seller towards broken period interest. That, it was not open to the department to treat receipt on account of broken period interest as business income and deny deduction on payment made by the assessee for broken period interest for computing the business income under section 28. The Commissioner (Appeals) also come to the conclusion that the judgment in the case of Vijaya Bank (supra) had no application to the facts of this case. Being aggrieved, the department carried the matter in appeal to the Tribunal which has confirmed the order passed by the Commissioner (Appeals). Hence this reference. Arguments 5. On behalf of the revenue, Mr. R.V. Desai, learned senior counsel, contended that in the present case, Dated Government Securities were bought by the assessee-bank by paying consideration for purchase of such assets. That, the assets bought were income-bearing assets. That such assets were bought by the assessee, which laid out an amount as capital outlay for such purchase. That, no part of capital outlay can be set off as expenditure against income accruing from the asset in question. He relied upon the judgment of the Supreme Court in Vijaya Bank Ltd. v. Addl. CIT (1991) 187 ITR 541 (SC). He also relied upon the judgment of the Karnataka High Court in the case of Vijaya Bank v. CIT (supra) from which the bank had gone in appeal which was disposed of by the Supreme Court in s (1991) 187 ITR 541 (SC) (supra). Mr. Desai also placed reliance on the judgment of the Supreme Court in United Commercial Bank Ltd. v. CIT (1957) 32 ITR 688 (SC). He contended that on purchase, assessee paid a composite price. He contended that in this case, the basic issue was whether such composite price would be apportioned or bifurcated into interest accrued upto date of purchase and balance of the price. He contended that there is no provision under the Income Tax Act which supports such bifurcation. He further contended that interest income had accrued to the assessee by virtue of purchase and sale of dated Government securities. That, such interest income was assessable during the assessment year 1977-78 only under section 18. That, since such interest income came under section 18, it cannot fall under section 28. He contended that once the source of income and the class of income came under section 18, section 28 stood ruled out. In this connection, once again, Mr. Desai has placed reliance on the aforestated judgment of the Supreme Court in Vijaya Bank's case (supra). He cited numerous authorities in support of his contention that once a receipt is classified as income under one of the heads under section 14,

such income cannot fall simultaneously under any other head of income under section 14. This proposition cannot be disputed. Mr. Desai contended that long standing practice followed by the assessee cannot prevent the department from rejecting the impugned adjustments in computation of business income if it results in loss of revenue. He contended that ultimately the touchstone of this exercise is to see that the income chargeable to tax is not understated. He contended that the Tribunal erred in not following the judgment in Vijaya Bank's case (supra). 5. On behalf of the revenue, Mr. R.V. Desai, learned senior counsel, contended that in the present case, Dated Government Securities were bought by the assessee-bank by paying consideration for purchase of such assets. That, the assets bought were income-bearing assets. That such assets were bought by the assessee, which laid out an amount as capital outlay for such purchase. That, no part of capital outlay can be set off as expenditure against income accruing from the asset in question. He relied upon the judgment of the Supreme Court in Vijaya Bank Ltd. v. Addl. CIT (1991) 187 ITR 541 (SC). He also relied upon the judgment of the Karnataka High Court in the case of Vijaya Bank v. CIT (supra) from which the bank had gone in appeal which was disposed of by the Supreme Court in s (1991) 187 ITR 541 (SC) (supra). Mr. Desai also placed reliance on the judgment of the Supreme Court in United Commercial Bank Ltd. v. CIT (1957) 32 ITR 688 (SC). He contended that on purchase, assessee paid a composite price. He contended that in this case, the basic issue was whether such composite price would be apportioned or bifurcated into interest accrued upto date of purchase and balance of the price. He contended that there is no provision under the Income Tax Act which supports such bifurcation. He further contended that interest income had accrued to the assessee by virtue of purchase and sale of dated Government securities. That, such interest income was assessable during the assessment year 1977-78 only under section 18. That, since such interest income came under section 18, it cannot fall under section 28. He contended that once the source of income and the class of income came under section 18, section 28 stood ruled out. In this connection, once again, Mr. Desai has placed reliance on the aforestated judgment of the Supreme Court in Vijaya Bank's case (supra). He cited numerous authorities in support of his contention that once a receipt is classified as income under one of the heads under section 14, such income cannot fall simultaneously under any other head of income under section 14. This proposition cannot be disputed. Mr. Desai contended that long standing practice followed by the assessee cannot prevent the department from rejecting the impugned adjustments in computation of business income if it results in loss of revenue. He contended that ultimately the touchstone of this exercise is to see that the income chargeable to tax is not understated. He contended that the Tribunal erred in not following the judgment in Vijaya Bank's case (supra). On behalf of the assessee, Mr. J.D. Mistry, learned counsel, contended that the assessee's method of accounting gives a correct and accurate picture as regards interest on securities bought and sold as opposed to interest on securities received by the assessee when it subscribed to SGL floated by RBI. He contended that the principle adopted by the assessee was that when one is accounting for trading

in securities, interest income on such securities should be recorded as income for the period during which the bank was the holder of the security. He contended that in the present case, we are concerned with quantification of profits and gains arising from the business of the bank of trading in securities. He contended that profit or loss resulting from bank's business of trading in securities was assessable under section 28 as it was a trading profit/loss. That, the judgment of the Supreme Court in the case of UCO Bank (supra) had no bearing on to the facts of this case as in that matter, the department had sought to assess interest income under section 18 whereas in the present case, the department has sought to assess the interest income resulting from bank's business of trading under section 28. Therefore, he contended that the said judgment of the Supreme Court has no application to the facts of this case. He contended that the method of accounting followed by the bank has been consistently followed by all banks as held by the Tribunal. He further contended that even under section 145(1) of the Act, it was mandatory to compute income chargeable under the head "Profits & gains of business" in accordance with the method of accounting regularly employed by the assessee and that the proviso to that section applied only when income could not be deduced therefrom. He contended that in the present matter, the proviso did not apply. He further contended that the choice of method of accounting lies with the assessee; that the valid method regularly followed by the assessee cannot be rejected on the ground that a better method could be visualized. He further contended, by citing illustrations, that there was no difference in the amounts chargeable to tax, whether the assessee's view is adopted or the view of the department is adopted. He further contended that the stand of the department would lead to double taxation. He contended that when the assessee bought securities, the assessee paid for broker period interest to the sellers. That payment amounted to Rs. 7,13,627. That, similarly, when the assessee sold the securities, the assessee received payment on account of broken period interest from the buyers amounting to Rs. 4,07,288. He contended that both the above figures are for broken period interest. However, the assessing officer has treated Rs. 4,07,288 as income, but has rejected assessee's claim for deduction for payment made by the assessee towards broken period interest. In other words, receipt is treated as business income, but payment is disallowed which amounts to double taxation. Lastly, he contended that the questions raised by the department in the present reference are erroneous inasmuch as the department has accepted the correctness of the decision of the Tribunal on certain points and yet, opinion is sought on those very points from this court. He pointed out that even the learned counsel for the department who appeared before the Tribunal was not able to explain as to how receipt could be charged to tax, whereas claim for deduction for payment is disallowed, particularly when both the figures of Rs. 7,13,627 and Rs. 4,07,288 relate to broken period interest (one being payment for broken period interest and the other being receipt for the broken period interest). Mr. Mistry demonstrated the method of accounting followed by the assessee over the years by giving a concrete example relating to purchase of 4-3/4 per cent Central Loan 1980 f.v. Rs. 5 lakhs on 11-8-1976 by the assessee (redeemable, on 12-5-1980) and sold

by assessee on 6-11-1978. The due dates for interest being 12th May and 12th November. We will deal with that illustration in our reasoning. Mr. Mistry further contended that the judgment of the Supreme Court in UCO Bank's case (supra) has been explained by the subsequent judgment of the Supreme Court in the case of CIT v. Cocanada Radhaswami Bank Ltd. (1965) 57 ITR 306 (SC) in which it has been laid down that UCO Bank's case (supra) does not say that income from securities is not income from business. That, UCO Bank's case (supra) has held that under the Income Tax Act, the head of income enumerated in different clauses were mutually exclusive and each specific head related to items of-income arising from a particular source and on that reasoning, the court held that even though the securities were part of trading assets of the company doing business, the interest income had to be assessed under section 8 of the Income Tax Act 1922 (corresponding to section 18 of the Income Tax Act 1961) Findings (A) Comparison between assessee's method of accounting and Department's method of accounting. 6. The key issue which arises for determination in this case is the correct treatment of broken period interest under the Income Tax Act. According to the department's contention, broken period interest (net) paid by the assessee at the time of purchase was a part of the capital cost of the investment and, therefore, the purchase price of the securities cannot be bifurcated into interest accrued upto date of purchase and balance of the price. Consequently, according to the department, payment for broken period interest (net) cannot be claimed as revenue expenditure. On the other hand, banks have been valuing the securities/interest held by it at the end of each year and offer for taxation, the appreciation in their value by way of profits/interest earned due to efflux of time. They also claimed deduction for broken period interest payment. According to the assessee-bank, on purchase of Dated Government Security i.e. for example, in 43/4 per cent GOI 1980 f.v. Rs. 5 lakhs for a lesser amount of Rs. 4,92,000, the difference of Rs. 8,000 represents profits, whereas according to the department, as argued before the court, the difference of Rs. 8,000 represents interest on securities. Consequently, according to the department the said difference must be charged to tax under section 18, whereas according to the assessee, the difference should be charged under section 28 of the Income Tax Act. In fact, in this very case, one of the items of debate before the assessing officer was treasury bills. According to the assessee, the discount relating to the treasury bills was to be considered as income from "interest on securities". It was argued that treasury bills are securities under Public Debt Act and, therefore, the discount earned represented interest on securities. This argument was rejected by the assessing officer. It was held by the assessing officer that the difference between the purchase price (discount value) and the sale price (maturity value) represented business profits and not interest on securities and, therefore, the difference was included in the business income of the assessee. The point which we would like to make in this case at the very outset is whether the difference is interest on securities or business income will depend on the facts of each case. In this case, the assessee-bank maintained a method of accounting under which they have accounted for this difference as business income. As held by the Commissioner (Appeals) and the Tribunal,

the department has also treated this difference as business income. However, under the impugned adjustment in the method of accounting of the assessee-bank, the assessee claimed deduction for broken period interest payments (net) at the time of purchase which was disallowed. The assessee sought deduction for broken period interest payment (net) on the ground that it constituted revenue expenditure; that it constituted expenditure to earn business income by way of six-monthly interest, which RBI paid to holders of Government Loans. This, argument was rejected by the assessing officer. It is argued by the department that broken period interest payment (net) was towards capital cost of the investment and consequently, profit on sale of a security should be taxed in the accounting year corresponding to the assessment year when the security is sold/redeemed. However, while disallowing deduction for broken period interest payment, the department has taxed broken period interest receipt in the hands of the assessee-bank when the security was sold. This anomaly is not answered till today by the department. Even before the Tribunal, the learned senior counsel who appeared before the department could not explain as to on what basis broken period interest payment was disallowed while broken period interest receipt was taxed. According to the department, the difference referred to above represented interest on securities. That, such difference came under section 18 of the Income Tax Act. This was the point which was argued orally before the court. This argument is contrary to what is on record. On record, and as held by the Tribunal, the department has assessed the assessee, not under section 18 as in the case of Vijaya Bank v. CIT (supra) but the assessee's income is brought to tax under section 28 of the Act. Therefore, on facts, this case does not fall in line with Vijaya Bank's case. 6. The key issue which arises for determination in this case is the correct treatment of broken period interest under the Income Tax Act. According to the department's contention, broken period interest (net) paid by the assessee at the time of purchase was a part of the capital cost of the investment and, therefore, the purchase price of the securities cannot be bifurcated into interest accrued upto date of purchase and balance of the price. Consequently, according to the department, payment for broken period interest (net) cannot be claimed as revenue expenditure. On the other hand, banks have been valuing the securities/interest held by it at the end of each year and offer for taxation, the appreciation in their value by way of profits/interest earned due to efflux of time. They also claimed deduction for broken period interest payment. According to the assessee-bank, on purchase of Dated Government Security i.e. for example, in 43/4 per cent GOI 1980 f.v. Rs. 5 lakhs for a lesser amount of Rs. 4,92,000, the difference of Rs. 8,000 represents profits, whereas according to the department, as argued before the court, the difference of Rs. 8,000 represents interest on securities. Consequently, according to the department the said difference must be charged to tax under section 18, whereas according to the assessee, the difference should be charged under section 28 of the Income Tax Act. In fact, in this very case, one of the items of debate before the assessing officer was treasury bills. According to the assessee, the discount relating to the treasury bills was to be considered as income from "interest on securities". It was argued that treasury bills are securities under

Public Debt Act and, therefore, the discount earned represented interest on securities. This argument was rejected by the assessing officer. It was held by the assessing officer that the difference between the purchase price (discount value) and the sale price (maturity value) represented business profits and not interest on securities and, therefore, the difference was included in the business income of the assessee. The point which we would like to make in this case at the very outset is whether the difference is interest on securities or business income will depend on the facts of each case. In this case, the assessee-bank maintained a method of accounting under which they have accounted for this difference as business income. As held by the Commissioner (Appeals) and the Tribunal, the department has also treated this difference as business income. However, under the impugned adjustment in the method of accounting of the assessee-bank, the assessee claimed deduction for broken period interest payments (net) at the time of purchase which was disallowed. The assessee sought deduction for broken period interest payment (net) on the ground that it constituted revenue expenditure; that it constituted expenditure to earn business income by way of six-monthly interest, which RBI paid to holders of Government Loans. This, argument was rejected by the assessing officer. It is argued by the department that broken period interest payment (net) was towards capital cost of the investment and consequently, profit on sale of a security should be taxed in the accounting year corresponding to the assessment year when the security is sold/redeemed. However, while disallowing deduction for broken period interest payment, the department has taxed broken period interest receipt in the hands of the assessee-bank when the security was sold. This anomaly is not answered till today by the department. Even before the Tribunal, the learned senior counsel who appeared before the department could not explain as to on what basis broken period interest payment was disallowed while broken period interest receipt was taxed. According to the department, the difference referred to above represented interest on securities. That, such difference came under section 18 of the Income Tax Act. This was the point which was argued orally before the court. This argument is contrary to what is on record. On record, and as held by the Tribunal, the department has assessed the assessee, not under section 18 as in the case of Vijaya Bank v. CIT (supra) but the assessee's income is brought to tax under section 28 of the Act. Therefore, on facts, this case does not fall in line with Vijaya Bank's case. 7. In the present case, the assessing officer computed the total income of the assessee at Rs. 5,01,20,289 against revised return of Rs. 4,03,55,680. One of the disputes which arose before Commissioner (Appeals) was whether the assessing officer was right in ignoring the impugned adjustment. Under the impugned adjustment, the assessee deducted broken period interest received, amounting to Rs. 4,07,288 from Rs. 7,13,627. Consequently, the net figure of Rs. 3,06,399 was claimed as deduction. This figure of Rs. 3,06,399, was broken period interest payment (net) paid at the time of purchase by the assessee. This was the impugned adjustment which has been ruled out by the assessing officer. However, at the same time, the assessing officer has taxed broken period interest received amounting to Rs. 4,07,288 as business income. It is this conflict which has led to the dispute. However, the

bottom-line yardstick which is required to be applied to the facts of this case would be whether the method of accounting followed by the assessee-bank does not disclose true and proper income. For that purpose as stated hereinabove, the basic point which needs to be decided is that when a security which is to mature at a later date is purchased for an amount lesser than the amount receivable on maturity then whether the difference is to be accounted for as interest on securities under section 18 or whether it would fall under section 28 of the Income Tax Act. According to the department, this difference came under section 18 and, therefore, the assessee-bank was not entitled to claim deduction for broken period interest payment. 7. In the present case, the assessing officer computed the total income of the assessee at Rs. 5,01,20,289 against revised return of Rs. 4,03,55,680. One of the disputes which arose before Commissioner (Appeals) was whether the assessing officer was right in ignoring the impugned adjustment. Under the impugned adjustment, the assessee deducted broken period interest received, amounting to Rs. 4,07,288 from Rs. 7,13,627. Consequently, the net figure of Rs. 3,06,399 was claimed as deduction. This figure of Rs. 3,06,399, was broken period interest payment (net) paid at the time of purchase by the assessee. This was the impugned adjustment which has been ruled out by the assessing officer. However, at the same time, the assessing officer has taxed broken period interest received amounting to Rs. 4,07,288 as business income. It is this conflict which has led to the dispute. However, the bottom-line yardstick which is required to be applied to the facts of this case would be whether the method of accounting followed by the assessee-bank does not disclose true and proper income. For that purpose as stated hereinabove, the basic point which needs to be decided is that when a security which is to mature at a later date is purchased for an amount lesser than the amount receivable on maturity then whether the difference is to be accounted for as interest on securities under section 18 or whether it would fall under section 28 of the Income Tax Act. According to the department, this difference came under section 18 and, therefore, the assessee-bank was not entitled to claim deduction for broken period interest payment. 8. Before we go into the question of law, we have to go to the facts. At this stage we may mention that the assessee-bank like all other banks, has been subscribing to Dated Government Securities and they have also been dealing in such securities. We are concerned with the latter aspect in this case. For the sake of clarity, we may mention that about 200 transactions were entered into during the assessment year 1977-78 and the figures involved run into lakhs and, therefore, for the sake of clarity, and for better understanding of the matter, we have focussed our attention on one transaction out of 200. This procedure was also followed by the lower authorities. 8. Before we go into the question of law, we have to go to the facts. At this stage we may mention that the assessee-bank like all other banks, has been subscribing to Dated Government Securities and they have also been dealing in such securities. We are concerned with the latter aspect in this case. For the sake of clarity, we may mention that about 200 transactions were entered into during the assessment year 1977-78 and the figures involved run into lakhs and, therefore, for the sake of clarity, and for better understanding of the matter, we have focussed our

attention on one transaction out of 200. This procedure was also followed by the lower authorities. 9. On 11-8-1976, 4-3/4 per cent GOI 1980 f.v. Rs. 5 lakhs was purchased for Rs. 4,92,000. That security was sold on 6-11-1978. The half-yearly interest was payable on 12th May and 12th November each year. 9. On 11-8-1976, 4-3/4 per cent GOI 1980 f.v. Rs. 5 lakhs was purchased for Rs. 4,92,000. That security was sold on 6-11-1978. The half-yearly interest was payable on 12th May and 12th November each year. The bank became the holder of the security on 11-8-1976, and it received interest on 12-11-1976, of Rs. 11,875 from RBI. The bank's year ending was 31-12-1976. At the time of purchase, the assessee-bank also paid for broken period interest of Rs. 5,871.63 to the transferor/seller. This amount was debited to interest Receivable Account (See page 117). On. 31-8-1976, the Interest Receivable Account was debited and the Interest Income Account was credited by Rs. 1,319.44 (being the interest from 11-8-1976, upto 31-8-1976). Similarly, on 30-9-1976, Rs. 1,979.17 was credited to Interest Income Account. Same method is followed for crediting interest income Account as on 31-10-1976, 12-11-1976, and 31-12-1976. Therefore, for 142 days, the interest which was credited to Interest Income Account came to Rs. 9,236.12, which was offered for tax. Similarly, on the above methodology, the interest which was credited to Interest Income Account for the calendar year 1977 and which is offered for tax is Rs. 23,750 (See Page 118 of the paper book.) Similarly, coming to the third year i.e. 1978, the Interest Income Account was credited by Rs. 20,122.52. Therefore, under the above method of accounting, at the close of every month, the assessee has credited Interest Income Account by Rs. 1,979.17. This figure of Rs. 1,979.17 represents interest at 4-3/4 per cent on Rs. 5 lakhs. To sum up, the income returned for the above security was Rs. 9,236.12 for 142 days in the year 1976; Rs. 23,750 for the calendar year 1977 and Rs. 20,121.52 for 309 days between 1-1-1978, to 6-11-1978. This calculation was made on the basis of the principle that when one is accounting for trading in securities, interest income on such securities should be recorded as income for the period during which the bank was the holder of the securities. As against this method of calculation, the department submitted that for 142 days of 1976, the assessee should have returned income of Rs. 11,875 and not Rs. 9,236 as the assessee had received half-yearly interest of Rs. 11,875 on 12-11-1976, from RBI. For the calendar year 1977, the income returned under the bank's method of accounting was Rs. 23,750. This is accepted by the department. For the third year 1978, the assessee has returned income under the above calculations of Rs. 20,122, whereas according to the principle applied by the department, it should have been Rs. 11,875. However, surprisingly, the assessing officer has accepted the figure of Rs. 20,122 without giving-any reason, the only reason being that under the above calculation, the assessee-bank has declared the higher figure of Rs. 20,122. The point which the court needs to clarify at this stage is that if one takes an overall view of the matter, there is no loss of revenue suffered by the department (See Annexure-I to judgment). The record shows that even counsel for the department has not been able to point out loss of revenue under the method followed by the bank. One reason for the difference in the two methods adopted by the parties is because broken period interest received is treated as

trading receipt, whereas broken period interest payment is disallowed as revenue expenditure. The above method is followed by the assessee in so far as interest on securities traded is concerned. Under the above method, the assessee has also accounted for Rs. 5,871.53, which the assessee paid for broken period interest and they have also accounted for Rs. 11,479.17, which is taxed, being the amount which the assessee received for broken period interest on 6-11-1978, when the above security was sold by the assessee. The department has taxed broken period interest received of Rs. 11,479.17 as business income. But, they have denied deduction for Rs. 5,871.53 for payment made for broken period interest at the time of purchase of the security. This point is very important. It distinguishes the facts of this case from that of Vijaya Bank's case (supra). In the present case, as held by the Tribunal, the department has proceeded to compute the entire income under section 28. In this case, the department has sought to tax the broken period interest received under the head "Business" and not under the head "Interest on Securities", whereas in the case of Vijaya Bank, the facts show that the department sought to assess the interest income under section 18 i.e. under the head "Interest on Securities." Once the department seeks to assess broken period interest under the head "Business", then the department could not have rejected the impugned adjustment in the method of accounting adopted by the bank unless the department was in a position to prove that the method adopted by the bank did not disclose the true and proper income. Now, when the assessee bought 4-3/4 per cent GOI 1980, the purchase price was Rs. 4,92,000 and the interest on purchase was Rs. 5,871.53, which was debited to Interest Receivable Account. However, the security was purchased for Rs. 4,92,000, which was debited to asset account. The face value of the security receivable on redemption was Rs. 5 lakhs. The date of purchase was 11-8-1976. The date of redemption was 12-5-1980, and the date of sale was 6-11-1978. As stated above, the difference was Rs. 8,000 between the face value and the amount paid for the security. This difference of Rs. 8,000 has been accounted for by the bank on a monthly basis, which is as follows : Rs. 20-8-1976 (See per para 114 & 115) 118.43 For the period September 1976 to April 1980 @ Rs. 177.65 is credited as profit on Revaluation Account 7,816.60 For May 1980 (for 12 days to redemption) is accounted for 64.97 If one totals up Rs. 118.43, Rs. 7,816,60 and Rs. 64.97, then the resultant figure is Rs. 8,000. Accordingly, the difference of Rs. 8,000 is accounted for in the profit on revaluation asccount. The amount, by which value of the security has been increased, has been offered for tax on accrual basis in the appropriate assessment years during which the assessee held the security i.e. for the year ending 31-12-1976, Rs. 829.03; for the year ending 31-12-1977, Rs. 2,131.80; and for the year ending 31-12-1978, Rs. 1,806. Now, according to the department, profit on sale of security comes to Rs. 9,857,64 during the assessment year 1977-78. This is calculated on the basis that broken period interest payment was towards the capital cost of the investment. On that basis, according to the department, profit on sale of security, which ought to be taxed, was Rs. 9,857.64 (See para 119 of the paper book). There is no difference in the amount in tax, whether one adopts the assessee's method or the department's method as the following would show. Under the assessee's

method of accounting, what is offered to tax is as follows : Rs. Revaluation of security for the year ending 31-12-1976 829.03 Revaluation of security for the year ending 31-12-1977 2,131.80 Revaluation of security for the year ending 31-12-1978 1,806.11 Loss on sale of security (p. 115) (516.94) Interest for broken period received at the time of sale (p. 118) 11.479.17 Interest for broken period paid at the time of purchase (p. 117) (5,871.53) 9,857.64 Therefore, under either method, the same amount is offered for tax. The department has not been able to show in this case as to why the method adopted by the assessee-bank ought to be rejected. On the other hand, the department has not been able to explain as to why broken period interest received should be taxed whereas broken period interest payment should be disallowed. In the circumstances, we uphold the order of the Tribunal. (B) Whether broken period interest payment by the assessee was allowable as revenue expenditure under the head "Business". 10. The assessee-bank, like several other banks, were consistently following the practice of valuing the securities/interest held by it at the end of each year and offer for taxation, the appreciation in their value by way of profit/interest earned due to efflux of time. The bank also claimed deduction for broken period interest payments. However, the department did not accept the assessee's method in the assessment year in question in view of the judgment of the Karnataka High Court in the case of CIT v. Vijaya Bank (supra). This judgment has been subsequently upheld by the Supreme Court in (1991) 187 ITR 541 (SC) (supra). In view of the judgment of the Karnataka High Court, the department took the view that broken period interest payment cannot be allowed as a deduction because it came within the ambit of interest on securities under section 18 of the Income Tax Act. It is the contention of the department that the assessee-bank received interest on dated Government securities from RBI on half-yearly basis. That, the assessee-bank also traded in such securities. That the assessee-bank bought dated Government Securities during the intervening period between two due dates. That, on purchase of the dated Government security, the assessee became the holder of the security and accordingly, the assessee received half-yearly interest on the due dates from RBI on purchase. Therefore, according to the department, the income which the assessee-bank received came under section 18 of the Income Tax Act interest on securities. Under the circumstances, it was not open to the assessee bank to claim deduction for broken period interest payment made to the selling/transferor bank. That, it was not open to the assessee to claim deduction as revenue expenditure for broken period interest payment as, no such deduction was permissible under sections 19 and 20 of the Income Tax Act. That, it was not a sum expended by the assessee for realising interest under section 19 and, therefore, the assessee was not entitled to claim deduction for broken period interest payment as a revenue expenditure under section 28 of the Income Tax Act. In this connection, the department followed the judgment of the Karnataka High Court in Vijaya Bank's case (supra). Therefore, the point which we are required to consider in this case is : Whether the judgment of the Karnataka High Court in Vijaya Bank's case was applicable to the facts of the present case. 10. The assessee-bank, like several other banks, were consistently following the practice of valuing the securities/interest held by it

at the end of each year and offer for taxation, the appreciation in their value by way of profit/interest earned due to efflux of time. The bank also claimed deduction for broken period interest payments. However, the department did not accept the assessee's method in the assessment year in question in view of the judgment of the Karnataka High Court in the case of CIT v. Vijaya Bank (supra). This judgment has been subsequently upheld by the Supreme Court in (1991) 187 ITR 541 (SC) (supra). In view of the judgment of the Karnataka High Court, the department took the view that broken period interest payment cannot be allowed as a deduction because it came within the ambit of interest on securities under section 18 of the Income Tax Act. It is the contention of the department that the assessee-bank received interest on dated Government securities from RBI on half-yearly basis. That, the assessee-bank also traded in such securities. That the assessee-bank bought dated Government Securities during the intervening period between two due dates. That, on purchase of the dated Government security, the assessee became the holder of the security and accordingly, the assessee received half-yearly interest on the due dates from RBI on purchase. Therefore, according to the department, the income which the assessee-bank received came under section 18 of the Income Tax Act interest on securities. Under the circumstances, it was not open to the assessee bank to claim deduction for broken period interest payment made to the selling/transferor bank. That, it was not open to the assessee to claim deduction as revenue expenditure for broken period interest payment as, no such deduction was permissible under sections 19 and 20 of the Income Tax Act. That, it was not a sum expended by the assessee for realising interest under section 19 and, therefore, the assessee was not entitled to claim deduction for broken period interest payment as a revenue expenditure under section 28 of the Income Tax Act. In this connection, the department followed the judgment of the Karnataka High Court in Vijaya Bank's case (supra). Therefore, the point which we are required to consider in this case is : Whether the judgment of the Karnataka High Court in Vijaya Bank's case was applicable to the facts of the present case.
11. Before going further we may mention at the very outset that the security in this case was of the face value of Rs. 5 lakhs. It was bought for a lesser amount of Rs. 4,92,000. The difference was of Rs. 8,000. The assessee has revalued the security. The assessee offered the notional profit for taxation, as explained hereinabove, on accrual basis in the appropriate assessment year during which the assessee held the security. This difference could have been treated by the department as interest on securities under section 18. However, in the instant case, the department has assessed the said difference under section 28 under the head "Business" and not under the head "Interest on Securities". Having treated the difference under the head "Business", the assessing officer disallowed the broken period interest payment, which gave rise to the dispute. It was open to the department to assess the above difference under the head "Interest on Securities" under section 18. However, they chose to assess the interest under the head "Business" and, while doing so, the department taxed broken period interest received, but disallowed brokenly period interest payment. It is in this light that one has to read the judgment of the Karnataka High Court and the

Supreme Court in Vijaya Bank's case (supra). In that case, the facts were as follows. During the assessment year under consideration, Vijaya Bank entered into an agreement with Jayalakshmi Bank Ltd., whereby Vijaya Bank took over the liabilities of Jayalakshmi Bank. They also took over assets belonging to Jayalakshmi Bank. These assets consisted of two items viz., Rs. 58,568 and Rs. 11,630. The said amount of Rs. 58,568 represented interest, which accrued on securities taken over by Vijaya Bank from Jayalakshmi Bank and Rs. 11,630 was the interest which accrued upto the date of purchase of securities by the assessee-bank from the open market. These two amounts were brought to tax by the assessing officer under section 18 of the Income Tax Act. The assessee-bank claimed that these amounts were deductible under sections 19 and 20. This was on the footing that the department had brought to tax, the aforestated two amounts as interest on securities under section 18. It is in the light of these facts that one has to read the judgment in Vijaya Bank's case (supra). In the light of the above facts, it was held that outlay on purchase of income bearing asset was in the nature of capital outlay and no part of the capital outlay can be set off as expenditure against income accruing from the asset in question. In our case, the amount which the assessee received has been brought to tax under the head "Business" under section 28. The amount is not brought to tax under section 18 of the Income Tax Act. After bringing the amount to tax under the head "Business", the department taxed the broken period interest received on sale, but at the same time, disallowed broken period interest payment at the time of purchase and this led to the dispute. Having assessed the amount received by the assessee under section 28, the only limited dispute was-whether the impugned adjustments in the method of accounting adopted by the assessee-bank should be discarded. Therefore, the judgment in Vijaya Bank's case has no application to the facts of the present case. If the department had brought to tax, the amounts received by the assessee-bank under section 18, then Vijaya Bank's case was applicable. But, in the present case, the department brought to tax such amounts under section 28 right from the inception. Therefore, the Tribunal was right in coming to the conclusion that the judgment in Vijaya Bank's case (supra) did not apply to the facts of the present case. However, before us, it was argued on behalf of the revenue that in view of the judgment in Vijaya Bank's case, even if the securities were treated as part of the trading assets, the income therefrom had to be assessed under section 18 of the Act and not under section 28 of the Act as income from securities can only come within section 18 and not under section 28. We do not find any merit in this argument. Firstly, as stated-above, Vijaya Bank's case has no application to the facts of this case. Secondly, in the present case, the Tribunal has found that the securities were held as trading assets. Thirdly, it has been held by the Supreme Court in the subsequent decision in the case of CIT v. Cocanada Radhaswami Bank Ltd. (supra) that income from securities can also come under section 28 as income from business. This judgment is very important. It analyzes the judgment of the Supreme Court in UCO Bank's case (supra), which has been followed by the Supreme Court in Vijaya Bank's case. It is true that once an income falls under section 18, it cannot come under section 28. However, as laid down by the

Supreme Court in Cocanada Radhaswami Bank's case (supra), income from securities treated as trading assets can come under section 28. In the present case, the department has treated income from securities under section 28. Lastly, the facts in the case of UCO Bank (supra) also support our view in the present case. In UCO Bank's case (supra), the assessee-bank claimed a set off under section 24(2) of the Income Tax Act 1922 (section 71(1) of the present Act) against its income from interest on securities under section 8 of the 1922 Act (similar to section 18 of the present Act). It was held that UCO Bank was not entitled to such a set off as the income from interest on securities came under section 8 of the 1922 Act. Therefore, even in UCO Bank's case, the department had assessed income from interest on securities right from the inception under section 8 of the 1922 Act and, therefore, the set-off was not allowed under section 24(2) of the Act. Therefore, UCO Bank's case has also no application to the facts of the present case in which the assessee's income from interest on securities is assessed under section 28 right from inception. In fact, in UCO Bank's case, the matter was remitted back as it was contended on behalf of UCO Bank that the securities in question were a part of trading assets held by the assessee in the course of its business and the income by way of interest on such securities was assessable under section 10 of the Income Tax Act 1922 (similar to section 28 of the present Act). It is for this reason that in the subsequent judgment of the Supreme Court in the case of Cocanada Radhaswami Bank Ltd. (supra), that the Supreme Court has observed, after reading UCO Bank's case, that where securities were part of trading assets, income by way of interest on such securities could come under section 10 of the Income Tax Act, 1922. 11. Before going further we may mention at the very outset that the security in this case was of the face value of Rs. 5 lakhs. It was bought for a lesser amount of Rs. 4,92,000. The difference was of Rs. 8,000. The assessee has revalued the security. The assessee offered the notional profit for taxation, as explained hereinabove, on accrual basis in the appropriate assessment year during which the assessee held the security. This difference could have been treated by the department as interest on securities under section 18. However, in the instant case, the department has assessed the said difference under section 28 under the head "Business" and not under the head "Interest on Securities". Having treated the difference under the head "Business", the assessing officer disallowed the broken period interest payment, which gave rise to the dispute. It was open to the department to assess the above difference under the head "Interest on Securities" under section 18. However, they chose to assess the interest under the head "Business" and, while doing so, the department taxed broken period interest received, but disallowed brokenly period interest payment. It is in this light that one has to read the judgment of the Karnataka High Court and the Supreme Court in Vijaya Bank's case (supra). In that case, the facts were as follows. During the assessment year under consideration, Vijaya Bank entered into an agreement with Jayalakshmi Bank Ltd., whereby Vijaya Bank took over the liabilities of Jayalakshmi Bank. They also took over assets belonging to Jayalakshmi Bank. These assets consisted of two items viz., Rs. 58,568 and Rs. 11,630. The said amount of Rs. 58,568 represented interest, which accrued on

securities taken over by Vijaya Bank from Jayalakshmi Bank and Rs. 11,630 was the interest which accrued upto the date of purchase of securities by the assessee-bank from the open market. These two amounts were brought to tax by the assessing officer under section 18 of the Income Tax Act. The assessee-bank claimed that these amounts were deductible under sections 19 and 20. This was on the footing that the department had brought to tax, the aforestated two amounts as interest on securities under section 18. It is in the light of these facts that one has to read the judgment in Vijaya Bank's case (supra). In the light of the above facts, it was held that outlay on purchase of income bearing asset was in the nature of capital outlay and no part of the capital outlay can be set off as expenditure against income accruing from the asset in question. In our case, the amount which the assessee received has been brought to tax under the head "Business" under section 28. The amount is not brought to tax under section 18 of the Income Tax Act. After bringing the amount to tax under the head "Business", the department taxed the broken period interest received on sale, but at the same time, disallowed broken period interest payment at the time of purchase and this led to the dispute. Having assessed the amount received by the assessee under section 28, the only limited dispute was-whether the impugned adjustments in the method of accounting adopted by the assessee-bank should be discarded. Therefore, the judgment in Vijaya Bank's case has no application to the facts of the present case. If the department had brought to tax, the amounts received by the assessee-bank under section 18, then Vijaya Bank's case was applicable. But, in the present case, the department brought to tax such amounts under section 28 right from the inception. Therefore, the Tribunal was right in coming to the conclusion that the judgment in Vijaya Bank's case (supra) did not apply to the facts of the present case. However, before us, it was argued on behalf of the revenue that in view of the judgment in Vijaya Bank's case, even if the securities were treated as part of the trading assets, the income therefrom had to be assessed under section 18 of the Act and not under section 28 of the Act as income from securities can only come within section 18 and not under section 28. We do not find any merit in this argument. Firstly, as stated-above, Vijaya Bank's case has no application to the facts of this case. Secondly, in the present case, the Tribunal has found that the securities were held as trading assets. Thirdly, it has been held by the Supreme Court in the subsequent decision in the case of CIT v. Cocanada Radhaswami Bank Ltd. (supra) that income from securities can also come under section 28 as income from business. This judgment is very important. It analyzes the judgment of the Supreme Court in UCO Bank's case (supra), which has been followed by the Supreme Court in Vijaya Bank's case. It is true that once an income falls under section 18, it cannot come under section 28. However, as laid down by the Supreme Court in Cocanada Radhaswami Bank's case (supra), income from securities treated as trading assets can come under section 28. In the present case, the department has treated income from securities under section 28. Lastly, the facts in the case of UCO Bank (supra) also support our view in the present case. In UCO Bank's case (supra), the assessee-bank claimed a set off under section 24(2) of the Income Tax Act 1922 (section 71(1) of the

present Act) against its income from interest on securities under section 8 of the 1922 Act (similar to section 18 of the present Act). It was held that UCO Bank was not entitled to such a set off as the income from interest on securities came under section 8 of the 1922 Act. Therefore, even in UCO Bank's case, the department had assessed income from interest on securities right from the inception under section 8 of the 1922 Act and, therefore, the set-off was not allowed under section 24(2) of the Act. Therefore, UCO Bank's case has also no application to the facts of the present case in which the assessee's income from interest on securities is assessed under section 28 right from inception. In fact, in UCO Bank's case, the matter was remitted back as it was contended on behalf of UCO Bank that the securities in question were a part of trading assets held by the assessee in the course of its business and the income by way of interest on such securities was assessable under section 10 of the Income Tax Act 1922 (similar to section 28 of the present Act). It is for this reason that in the subsequent judgment of the Supreme Court in the case of Cocanada Radhaswami Bank Ltd. (supra), that the Supreme Court has observed, after reading UCO Bank's case, that where securities were part of trading assets, income by way of interest on such securities could come under section 10 of the Income Tax Act, 1922. 12. In the light of what we have discussed hereinabove, we find that the assessee's method of accounting does not result in loss of tax/revenue for the department. That, there was no need to interfere with the method of accounting adopted by the assessee-bank. That, the judgment in the case of Vijaya Bank (supra) had no application to the facts of the case. That, having assessed the income under section 28, the department ought to have taxed interest for broken period interest received and the department ought to have allowed deduction for broken period interest paid. 12. In the light of what we have discussed hereinabove, we find that the assessee's method of accounting does not result in loss of tax/revenue for the department. That, there was no need to interfere with the method of accounting adopted by the assessee-bank. That, the judgment in the case of Vijaya Bank (supra) had no application to the facts of the case. That, having assessed the income under section 28, the department ought to have taxed interest for broken period interest received and the department ought to have allowed deduction for broken period interest paid. Conclusion 13. We now propose to answer the questions referred to us under section 256(1) of the Income Tax Act 1961. 13. We now propose to answer the questions referred to us under section 256(1) of the Income Tax Act 1961. Questions in Income Tax Ref, No. 346 of 1987 (1) Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the purchase price of securities should be bifurcated into (i) interest. accrued upto date of purchase and (ii) balance of the price and that such interest should be allowed as revenue expenditure, in the year of purchase, if it is the practice of banks to charge such interest to revenue account.? On the facts of this case, there was no reason for the department to discard the impugned adjustment done by the bank in computing its business income. Therefore, on facts, our answer is in the affirmative i.e. in favour of the assessee, and against the department. (2) Whether on the facts and in the circumstances , of the case, the Tribunal was might

in law in holding that the past assessments having been made on the footing that the interests accruing on securities upto the date of purchase having been allowed as revenue expenditure, this should be continued notwithstanding that the Karnataka High Court in the case of Vijaya Bank Ltd. (supra) has held that such part of the price is not revenue expenditure and in spite of it not having been established to be the departmental practice to allow such expenditure in case of all banks? do (3) Without prejudice to the above, whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that Commissioner (Appeals) was justified in directing that the sum of Rs. 4,07,283 being interest received on the broken period of the securities sold by the assessee should not be considered as part of the chargeable income for the year of account? Does not arise in view of our answers to questions (1) & (2) hereinabove. (4) Whether on the facts and in the circumstances of the case, the assessee is not liable to be taxed in respect of the amount credited to the interest suspense account representing interest on sticky loans and advances and which is not taken to the profit & loss account for the relevant accounting year? In view of the judgment of the Supreme Court in the case of UCO Bank v. CIT (1999) 237 ITR 889 (SC), question No.4 is answered in favour of assessee and against the department. Therefore the assessee is not liable to be taxed for amounts credited to Interest Suspense Account on account of interest on sticky loans and advances and which is not taken to profit & loss account. (5) Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the restriction of deduction of expenses at 5 per cent, laid down in section 44C of the Act, was not applicable in respect of expenditure incurred upto 1-6-1976? In view of the judgment of this court in the case of Mercantile Bank Ltd. v. CIT (2002) 172 CTR (Bom) 630 : (2001) 252 ITR 225 (Bom) the question is answered in favour of the assessee and against the department, i.e., section 44C came into force from 1-6-1976 and, therefore, restriction of deduction of expenses at 5 per cent was not applicable to expenditure incurred upto 1-6-1976. (6) Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the provisions of section 40A(5) of the Income Tax Act are not applicable for disallowance of the expenses incurred by the assessee in respect of the club membership subscription fees paid in respect of the employees of the assessee-company.? In view of the judgment of this court in the case of Otis Elevator Co. (India) Ltd. v. CIT (1992) 195 ITR 682 (Bom), question No.6 is answered in the affirmative i.e. in favour of the assessee and against the department i.e., section 40A(5) is not applicable for disallowance of expenses incurred by the assessee in respect of club membership subscription fees, which is held to be business expenditure and not a perquisite. Questions in Income Tax Ref No. 75 of 1986 (1) Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that for the purposes of computing the disallowance under section 40A(5) of the Income Tax Act, 1961, rule 3 of the Income Tax Rules, 1962 cannot be invoked in the case of the applicant for determining the value of rent-free accommodation and the conveyance provided to their employees? In the affirmative i.e., in favour of the department and against the assessee in view of the judgment in CIT v.

British Bank of Middle East (2001) 251 ITR 217 (SC). (2) Whether on the facts and in the circumstances of the case, the Tribunal was right in disallowing a sum of Rs. 8,77,264 Rs. 3,57,842 being the net interest paid by the applicant for the broken period on purchase/sale of securities? In the negative, i.e., in favour of the assessee and against the department. Questions in Income Tax Reference No. 173 of 1983 (1) Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that for the purpose of computing the disallowance under section 40A(5) of the Income Tax Act 1961, rule 3 of the Income Tax Rules 1962, cannot be invoked in the case of the applicant for determining the value of rent-free accommodation? In the affirmative, i.e., in favour of department and against the assessee in view of (2001) 251 ITR 217 (SC) (supra). (2) Whether on the facts and in the circumstances of the case, the assessee was entitled to deduct the sum of Rs. 6,07,302 being the net interest paid by the assessee for the broken period to the persons from whom it brought the securities while computing its business income? In the affirmative i.e., in favour of the assessee and against the department. 14. Accordingly, all the above references are accordingly disposed of. No order as to costs. 14. Accordingly, all the above references are accordingly disposed of. No order as to costs. Annexure-I Statement showing interest received and interest offered for tax Interest received on 12-11-1976 (See para 117) 11,875.00 Interest received on 12-5-1977 (Section para 117) 11,875.00 Interest received on 12-11-1977 (See para 117) 11,875.00 Interest received on 12-5-1978 (See para 118) 11,875.00 Interest received (on sale) on 6-11-1978 (See para 118) 11,479.17 Total interest received (A) 58,97.17 Less : Interest paid (on purchase) on 11-8-1976 (See para 117) (B) (5,871.53) Total interest received (A)-(B) 53,107.64 Interest Income A/c 9,236.12 (Amount transferred to profit & loss account for the year ending 31-12-1976) (See para 118) Interest Income A/c 23,750,00 (Amount transferred to profit & loss account for the year ending 31-12-1977) (See para 118) Interest Income A/c 20,121.52 (Amount transferred to profit & loss account for the year ending 31-12-1978) (See para 118) Total of interest income transferred to profit & loss account 53,107.64 Total interest received 53,107.64 Total interest transferred to profit & loss and offered for tax 53,107.64 OPEN