

## Interest on NPAs is taxable in the year of receipt only

**Summary – The High Court of Bombay in a recent case of Solapur District Central Co-op. Bank Ltd., (the Assessee) held that where income on NPA was actually not credited but was shown as receivable in balance sheet of assessee-co-operative bank, interest on NPA would be taxable in year when it would be actually received by assessee bank**

### Facts

- During the assessment, the Assessing Officer noticed that the assessee co-operative bank had transferred an amount of Rs. 7.80 crores to Overdue Interest Reserve (OIR) by debiting the interest received in profit and loss account related to Non Performing Assets. He was of the opinion that the assessee-bank had to offer the interest due to tax on accrual basis.
- The explanation of the assessee-bank was that, the Reserve Bank of India guidelines provide that income on Non Performing Assets ('NPA') is not be credited to profit and loss account but instead to be shown as receivable in the balance sheet and it is to be taken as income in the profit and loss account only when the interest is actually received.
- It was also pointed out that, as per the Reserve Bank of India norms, interest on assets not received within 180 days, is to be taken to OIR account. Similarly, the interest which was not received for the earlier years, was also taken into OIR account. In this manner, only the interest received during year was credited to profit and loss account and offered to tax. However, the Assessing Officer discarded the explanations of the assessee, principally on the basis of accrual of interest income.
- On the assessee's appeal, the Commissioner (Appeals) confirmed the decision of the Assessing Officer.
- On appeal, the Tribunal reversed the decisions of the Revenue authorities. The Tribunal broadly relied upon the principle of real income theory and referred to the decision of the Supreme Court in case of *CIT v. Shoorji Vallabhdas & Co.* [\[1962\] 46 ITR 144](#).
- On the revenue's appeal before the High Court:

### Held

- The issue is squarely covered by the judgments of Gujarat High Court and Punjab & Haryana High Courts. The Gujarat High Court in case of *Pr. CIT v. Shri Mahila Sewa Sahakari Bank Ltd.* [\[2017\] 395 ITR 324/\[2016\] 242 Taxman 60/72 taxmann.com 117](#) had undertaken the detailed exercises to examine an identical situation. The Court held that the Cooperative Banks were acting under the directives of the Reserve Bank of India with regard to the prudential norms set out. The Court was of the opinion that taxing interest on NPA cannot be justified on the real income theory. The decision of the Gujarat High Court in *Shri Mahila Sewa Sahakari Bank Ltd.*, (supra) was carried in Appeal by the Revenue to the Supreme Court and such appeal was dismissed.
- The Court concluded in case of *Pr. CIT v. Ludhina Central Co-operative Bank Ltd.* [\[2018\] 99 taxmann.com 81](#) concluded that the Tribunal while relying upon the various pronouncements had

correctly decided the issue regarding taxability of interest on NPA in favour of the assessee as being taxable in the year of receipt; the Tribunal had upheld the deletion made by the CIT(A) on account of addition of Rs.3,02,82,000 regarding interest accrued on NPA and that there was no illegality or perversity in the aforesaid findings recorded by the Tribunal.

- The issue is thus, covered by the decisions of two High Courts. Against the judgment of the Gujarat High Court, the appeals have been dismissed by the Supreme Court. Thus, the Supreme Court can be seen to have approved the decision of the Gujarat High Court. Therefore, there is no reason to entertain these Appeals, since no question of law can be stated to have arisen.
- For the reference, it may also be noticed that subsequently, legislature has amended section 43D. Section 43D essentially provides for charging of interest on actual basis in case of certain special circumstances, in the hands of the public financial institutions, public companies etc. *Explanation* to section 43D defines certain terms for the purpose of said section. Clause (g) was inserted in the said explanation by Finance Act, 2016 which provides that for the purpose of such section, Cooperative Banks, Primary Agricultural Credit Society and Primary Agricultural and Rural Development Bank shall have meanings respectively assigned in *Explanation* to sub-section 4 of section 80B. By virtue of such insertion, the Cooperative Banks would get the benefit of section 43D. One way of looking at this amendment, can be that, the same is curative in nature and would, therefore, apply to pending proceedings, notwithstanding the fact that, the legislature has not made the provision retrospective.
- As per the Memorandum explaining the provision, the insertion of clause (g) to the *Explanation* was to provide for a level playing field to the Cooperative Banks. This may be one more indication to hold a belief that, the legislature in order to address a piquent situation and to obviate unintended hardship to the assessee, has introduced the amendment. However, in the present case, there is no need to conclude this issue and leave it to be judged in appropriate proceedings.