**IN THE INCOME TAX APPELLATE TRIBUNAL**
**MUMBAI BENCHES "J", MUMBAI**

**BEFORE SHRI C.N. PRASAD (JUDICIAL MEMBER)**
AND
**SHRI ASHWANI TANEJA (ACCOUNTANT MEMBER)**

I.T.A. No.100/Mum/2015
(Assessment Year: 2009-10)

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| M/s Juniper Hotels P Ltd<br>Off Western Express Highway<br>Santacruz (E), Mumbai | vs | Addl CIT, Wd.10(1), Mumbai |
| PAN : AAECS6336E | | |
| (Appellant) | | (Respondent) |

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| Appellant by | Shri Sunil Bhandari |
| Respondent by | Ms. Arju Garodia, DR |

Date of hearing : 06-09-2016
Date of pronouncement : 21 -09-2016

**O R D E R**

**Per ASHWANI TANEJA, AM**

This is an appeal filed by the assessee against the order of Ld. CIT(A) dt 17-10-2014 passed against the assessment order u/s 143(3) dt 05-03-2013 for A.Y. 2009-10 on the following grounds:

*"Being aggrieved by the order passed by the Commissioner of Income-tax (Appeals) - 21 Mumbai (hereinafter referred to as the CIT(A)") your Appellant submits, among them following grounds for your sympathetic consideration :-*

1. *Ld. CIT(A) erred in confirming the action of the AO of not allowing the depreciation claim of Rs. 16,49,070/- in respect of capital expenditure being technical fee and other expenses, incurred*

*towards setting up of the Hotel project.*

2. *Ld. CIT(A) erred in confirming disallowance of Other Expenses u/s 14A as per Rule 8D at 0.50% of average Investments without appreciating the fact that assessee had made investments in Mutual Funds wherein NAV is calculated after deducting expenses and as such, based on 106 transactions of purchase and sale, assessee had correctly estimated administrative expenses at Rs. 50,000/-. Consequentially AO made similar addition in computation of book profits u/s 11 5JB which also deserves to be restricted to Rs. 50,000/-.*
3. *Ld. CIT(A) erred in confirming addition of Rs. 53,43,800/- being un-accrued interest on Loan extended to Appellant's wholly owned subsidiary, in the course of carrying on its business, applying the rule of consistency even though the AO had invoked provisions of section 61 for making said addition."*

**2.** **Ground 1:** In this grounds, the assessee challenges the action of Ld. CIT(A) in confirming the action of AO in not allowing the claim of depreciation of Rs.16,49,070/- in respect of capital expenditure incurred on account of technical fee and other related expenses towards setting up of the hotel project.

**3.** During the course of hearing, it was submitted at the very outset by the Ld. Counsel that this issue had come up before the Tribunal in earlier years also wherein the Tribunal had decided this issue in favour of the assessee.

**4.** Per contra, the Ld. DR did not make any distinction in facts or legal position with regard to the order of the Tribunal for earlier years.

**5.** We have gone through the orders of lower authorities. It is noted that similar issue had come up before the Tribunal in A.Ys. 2007-08 and 2008-09

wherein the Tribunal vide its order dt 22-10-2014 in ITA No.344 & 4858/Mum/2012 decided this issue as under:

> *"10. We have considered rival contentions and found that some of the expenditure incurred on construction of hotel was not approved by the projectee, therefore, same were neither paid nor booked in accounts in the year of incurring. However, in the previous year relevant to A.Y.2007-08 under consideration, a settlement was reached with the projectee, assessee company approved the same and amount was remitted after deducting required tax at source u/s.195. As the expenses were crystallized during the year itself, the assessee has capitalized the same and claimed depreciation thereon which was disallowed by the AO on the plea that expenses were related to the earlier year. As per our considered view since the expenses were crystallized only during the year under consideration, the assessee was entitled to capitalize the same and claim depreciation thereon. So far as issue of bills in the name of Seajuli Property & Viniyog Pvt. Ltd. is concerned, we find that as per Registrar of Companies's letter, the name of assessee company was later on changed to M/s Juniper Hotels Pvt. Ltd.. Accordingly, we do not find any merit in the action of the lower authorities for denial of claim of depreciation in respect of expenditure which was crystallized and paid during the year under consideration. It is also not the case of the AO that tax was not deducted at source in respect of such payments. Keeping in view the totality of the facts and circumstances of the case, we restore the matter back to the file of the AO in both the years with a direction to verify the bills of expenditure so incurred and crystallized during the year, and if the AO found after verification of bills that after deduction of tax at source u/s.195, the same has been paid during the year under consideration, he should allow assessee's claim of depreciation on such capitalized value. We direct accordingly."*

**6.** Thus, it may be noted from the above that the Tribunal decided this issue principally in favour of the assessee and held that assessee was entitled to capitalise the amount and claim depreciation thereon. But for the purpose of verification of facts, this issue was sent back to the file of the AO with the direction to verify the amount of expenditure and allowing depreciation

accordingly. Thus, this year also we send this issue back to the file of the AO with direction to follow the order of the Tribunal for the A.Ys 2007-08 & 2008-09 and accordingly allow depreciation after verification of requisite facts. With these directions, this issue is sent back to the file of the AO and may be treated as allowed, for statistical purposes.

**7. Ground 2 :** In this ground, the assessee has contested the action of lower authorities in making disallowance u/s 14A on account of administrative expenses @0.50% of average investment u/r 8D(2)(iii).

**8.** During the course of hearing it has been submitted by the Ld. Counsel that during the assessment proceedings, the assessee submitted that the assessee had made investment mostly in mutual funds wherein no active involvement of assessee's infrastructure was required. But, the AO did not record any reasons or any kind of satisfaction in arriving at a conclusion that expenses to be disallowed u/s 14A are more than what was offered by the assessee and he simply proceeded to invoke rule 8D(2)(iii) and made disallowance @0.50% without giving any reasoning, whatsoever.

**9.** Per contra, the Ld. DR submitted that admittedly, no reasoning has been given by the AO for making disallowance @0.50%, but since the rule has prescribed disallowance @0.50%, the AO has followed the law by applying the rate of 0.50%.

**10.** We have gone through the order of the AO. It is noted by us that assessee made submissions before the AO wherein it was submitted in detail that investment was made only in mutual fund and only for 7 – 8 times during the year which was an automatic process and no heavy expenses were involved and that is why assessee offered a sum of Rs.50,000 for the purpose of

disallowance out of indirect expenses. It is noted by us that the AO has not mentioned even a single line in the assessment order as to why he did not accept the disallowance offered by the assessee. He has not recorded any finding that having regard to the books of account and other material, more disallowance was required to be made. Reliance has been placed in this regard by the Ld. Counsel on the judgement of the Hon'ble Delhi High Court in the case of CIT vs I.P. Support Services India Pvt Ltd 378 ITR 240 (Del). We find the following observations of the Hon'ble High Court are worth reproducing hereunder:

*"Having heard the learned counsel for the parties, the court finds that the Assessing Officer has indeed proceeded on the erroneous premise that the invocation of section 14A is automatic and comes into operation as soon as the dividend income is claimed exempt. in Maxopp Investment Ltd. (supra) this court held:*

> *"30. Sub-section (2) of section 14A of the said Act provides the manner in which the Assessing Officer is to determine the amount of expenditure incurred in relation to income which does not form part of the total income. However, if we examine the provision carefully, we would find that the Assessing Officer is required to determine the amount of such expenditure only if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under the said Act. In other words, the requirement of the Assessing Officer embarking upon a determination of the amount of expenditure incurred in relation to exempt income would be triggered only if the Assessing Officer returns a finding that he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. Therefore, the condition precedent for the Assessing Officer entering upon a determination of the amount of the expenditure incurred in relation to exempt income is that the Assessing Officer must record that he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. Subsection (3) is nothing but an offshoot of sub-section (2) of section 14A. Sub-section (3) applies to cases where the assessee claims that no expenditure has been incurred in relation to income which does not form part of the total income under the said Act. In other words, sub-section (2) deals with cases where the assessee specifies a positive amount of expenditure in relation to income which does not form part of the total income*

*under the said Act and sub-section (3) applies to cases where the assessee asserts that no expenditure had been incurred in relation to exempt income. in both cases, the Assessing Officer, if satisfied with the correctness of the claim of the assessee in respect of such expenditure or no expenditure, as the case may be, cannot embark upon a determination of the amount of expenditure in accordance with any prescribed method, as mentioned in sub-section (2) of section 14A of the said Act. It is only if the Assessing Officer is not satisfied with the correctness of the claim of the assessee, in both cases, that the Assessing Officer gets jurisdiction to determine the amount of expenditure incurred in relation to such income which does not form part of the total income under the said Act in accordance with the prescribed method. The prescribed method being the method stipulated in rule 8D of the said Rules. While rejecting the claim of the assessee with regard to the expenditure or no expenditure, as the case may be, in relation to exempt income, the Assessing Officer would have to indicate cogent reasons for the same.*

*In **CIT v. Taikisha Engineering India Ltd. [2015] 370 ITR 338 (Delhi)**, in similar circumstances, the court disapproved of an Assessing Officer invoking section 14A read with rule 8D(2) of the Rules without recording his satisfaction and noted that the recording of satisfaction as to why "the voluntary disallowance made by the assessee was unreasonable and unsatisfactory" is a mandatory requirement of the law.*
*No substantial question of law arises. The appeal is dismissed."*

**11.** Thus, from the above observations it is clear that invocation of section 14A is not automatic. The AO is bound to record his satisfaction before proceeding to make disallowance u/s 14A for more than the voluntary disallowance made by the assessee. The AO in the case before us failed to record any reasoning whatsoever or satisfaction and thus he did not assume jurisdiction to make disallowance u/s 14A read with rule 8D(2) (iii) as per law. Under these circumstances, respectfully following the judgement of the Hon'ble Delhi High Court and keeping in view the facts of this case, we delete the disallowance made by the AO u/s 14A. This ground is allowed.

**12. Ground 3 :** In this ground, the assessee has contested the action of lower authorities in making addition of R.53,43,800/- being the amount of notional interest on the loan given by the assessee to its wholly owned subsidiary, viz.

M/s Mahima Holdings Pvt Ltd. The brief facts of the case are that the assessee had given loan to its 100% subsidiary company, M/s Mahima Holdings Pvt Ltd in the earlier years. The assessee had booked interest income from the said company in the preceding two years. But, in the year under consideration, the assessee did not book any interest income on the ground that during the year, loan was converted into equity and the said company had incurred huge losses and its net worth had been eroded and the said company was not in a position to pay any interest, therefore, there was no chance of recovery and there was uncertainty in realising income and, therefore, no provision was made on account of interest income. But, the AO did not agree with the approach of the assessee and he held that interest becomes accrued with the passage of time and, therefore, till the amount was converted into equity, the assessee was bound to charge interest from the said company and, therefore, assessee should have booked interest income in its P&L Account. Under these circumstances, the AO made addition on account of notional interest for an amount of Rs.53,43,800/-.

**13.** Being aggrieved, assessee filed appeal before the Ld. CIT(A) and made exhaustive submissions, a part of which is reproduced hereunder:-

> *"Appellant is in the business of construction and running of hotels and has set up a Five Star Hotel at Vakola in Santacruz(East), Mumbai.*
>
> *Appellant Holding Company had a vision to set up Training Institute for the Hotel Industry which could also be beneficial from the point of sourcing new employees for its Hotel business and could also use the name for training of its existing employees. Appellant, therefore, started scouting for a suitable plot of land and finally succeeded in identifying and striking the deal. Since setting up and running Training Institute for Hotel Industry is quite different from running of hotel. Appellant company formed a separate company as its 100% subsidiary and acquired the plot in the said subsidiary for which funding was done by the holding company by way of loan.*

*Loan given to Subsidiary was substantially utilized for meeting its administrative expenses and working capital. A perusal of the Financial Statements of Mahima would show that loan received from JHPL has been fully utilized in the business of Mahima and not diverted therefrom for any other business.*

*However, the process of converting the long term vision of setting up training institute in to a reality required an elaborate planning among others, in terms of infrastructure, identifying training courses which included market surveys, faculties, marketing and funding which was a long drawn process. In the meantime, since plot of land was at its disposal, it was decided to use the plot for holding functions through hotel and generate revenue. This stream of revenue of the subsidiary also ensured payment of interest on the loans given by Holding company. This continued till the FY 2007-08 It was then realized that for setting up Training Institute, substantial funds would be required through banks/financial institution. The pre condition from the banks and financial institutions was that the borrowing money should have sizeable equity. Appellant company, therefore, decided to convert its loan into equity and as of 31st march 2009, loan was converted into share application money and equity shares were then issued by Mahima during FY 2009-10. During FY 2008-09, there was only marginal increase of around 2% in the amount of loan given by JHPL to Mahima.*

*On justification being sought by AO appellant company believed that the AO is harbouring the view that part of the interest expenditure incurred by JHP calls for disallowance u/s.36(1)(iii). Appellant therefore demonstrated that funding of Mahima was out of owned funds of the JHPL and even otherwise borrowals of JHPL were fully utilized in the hotel business. It was further submitted that funds provided to Mahima have remained utilized in business assets of the company and in fact no loan is given there from to any individual or entity. Business of the subsidiary being business of the holding company, interest paid on borrowals made for the funding of subsidiary deserves to be fully allowed u/s.36(1)(iii) of the Act. For this proposition appellant also relied on the decision of the Hon'ble Apex Court in the case of S. A. builders Ltd. vs. CIT(A) Chandigarh reported in 288 ITR 1 (SC). AO obviously could not make any disallowance of interest u/s.36(i)(ii) on the facts of the case but then invoked provisions of section 61.*

*The appellant had demonstrated how the AO has erred in invoking*

*provisions of sec. 61 and extract of sec. 61, 62 and 63 was also submitted during appellate proceedings.*

*The plain reading of section 61 shows that even if one were to apply section 61 what can be taxed in the hands of transferor is "all income arising to any person by virtue of a revocable transfer of assets." Obviously what can be brought to tax is restricted to income actually arising to the and not any notional or fictitious income. Income must be real making the transferee richer immediately and not presumed income which may arise in future. From the Audited Financial Statements, it can be see that in the hands of Mahima no revenue, whatsoever, accrued during FY 2008-09 and on the debit side of the P&L A/c. it incurred administrative expenses of Rs. 10,164/- and the resultant loss of Rs. 10,164/- was carried forward.*

*The appellant had discussed the meaning of transaction of loan in detail and reliance was also placed in the case of S. A. builders Ltd. vs. CIT 288 ITR 1 (SC).*

*Section 61 is part of the scheme of Income clubbing provisions contained in Chapter V which is designed to meet the situation arising out of tendency on the part of tax payers to endeavour to avoid or reduce the tax liability. In the case of your appellant, loan was never given to transfer income to subsidiary. It also needs to be appreciated that during the succeeding Financial Year i.e. FY 2009-10 said loan as converted into equity and hence is "no more revocable even for FY 2008-09.*

*We would also like to draw your attention to the decision of the Hon'ble Supreme Court in the case of S. P. Jaiswal vs. CIT 224 ITR 619 (SC). Though facts of the decision are quite different (loan given by father to children was routed back for the benefit of father) But it is a case where clubbing provision came under the scanner of the Hon'ble Apex Court and arguments, discussions and case laws referred to in this case favour our case.*

*In view of out above submissions on facts and the law point involved, it is respectfully submitted that AO feel in grave error in invoking provisions of section 61 and consequently addition of Rs.53,43,800/- deserves to be deleted."*

**14.** Ld. CIT(A) did not find force in the submissions of the assessee and upheld the addition made by the AO with following observations:-

*"5.3 I have considered appellant's submission. The appellant had extended loan of Rs.5,04,70,700/- to a 100% subsidiary company M/s. Mahima Holding Pvt. Ltd. The appellant was charging interest of Rs.53,43,800/- till the last assessment year and this interest was offered for income-tax purposes. However, at the end of this year appellant had converted this loan into equity and not offered any income for the loan which was extended to the subsidiary company for the whole year. The A.O. had added this amount considered it u/s.61 as irrevocable transfer of assets. The A.O. considered transfer of loan into equity as irrevocable transfer of assets and added into income of the appellant. On examination of various details of the appellant and also earlier years assessment it was clear that appellant is offering this income for the income tax purposes for the loan extended to the subsidiary company. However, the loan which was converted into equity this year, at the end of the year appellant had not offered any income. Here it clearly shows that appellant's loan was with the subsidiary company throughout the year, following the rule of consistency as held in the case of CIT vs. Paul Brothers 216 ITR 548 (Born) and CIT vs. Western Outdoor Interactive 80 DTR 246 (Born). Following the above Rule as appellant had failed to offer the interest income which was offered earlier has to be treated as income and A.Os addition of Rs.53,43,800/- is confirmed."*

**15.** Being aggrieved, the assessee filed appeal before the Tribunal. During the course of hearing, it has been submitted by the Ld. Counsel, drawing our attention on the balance-sheet of the subsidiary company that the said company did not make any provision of interest payable to the assessee and its balance-sheet showing continuous losses, the income was not recoverable. Thus, a decision was taken not to credit interest income. An amount can be taxed in the hands of the assessee only if it is in the nature of income. The AO made notional addition on account of interest which was neither recoverable nor has ever been recovered. The AO disregarded the well accepted concept of

'real income' theory. He also placed reliance on Accounting Standarde-9 on revenue recognition issued by the Institute of Chartered Accountants of India.

**16.** Per contra, the Ld. DR submitted that since in the earlier two years assessee had booked interest income, therefore, in this year also, the assessee is bound to book the interest income.

**17.** We have gone through the orders passed by the lower authorities as well as the submissions and evidences placed before us. The admitted facts on record are that the interest booked in earlier years has also never been recovered by the assessee. It is further noted that the said company in its balance-sheet as on 31-03-2009 dt 28-04-2009 contained following note in the 'Notes forming part of Balance-sheet' under Schedule A:-

> *"The Holding Company M/s Juniper Hotels Private Ltd has approached Mahima Holding Private Ltd to convert outstanding unsecured loan and interest accrued thereon into equity to the extent of Rs. 5,16,00,000 ; due to Mahirna Holding Private Ltd's inability to repay the said loan and interest accrued thereon. The relevant documentation and other statutory formalities are underway and same shall be completed during 2009-10.Pending completion of these formalities, company has transferred aforesaid loan of Rs.5,16,00000/- to share application money. This money shall be adjusted against allotment of shares to Holding company on completion of formalities."*

It is further noted by us from the perusal of the P&L Account of the said company that there was no income earned during the year under consideration and expenses incurred during the year were transferred to the Balance Sheet as loss.

**18.** Thus from the above it is clear that neither the said company had made any provision of interest nor it had capacity to make payment of interest or repayment of loan to the assessee company. Under these circumstances, the assessee took a decision to **not** to book any interest income by way of just

creating an accounting entry. It is further noted that during the year under consideration, the loan was converted into share application money. Under these circumstances, we find that merely because the assessee was following mercantile system of accounting and merely because interest accrues with the passage of time, the interest income will not automatically accrue to the assessee in the given facts of the case where neither the liability of interest has been provided by the said company nor are there any chances of recovery of the interest amount in the hands of the assessee company. The income of an assessee must be computed fairly and in accordance with real life facts. The income should be computed on realistic terms and should not be based merely on theoretical ideas or notions. The assessee can be made bound to pay tax only on the amount of income that has been earned by the assessee and not upon any artificial or hypothetical income. In the peculiar facts of this case, the department cannot assess the income of the assessee by ignoring the sound principles of 'real income theory'. The taxable income of the assessee must be computed in accordance with sound judicial principles. It would be too harsh to ask the assessee to pay tax on the amount of notional interest, which the assessee is apparently not going to receive / recover. In the case of **CIT vs Neon Solutions Pvt Ltd,** order dt April 5, 2016 in ITA No.2251 of 2013 & 2300 of 2013, **Hon'ble Bombay High Court** held that interest income could not be added on notional basis by the AO where the parties had agreed not to make provision for interest. The observations of the Hon'ble High Court are relevant to the issue and, therefore, reproduced below:

> *6. "On further appeal, the Tribunal by the impugned order takes into account the fact that even in mercantile system of accounting an item would be regarded as accrued income only if there is certainty of receiving it and not when it has been waived. The*

*Tribunal has in the impugned order very succinctly set out the principles to be applied while recovering income in following the mercantile system of accounting :-*

*"(A) that merely because assessee was following mercantile system of accounting, it could not be held that income had accrued to it.*

*(B) earning of the income, whether actual or notional, has to be seen from the viewpoint of a prudent assessee. If in given facts and circumstances the assessee decides not to charge interest in order to safeguard the principal amount and ensure its recovery, it cannot be said that he has acted in a manner in which no reasonable person can act.*

*(C) The guidance note on accrual of income on accounting issued by the ICAI lays down that where the ultimate collection with reasonable certainty is lacking, the revenue recognition is to be postponed to the extent of uncertainty involved. in terms of the guidance note, it is appropriate to recognize revenue in such cases only when it becomes reasonably certain that ultimate collection will be made.*

*(D) Non-recognition of income on the ground that the income had not really accrued as the realisability of the principal outstanding itself was doubtful, is legally correct under the mercantile system of accounting, when the same is in accordance with AS-1 notified by the Government.*

*(E) It is one of the fundamental principles of accounting that, as a measure of prudence and following the principle of conservatism, the incomes are not taken into account till the point of time that there is a reasonable degree of certainty of its realization, while all anticipated losses are taken into account as soon as there is a possibility, howsoever uncertain, of such losses being incurred.*

*(F) The provisions of Section 145(1) are subject to, inter alia, mandate of AS-1 which also prescribes that Accounting policies adopted by an assessee should be such so as to represent a true and fair view of the state of affairs of the business, profession or vocation in the financial statements prepared and presented on the basis of such accounting policies. 'In the name of compliance with Section 145(1), it cannot be open to anyone to force adoption of accounting policies which result in a distorted view of the affairs of the business. Therefore, even under the mercantile method of accounting, and, on peculiar facts of instant case, the assessee was justified in following the policy of not recognizing these interest revenues till the point of time when the uncertainty to realize the revenues vanished."*

*The Tribunal further referred to the fact that the various resolutions*

*which were passed by the company as well as the communication exchanged between the parties would establish on facts that interest has been waived. Further on facts it holds that there is no reason to disbelieve the resolution passed by the Respondent-Assessee waiving interest. The Tribunal further adverted to the fact that subsequently, M/s, Marketing & Brand Solutions (I) Pvt. Ltd. had amalgamated with the Respondent-Assessee which would also establish that the debentures issuing company was in serious financial difficulties which was incidentally a group company of the Respondent. The decision rendered by the Tribunal in the impugned order is a decision on facts and nothing has been shown to us which could warrant interference by this Court on account of any finding being perverse or arbitrary."*

**19.** Further, in the case of **CIT vs Excel Industries Ltd 358 ITR 295(SC),** the revenue raised the question of taxability of benefits accruing to the said assessee on account of duty entitlement passbook benefits arising out of exports made by the assessee. According to the assessee, the amounts of benefits were excluded from its total income since it could not be said to have accrued unless imports were made and raw materials consumed. But the Assessing Officer did not accept the assessee's claim on the ground that such benefits were covered u/s 28(iv) and, therefore, along with the fulfillment of obligation of export commitment, the assessee gets the benefit of importing raw material duty free. Thus, when exports were made, the obligation of the assessee was fulfilled and the right to receive the benefit became vested and absolute, at the end of the year. However, the CIT(A) did not agree with the Assessing Officer and allowed the relief to the assessee which was confirmed by the Tribunal as well as Hon'ble High Court. The revenue carried the matter before Hon'ble Supreme Court. While answering this question in favour of the assessee and dismissing the plea of the revenue, Hon'ble Apex Court analysed law in this regard and facts of this case and held as under:

*15. "It was submitted before us by learned counsel for the Revenue that in view of the provisions of Section 28(iv) of the Act, the*

*value of the benefit obtained by the assessee is its income and is liable to tax under the head "Profits and gains of business or profession". We are unable to accept the contention of learned counsel for the Revenue for several reasons.*

*16. Section 28(iv) of the Act reads as follows:*

***"Profits and gains of business or profession***

*28. The following income shall be chargeable to income-tax under the head "Profits and gains of business or profession" –*

*……*

*(iv) the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession;*

*…….*

*17. First of all, it is now well settled that income-tax cannot be levied on hypothetical income. In Commissioner of Income Tax v. Shoorji Vallabhdas and Co. [1962] 46 ITR 144 (SC) it was held as follows:-*

*"Income-tax is a levy on income. No doubt, the Income-tax takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a 'hypothetical income', which does not materialise. Where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account."*

*18. The above passage was cited with approval in Morvi Industries Ltd. v. Commissioner of Income- Tax (Central), [1971] 82 ITR 835 (SC) in which this Court also considered the dictionary meaning of the word "accrue" and held that income can be said to accrue when it becomes due. It was then observed that: .....the date of payment .....does not affect the accrual of income. The moment the income accrues, the assessee gets vested with the right to claim that amount even though it may not be immediately."*

*19. This Court further held, and in our opinion more importantly, that income accrues when there "arises a corresponding liability of the other party from whom the income becomes due to pay that amount."*

*20. It follows from these decisions that income accrues when it becomes due but it must also be accompanied by a corresponding liability of the other party to pay the amount. Only then can it be said that for the purposes of taxability that the income is not hypothetical and it has really accrued to the assessee.*

*21. In so far as the present case is concerned, even if it is assumed that the assessee was entitled to the benefits under the advance licences as well as under the duty entitlement pass book, there was no corresponding liability on the customs authorities to pass on the benefit of duty free imports to the assessee until the goods are actually imported and made available for clearance. The benefits represent, at best, a hypothetical income which may or may not materialise and its money value is therefore not the income of the assessee.*

*22. In Godhra Electricity Co. Ltd. v. Commissioner of Income Tax, [1997] 225 ITR 746 (SC) this Court reiterated the view taken in Shoorji Vallabhdas and Morvi Industries.*

*23. Godhra Electricity is rather instructive. In that case, it was noted that the High Court held that the assessee would be obliged to pay tax when the profit became actually due and that income could not be said to have accrued when it is based on a mere claim not backed by any legal or contractual right to receive the amount at a subsequent date. The High Court however held on the facts of the case that the assessee had a legal right to recover the consumption charge in dispute at the enhanced rate from the consumers.*

*24. This Court did not accept the view taken by the High Court on facts. Reference was made in this context to Commissioner of Income Tax v. Birla Gwalior (P.) Ltd., [1973] 89 ITR 266 (SC) wherein it was held, after referring to Morvi Industries that real accrual of income and not a hypothetical accrual of income ought to be taken into consideration. For a similar conclusion, reference was made to Poona Electric Supply Co. Ltd. v. Commissioner of Income Tax, [1965] 57 ITR 521 (SC) wherein it was held that income tax is a tax on real income.*

*25. Finally a reference was made to State Bank of Travancore v. Commissioner of Income Tax, [1986] 158 ITR 102 (SC) wherein the majority view was that accrual of income must be real, taking into account the actuality of the situation; whether the accrual had taken place or not must, in appropriate cases, be judged on the principles of real income theory. The majority opinion went on to say "What has really accrued to the assessee has to be found out and what has accrued must be( considered from the point of view of real income taking the probability or improbability of*

*realisation in a realistic manner and dovetailing of these factors together but once the accrual takes place, on the conduct of the parties subsequent to the year of closing an income which has accrued cannot be made "no income".*

*26. This Court then considered the facts of the case and came to the conclusion (in Godhra Electricity) that no real income had accrued to the assessee in respect of the enhanced charges for a variety of reasons. One of the reasons so considered was a letter addressed by the Under Secretary to the Government of Gujarat, to the assessee whereby the assessee was "advised" to maintain status quo in respect of enhanced charges for at least six months. This Court took the view that though the letter had no legal binding effect but "one has to look at things from a practical point of view." (R.B. Jodha Mal Kuthiala v. Commissioner of Income Tax, [1971] 82 ITR 570 (SC)). This Court took the view that the probability or improbability of realisation has to be considered in a realistic manner and it was held that there was no real accrual of income to the assessee in respect of the disputed enhanced charges for supply of electricity. The decision of the High Court was, accordingly, set aside.*

*27. Applying the three tests laid down by various decisions of this Court, namely, whether the income accrued to the assessee is* ***real or hypothetical****; whether there is a corresponding liability of the other party to pass on the benefits of duty free import to the assessee even without any imports having been made; and the probability or improbability of realisation of the benefits by the assessee considered from a* ***realistic and practical point of view (****the assessee may not have made imports), it is quite clear that in fact no real income but only hypothetical income had accrued to the assessee and Section 28(iv) of the Act would be inapplicable to the facts and circumstance of the case. Essentially, the Assessing Officer is required to be pragmatic and not pedantic."*

**20.** Thus, from the above observations of Hon'ble Supreme Court, it is noted that well accepted principles under the Income-tax law have been again re-iterated laying down that income-tax cannot be levied on hypothetical income. Hon'ble Apex Court further observed that when we talk about accrual of income, we mean real accrual of income and not hypothetical accrual of income. Thus, accrual of income must be real, taking into account the actuality of situation considered from a **realistic and practical point of view.** Thus,

whether the accrual had taken place or not, must in appropriate cases, be judged on the principles of 'real income theory'. Finally, the Hon'ble Apex Court suggested that under such circumstances, essentially, the Assessing Officer is required to be pragmatic and not pedantic.

**21.** Further, apart from the above reasoning, the assessee is a company and is bound to follow the Accounting Standards issued by the Institute of Chartered Accountants of India while maintaining its final accounts. As per Accounting Standards-9 pertaining to 'Revenue Recognition', if there is uncertainty with regard to collection of the amount, then recognition of same as income should be deferred in the books of account.

**22.** Coming back to the facts of this case, the fact that the said company as well as the assessee never recorded the impugned amount in its books of account shows that none of the parties considered the amount of interest for the year under consideration as expenses / income. The assessee company took a decision for not booking the interest income in view of the facts and circumstances of the case as have been discussed in detail in above part of our order. Thus, in the given facts of this case, the impugned amount of interest was merely a hypothetical income, therefore it cannot be considered as income as per principles of 'real income theory'. The AO has wrongly added it as part of income on notional basis and the same is directed to be deleted. This ground is allowed.

**23.** As a result, appeal of the assessee is partly allowed, for statistical purpose.

*Order pronounced in the court on this 9th day of September, 2016.*

| Sd/- | Sd/- |
|---|---|
| (C.N. PRASAD) | (ASHWANI TANEJA) |
| JUDICIAL MEMBER | ACCOUNTANT MEMBER |

Mumbai, Dt : 9th September, 2016

Pk/-

Copy to :

1. The appellant
2. The respondent
3. The CIT(A)
4. The CIT
5. The Ld. Departmental Representative for the Revenue, J-Bench

(True copy) By order

ASSTT.REGISTRAR, ITAT, MUMBAI BENCHES