Uco Bank, Calcutta vs Commissioner Of Income-Tax, West ... on 13 May, 1999

Equivalent citations: AIR 1999 SUPREME COURT 2082, 1999 (4) SCC 599, 1999 AIR SCW 1806, 1999 TAX. L. R. 587, (1999) 104 TAXMAN 547, 1999 (3) LRI 615, 1999 (6) ADSC 153, 1999 (4) SCALE 1, 1999 ADSC 6 153, (1999) 4 JT 40 (SC), 1999 (7) SRJ 77, (1999) 4 SCALE 1, (1999) 111 ELT 673, (1999) 237 ITR 889, (1999) 151 TAXATION 103, (1999) 5 SUPREME 449, (1999) 154 CURTAXREP 88, (1999) 3 CURCC 30

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Bench: Sujata V.Manohar, D.P.Mohapatra, R.C.Lahoti

PETITIONER:
UCO BANK, CALCUTTA

Vs.

RESPONDENT:
COMMISSIONER OF INCOME-TAX, WEST BENGAL

DATE OF JUDGMENT: 13/05/1999

BENCH:
Sujata V.Manohar, D.P.Mohapatra, R.C.Lahoti

JUDGMENT:

Mrs. Sujata V. Manohar, J.

Civil Appeal No.235 of 1996 Civil Appeal No.235 of 1996 pertains to the assessment of the income of the appellant, United Commercial Bank Ltd., for the assessment year 1981-82. The assessee had credited a total sum of Rs.49,15,435/- by way of interest to a suspense account since recovery of the said amount was doubtful and no recovery of the said amount or any part of it which was by way of interest on loans advanced by it, had been effected in the three previous years. The assessee excluded the said sum of Rs.49,15,435/- while computing its total income.

The Income-tax department completed the assessment for assessment year 1981-82 on 28th of February, 1985, by following the Central Board of Direct Taxes Circular No.F.201/21/84 TTA-II dated 9th of October, 1984 excluding from the total income of the assessee, the said sum of Rs.49,15,435/- while computing the total income of the assessee. The Commissioner of Income-tax

on examination of the assessment records considered the exclusion of the said sum of Rs.49,15,435/- to be erroneous and prejudicial to the interest of the revenue. By his order dated 5th of March, 1987 he included the said amount in the total income of the assessee. On appeal, the Income-tax Appellate Tribunal, by its order dated 14.10.1988, allowed the appeal of the assessee. A reference was made to the High Court at the instance of the revenue under Section 256(1) of the Income-tax Act. The following question was referred to the High Court:

> "Whether, on the facts and in the circumstances of the case, the Tribunal is justified in law in cancelling the CIT's order under section 263 of the Income-tax Act holding that when the assessment was completed, the only paper available was the Board's circular dated 9th October, 1984 and, therefore, it cannot be said that the IAC's order of assessment not taxing the interest in suspense of Rs.49,15,435/- in view of that circular was erroneous and prejudicial to the interest of revenue."

The High Court has answered the reference in favour of the revenue in view of the decision of this Court in State Bank of Travancore v. Commissioner of Income-tax, Kerala [(1986) 158 ITR 102].

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

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

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

> taken to the credit of an Interest Suspense Account and carried forward and not treated as profit until actually received."

Similarly, referring to interest on doubtful debts, Shukla and Grewal on Advanced Accounts, Ninth Edition at page 1089 state as follows:

> "Interest on doubtful debts should be debited to the loan account concerned but should not be credited to interest account. Instead, it should be credited to Interest Suspense Account. To the extent the interest is received in cash, the Interest Suspense Account should be transferred to Interest account; the remaining amount should be closed by transfer to the Loan account. This treatment accords with the principle that no item should be treated as income unless it has been received or there is a reasonable certainty that it will be realised."

(Vide State Bank of Tranvacore v. CIT [supra]) The assessee's method of accounting, therefore, transferring the doubtful debt to an interest suspense account and not treating it as profit until actually received, is in accordance with accounting practice.

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

For this same reason, and to aid proper determination of income, the Central Board of Direct Taxes had issued Circular No.41(V-6)D of 1952 dated 6th October, 1952. The circular, inter alia, stated that "interest accruing to a money lender on loans entered in the suspense account because of the extreme unlikelihood of their being recovered need not be included in the assessee's taxable income if the Income-tax Officer is satisfied that there is really little probability of the loans being repaid. It is considered desirable to extend this principle to banks which, instead of transferring the doubtful debts to a suspense account, credit the interest on such debts to that account provided the Income-tax Officer is satisfied that recovery is practically improbable." This circular was in force till 20th of June, 1978 when the Central Board of Direct Taxes issued a circular dated 20th of June, 1978 withdrawing with immediate effect the earlier circular of 6th of October, 1952. The reason for the withdrawal of the circular of 1952 is set out in the circular of 20th of June, 1978. The reason is stated thus: "the Board has been advised that where accounts are kept on mercantile basis, interest thereon is taxable irrespective of whether the interest is credited to suspense account or to interest account. The Kerala High Court has also expressed the same view in the case of State Bank of Travancore v. Commissioner of Income-tax, Kerala [110 ITR 336]. The amount of such interest is, therefore, includible in the taxable income." The withdrawal of the circular of 6th of October, 1952 which had been in force for thirty six years was on account of the decision of the Kerala High Court in State Bank of Travancore v. Commissioner of Income-tax, Kerala (Supra). The Central Board of

Direct Taxes, however, issued another circular of 9th of October, 1984 under which the Central Board of Direct Taxes decided that "interest in respect of doubtful debts credited to suspense account by the banking companies will be subjected to tax but interest charged in an account where there has been no recovery for three consecutive accounting years will not be subjected to tax in the fourth year and onwards. However, if there is any recovery in the fourth year or later the actual amount recovered only will be subjected to tax in the respective years. This procedure will apply to assessment year 1979- 80 and onwards. The Board's Instruction No.1186 dated 20.6.78 is modified to this extent." The same circular has also further clarified that upto assessment year 1978- 79 the taxability of interest on doubtful debts credited to suspense account will be decided in the light of the Board's earlier circular dated 6.10.1952 as the said circular was withdrawn only in June, 1978. The new procedure under the circular of 9th of October, 1984 will be applicable for and from the assessment year 1979-80. All pending disputes on the issue should be settled in the light of these instructions. Therefore, upto the assessment year 1978-79, the Central Board of Direct Taxes' circular of 6th October, 1952 would be applicable; while from the assessment year 1979-80, the Central Board of Direct Taxes' circular of 9th of October, 1984 is made applicable. In the present case, the assessment was made on the basis of the Central Board of Direct Taxes circular of 9th of October, 1984, since the assessment pertains to assessment year 1981-82 to which the circular of 6th October, 1984 is applicable.

What is the status of these circulars? Section 119(1) of the Income-tax Act, 1961 provides that, "The Central Board of Direct Taxes may, from time to time, issue such orders, instructions and directions to other income-tax authorities as it may deem fit for the proper administration of this Act and such authorities and all other persons employed in the execution of this Act shall observe and follow such orders, instructions and directions of the Board. Provided that no such orders, instructions or directions shall be issued (a) so as to require any income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner; or (b) so as to interfere with the discretion of the Appellate Assistant Commissioner in the exercise of his appellate functions". Under sub-section (2) of Section 119, without prejudice to the generality of the Board's power set out in sub-section (1), a specific power is given to the Board for the purpose of proper and efficient management of the work of assessment and collection of revenue to issue from time to time general or special orders in respect of any class of incomes or class of cases setting forth directions or instructions, not being prejudicial to assessees, as the guidelines, principles or procedures to be followed in the work relating to assessment. Such instructions may be by way of relaxation of any of the provisions of the sections specified there or otherwise. The Board thus has power, inter alia, to tone down the rigour of the law and ensure a fair enforcement of its provisions, by issuing circulars in exercise of its statutory powers under Section 119 of the Income-tax Act which are binding on the authorities in the administration of the Act. Under Section 119(2)(a), however, the circulars as contemplated therein cannot be adverse to the assessee. Thus, the authority which wields the power for its own advantage under the Act is given the right to forego the advantage when required to wield it in a manner it considers just by relaxing the rigour of the law or in other permissible manners as laid down in Section 119. The power is given for the purpose of just, proper and efficient management of the work of assessment and in public interest. It is a beneficial power given to the Board for proper administration of fiscal law so that undue hardship may not be caused to the assessee and the fiscal laws may be correctly applied. Hard cases which can be properly categorised

as belonging to a class, can thus be given the benefit of relaxation of law by issuing circulars binding on the taxing authorities.

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

In the case of Navnitlal C. Javeri v. K.K. Sen, Appellate Assistant Commissioner of Income-Tax, 'D' Range, Bombay (1965 (1) SCR 909), the legal effect of such circulars is, inter alia, considered by a Bench of five judges of this Court. Section 2(6A)(e) and Section 12(1B) were introduced in the Income-tax Act by the Finance Act 15 of 1955 which came into force on 1st of April, 1955. The Government, however, realised that the operation of Section 12(1B) would lead to extreme hardship because it would have covered the aggregate of all outstanding loans of past years and would impose an unreasonably high liability on the shareholders to whom the loans might have been advanced. The Minister, therefore, gave an assurance in Parliament that outstanding loans and advances which are otherwise liable to be taxed as dividends in the assessment years 1955-56 will not be subjected to tax if it is shown that they had been genuinely refunded to the respective companies before 30th of June, 1955. Accordingly, a circular was issued by the Central Board of Revenue on 10th of May, 1955 pointing out to all income tax officers that it was likely that some of the companies might have advanced loans to their shareholders as a result of genuine transactions of loans, and the idea was not to affect such transactions and not bring them within the mischief of the new provision. The officers, therefore, were asked to intimate to all the companies that if the loans were repaid before 30th of June, 1955 in a genuine manner, they would not be taken into account in determining the tax liability of the shareholders to whom they may have been advanced despite the new section. This circular was held by this court as binding on the Revenue, though limiting the operation of Section 12(1B) or excluding certain transactions from the ambit of Section 12(1B). It was so held because the circular was considered as issued for the purpose of proper administration of the provisions of Section 12(1B) and the court did not look upon this circular as being in conflict with Section 12(1B).

A similar view of CBDT circulars has been taken in the case of K.P. Varghese v. Income Tax Officer, Ernakulam and Ors. (1981 (4) SCC 173 [at page 188]), by a Bench of two judges consisting of P.N.

Bhagwati and E.S. Venkataramiah, JJ. The Bench has held that circulars of Central Board of Direct Taxes are legally binding on the Revenue and this binding character attaches to the circulars even if they be found not in accordance with the correct interpretation of the section and they depart or deviate from such construction. Citing the decision of Navnitlal C. Javeri v. K.K. Sen (Supra), this Court observed that circulars issued by the Central Board of Direct Taxes under Section 119 of the Act are binding on all officers and persons employed in the execution of the Act even if they deviate from the provisions of the Act. In Keshavji Ravji and Co. v. Commissioner of Income-Tax (1990 [183] ITR 1) a Bench of three judges of this Court has also taken the view that circulars beneficial to the assessee which tone town the rigour of the law and are issued in exercise of the statutory powers under Section 119 are binding on the authorities in the administration of the Act. The benefit of such circulars is admissible to the assessee even though the circulars might have departed from the strict tenor of the statutory provision and mitigated the rigour of the law. This Court, however, clarified that the Board cannot pre-empt a judicial interpretation of the scope and ambit of a provision of the Act. Also a circular cannot impose on the tax-payer a burden higher than what the Act itself, on a true interpretation, envisages. The task of interpretation of the laws is the exclusive domain of the courts. However, the Board has the statutory power under Section 119 to tone down the rigour of the law for the benefit of the assessee by issuing circulars to ensure a proper administration of the fiscal statute and such circulars would be binding on the authorities administering the Act.

In the case of C.B. Gautam v. Union of India and Ors. (1993 (199) ITR 530 at page 546) a Bench of five judges of this Court considered as enforceable, Instruction No.1A88 issued by the Central Board of Direct Taxes relating to the enforcement of the provisions of Chapter XX-C of the Income-tax Act. The Central Board pointed out in the said instruction that in administering the provisions of the said Chapter, it has to be ensured that no harassment is caused to bona fide and honest purchasers or sellers of immovable property and that the power of pre-emptive purchase has to be exercised by the appropriate authority only when it has good reason to believe that the property has been sold at an undervalue and there is payment of black money in the transaction. The instruction that when the property is put up for sale by the appropriate authority, the reserve price should be fixed at a minimum of 15% above the purchase price shown as the apparent consideration under the agreement between the parties, was held to be binding on the authority. The Constitution Bench in the above case also approved of the decision of this Court in K.P. Varghese v. Income Tax Officer (Supra).

There are, however, two decisions of this Court which have been strongly relied upon by the respondents in the present case. The first decision is the majority judgment in The State Bank of Travancore v. Commissioner of Income- Tax, Kerala (1986 (158) ITR 102) decided by a Bench of three Judges of this court by a majority of two to one. This judgment directly deals with interest on "sticky advances"

> which have been debited to the customer but taken to the interest suspense account by a banking company. The majority judgment has referred to the circular of 6th of October, 1952 and its withdrawal by the second circular of 20th of June, 1978. The majority appears to have proceeded on the basis that by the second circular of 20th of June, 1978 the Central Board had directed that interest in the suspense account on

> "sticky" advances should be includible in the taxable income of the assessee and all pending cases should be disposed of keeping these instructions in view. The subsequent circular of 9th of October, 1984 by which, from the assessment year 1979-80 the banking companies were given the benefit of the circular of 9th of October, 1984, does not appear to have been pointed out to the Court. What was submitted before the Court was, that since such interest had been allowed to be exempted for more than half a century, the practice had transformed itself into law and this position should not have been deviated from. Negativing this contention, the Court said that the question of how far the concept of real income enters into the question of taxability in the facts and circumstances of the case, and how far and to what extent the concept of real income should intermingle with the accrual of income, will have to be judged "in the light of the provisions of the Act, the principles of accountancy recognised and followed, and feasibility". The Court said that the earlier circulars being executive in character cannot alter the provisions of the Act. These were in the nature of concessions which could always be prospectively withdrawn. The Court also observed that the circulars cannot detract from the Act. The decision of the Constitution Bench of this Court in Navnitlal C. Javeri v. K.K. Sen (Supra), or the subsequent decision in K.P. Varghese v. Income Tax Officer (supra) also do not appear to have been pointed out to the Court. Since the later circular of 9.10.1984 was not pointed out to the Court, the Court naturally proceeded on the assumption that the benefit granted under the earlier circular was no longer available to the assessee and those circulars could not be resorted to for the purpose of overcoming the provisions of the Act. Interestingly, the concurring judgment of the second judge has not dealt with this question at all but has decided the matter on the basis of other provisions of law.

The said circulars under Section 119 of the Income- tax Act were not placed before the Court in the correct perspective because the later circular continuing certain benefits to the assessees was overlooked and the withdrawn circular was looked upon as in conflict with law. Such circulars, however, are not meant for contradicting or nullifying any provision of the statute. They are meant for ensuring proper administration of the statute, they are designed to mitigate the rigours of the application of a particular provision of the statute in certain situations by applying a beneficial interpretation to the provision in question so as to benefit the assessee and make the application of the fiscal provision, in the present case, in consonance with the concept of income and in particular, notional income as also the treatment of such notional income under accounting practice.

In the premises the majority decision in the State Bank of Travancore v. Commissioner of Income-Tax (Supra) cannot be looked upon as laying down that a circular which is properly issued under Section 119 of the Income-tax Act for proper administration of the Act and for relieving the rigour of too literal a construction of the law for the benefit of the assessee in certain situations would not be binding on the departmental authorities. This would be contrary to the ratio laid down by the Bench of five judges in Navnitlal C. Javeri v. K.K. Sen (Supra). In fact, State Bank of Travancore v. Commissioner of Income- Tax (Supra) has already been distinguished in the case of Keshavji Ravji and Co. v. Commissioner of Income-Tax (Supra) by a Bench of three judges in a

similar fashion. It is held only as laying down that a circular cannot alter the provisions of the Act. It being in the nature of a concession, could always be prospectively withdrawn. In the present case, the circulars which have been in force are meant to ensure that while assessing the income accrued by way of interest on a "sticky" loan, the notional interest which is transferred to a suspense account pertaining to doubtful loans would not be included in the income of the assessee, if for three years such interest is not actually received. The very fact that the assessee, although generally using a mercantile system of accounting, keeps such interest amounts in a suspense account and does not bring these amounts to the profit and loss account, goes to show that the assessee is following a mixed system of accounting by which such interest is included in its income only when it is actually received. Looking to the method of accounting so adopted by the assessee in such cases, the circulars which have been issued are consistent with the provisions of Section 145 and are meant to ensure that assessees of the kind specified who have to account for all such amounts of interest on doubtful loans are uniformly given the benefit under the circular and such interest amounts are not included in the income of the assessee until actually received if the conditions of the circular are satisfied. The circular of 9.10.1984 also serves another practical purpose of laying down a uniform test for the assessing authority to decide whether the interest income which is transferred to the suspense account is, in fact, arising in respect of a doubtful or "sticky" loan. This is done by providing that non-receipt of interest for the first three years will not be treated as interest on a doubtful loan. But if after three years the payment of interest is not received, from the fourth year onwards it will be treated as interest on a doubtful loan and will be added to the income only when it is actually received.

We do not see any inconsistency or contradiction between the circular so issued and Section 145 of the Income-tax Act. In fact, the circular clarifies the way in which these amounts are to be treated under the accounting practice followed by the lender. The circular, therefore, cannot be treated as contrary to Section 145 of the Income-tax Act or illegal in any form. It is meant for a uniform administration of law by all the income tax authorities in a specific situation and, therefore, validly issued under Section 119 of the Income-tax Act. As such, the circular would be binding on the Department.

The other judgment on which reliance was placed by the Department was a judgment of a Bench of two judges of this Court in Kerala Financial Corportion V. Commissioner of Income-Tax (1994 (4) SCC 375) where this Court, following the majority view in State Bank of Travancore v. Commissioner of Income-Tax (Supra) held that interest which had accrued on a "sticky" advance has to be treated as income of the assessee and taxable as such. It is said that ultimately, if the advance takes the shape of a bad debt, refund of the tax paid on the interest would become due and the same can be claimed by the assessee in accordance with law. For reasons set out above, we are not in agreement with the said judgment. The relevant circulars of C.B.D.T. cannot be ignored. The question is not whether a circular can override or detract from the provisions of the Act; the question is whether the circular seeks to mitigate the rigour of a particular section for the benefit of the assessee in certain specified circumstances. So long as such a circular is in force it would be binding on the departmental authorities in view of the provisions of Section 119 to ensure a uniform and proper administration and application of the Income-tax Act.

The appeal is, therefore, allowed and the question is answered in favour of the assessee and against the department.

Civil Appeal No. 9885-87 of 1996 and 10408 of 1996 :

> These two appeals are filed by M/s Tamil Nadu Industrial Investment Corporation Ltd. The question raised is similar to the question which we have considered in Civil Appeal No. 235 of 1996 pertaining to the United Commercial Bank Ltd. In these two appeals the relevant assessment years are 1972-73, 1973-74, 1974-75 and 1976- 77. During these assessment years the circular which was in force was the circular of 6th of October, 1952. This circular, unlike the later circular of 9.10.1984 which applies to banking companies, applies to interest accruing to a money lender on loans entered in a suspense account because of the extreme unlikelihood of their being recovered. The circular is widely worded to include within its ambit a public financial institution such as the assessee. In view of this circular which was then in force and which was binding on the assessing authorities, these two appeals also have to be allowed for reasons which we have set out in Civil Appeal No. 235 of 1996. These appeals are also, therefore, allowed and the question referred is answered in favour of the assessee and against the department.