

**IN THE HIGH COURT FOR THE STATE OF TELANGANA
AT HYDERABAD**

**MONDAY, THE FIRST DAY OF DECEMBER
TWO THOUSAND AND TWENTY FIVE**

PRESENT

THE HONOURABLE SRI JUSTICE P.SAM KOSHY

AND

THE HONOURABLE SRI JUSTICE SUDDALA CHALAPATHI RAO

REFERRED CASE NO: 3 OF 2003

Between:

The Commissioner of Income Tax, Andhra Pradesh-I, Hyderabad.

...APPLICANT

AND

M/s. A.P. Financial Corporation, Hyderabad.

...RESPONDENT

Case Referred to the High Court by the Income Tax Appellate Tribunal under Section 256(1) of the Income Tax Act, 1961 in R.A.Nos. 201 & 202/Hyd/1998 (ITA Nos.1 & 2/Hyd/95) Assessment Year 1992-93 & 1993-94 of Income Tax Appellate Tribunal Hyderabad Bench 'A' Hyderabad on its file for Decision on the following questions of law viz;

For Assessment Year 1992-93:

1. Whether on the facts and in the circumstances of the case, the ITAT was correct in law in holding that the interest income should be computed on accrual basis and interest accrued from 01.10.91 to 31.03.92 alone has to be computed?
2. Whether on the facts and in the circumstances of the case, the ITAT was correct in holding that the interest income accrued prior to 1.10.91 and realized in cash after 01.10.91 and before 31.03.92 has not be considered for computation of interest income for asst.year 1992-93 though the

assessee is following cash system for I.T. Purpose and in view of sec.5 read with section 21 of Interest Tax Act?

3. Whether on the facts and in the circumstances of the case, the ITAT was correct in directing the A.O. that the commitment charges are to be computed only on accrual basis instead of receipt basis?

For Assessment Year 1993-94:

1. Whether on the facts and in the circumstances of the case, the ITAT was correct in law in holding that the interest income should be computed on accrual basis and interest accrued from 01.04.92 to 31.03.93 alone has to be computed?
2. Whether on the facts and in the circumstances of the case, the ITAT was correct in holding that the interest income accrued prior to 1.04.92 and realized in cash after 01.04.92 and before 31.03.93 has not be considered for computation of interest income for asst.year 1993-94 though the assessee is following cash system for I.T. Purpose and in view of sec.5 read with section 21 of Interest Tax Act?
3. Whether on the facts and in the circumstances of the case, the ITAT was correct in directing the A.O. that the commitment charges are to be computed only on accrual basis instead of receipt basis?

Counsel for the Petitioner: Sri. Bokaro Sapna Reddy (Senior Standing Counsel for Income Tax)

Counsel for the Respondent: Mr. S.Ravi Representing R.S. Associates

The Court made the following: ORDER

**IN THE HIGH COURT FOR THE STATE OF TELANGANA AT
HYDERABAD**

**THE HONOURABLE SRI JUSTICE P.SAM KOSHY
AND
THE HONOURABLE SRI JUSTICE SUDDALA CHALAPATHI RAO**

REFERENCE CASE No.3 of 2003

DATE OF ORDER : 01.12.2025

Between:

The Commissioner of Income Tax,
Andhra Pradesh-I, Hyderabad.

...Applicant

AND

M/s. A.P.Financial Corporation,
Hyderabad.

...Respondent

ORDER: *(per the Hon'ble Sri Justice P.Sam Koshy)*

Heard Ms. Bokaro Sapna Reddy, learned Senior Standing Counsel for Income Tax Department appearing on behalf of the applicant / Revenue; and Mr. S.Ravi, learned Senior Counsel representing M/s. R.S. Associates for the respondent / assessee.

2. The instant Reference Case has been forwarded by the Income Tax Appellate Tribunal, Hyderabad Bench 'A', Hyderabad (for short 'ITAT') at the behest of the Commissioner of Income-tax, A.P.I, Hyderabad, for answering the following questions of law, viz.,

"1. Whether on the facts and in the circumstances of the case, the ITAT was correct in law in holding that the interest income should be computed on accrual basis and interest accrued from 1.10.91 to 31.03.92 alone has to be computed?"

2. Whether on the facts and in the circumstances of the case, the ITAT was correct in holding that the interest income accrued prior to 1.10.91 and realized in cash after 1.10.91 and before 31.3.92 has not to be considered for computation of interest income for asst. year 1992-93 though the assessee is following cash system for I.T. purpose and in view of sec. 5 read with section 21 of Interest Tax Act?"

3. Whether on the facts and in the circumstances of the case, the ITAT was correct in directing the A.O. that the commitment charges are to be computed only on accrual basis instead of receipt basis?"

3. The terms of reference for the two assessment years i.e. 1992-93 and 1993-94 are the same.

4. The respondent / assessee in the instant case is a State owned Financial Corporation registered under the Companies Act.

For the assessment year 1992-93, it had filed its return declaring a chargeable interest of Rs.66,81,75,336/-. Later a revised return was filed declaring the chargeable interest at Rs.29,04,29,000/-. The assessee filed yet another revised return admitting a chargeable interest of Rs.15,12,17,005/-. During the course of assessment proceedings, the assessee claimed that it was following the cash system of accounting, and since it was following the cash system of accounting, the accrued interest relevant to the period from 01.10.1991 to 31.03.1992 was offered to assessment.

5. It was contended by the Revenue that out of the total interest receipts, interest accrued upto 30.09.1991 and which was received after 01.10.1991, was also not offered for assessment in terms of Section 5 of the Interest Tax Act, 1974 (for short the 'Act'). The claim of the assessee for not offering interest accrued for the period prior to 30.09.1991 was on account of the assessee maintaining its books of accounts on cash system basis and it was only the interest received out of the accrued interest during 01.10.1991 to 31.03.1992 that was considered for assessment. However, the Assessing Officer in respect of the interest collected during 01.10.1991 to 31.03.1992 subjected to tax an amount of

Rs.29,46,55,315/-. This subjecting of the said amount to tax was put to challenge by the assessee before the Commissioner of Income-tax (Appeals). The Commissioner of Income-tax (Appeals), however, affirmed the order passed by the Assessing Officer and rejected the appeal preferred by the assessee. Similar stand was taken for the assessment year 1993-94 as well.

6. Being aggrieved by the two orders i.e. the order passed by the Assessing Officer and that which was passed by the Commissioner of Income-tax (Appeals), the assessee took the matter to the ITAT. The ITAT, *vide* its order dated 16.08.2000, at the first instance held that computation of tax so far as commitment charges is concerned has to be made on accrual basis. However, it referred the matter to the High Court to answer the questions which have already been reproduced in the initial part of this order.

7. Now to answer the terms of reference, it would be relevant at this juncture to take note of certain provisions of the Act.

8. Admittedly, the assessee in this case is a credit institution and credit institution is defined under Section 2 (5A) of the Act. For

ready reference, Section 2 (5A) of the Act is reproduced hereunder, viz.,

"2 (5A) "credit institution" means,-

(i) a banking company to which the Banking Regulation Act, 1949 (10 of 1949), applies (including any bank or banking institution referred to in section 51 of at Act);

(ii) a public financial institution as defined in section 4A of the Companies Act, 1956 (1 of 1956);

(iii) a State financial corporation established under section 3 or section 3A or an institution notified under section 46 of the State Financial Corporations Act, 1951 (63 of 1951); and

(iv) any other financial company;"

A State financial corporation established under the provisions of the State Financial Corporation Act has been brought under the purview of credit institution.

9. Chargeable interest is that which is defined under Section 2(5) of the Act, which also for ready reference is reproduced hereunder, viz.,

"2(5) "chargeable interest" means the total amount of interest referred to in section 5, computed in the manner laid down in section 6;"

10. Interest has been defined under Section 2(7) of the Act, which again for ready reference is reproduced hereunder, viz.,

"[(7) "interest" means interest on loans and advances made in India and includes-

(a) commitment charges on unutilised portion of any credit sanctioned for being availed of in India; and

(b) discount on promissory notes and bills of exchange drawn or made in, India, but does not include-

(i) interest referred to in sub-section (1B) of the Reserve Bank of India Act, 1934;

(ii) discount on treasury bills;]"

11. The scope of chargeable interest has been defined under Section 5 of the Act, which again for ready reference is reproduced hereunder, viz.,

*"[5. **Scope of chargeable interest.**-Subject to the provisions of this Act, the chargeable interest of any previous year of a credit institution shall be the total amount of interest (other than interest on loans and advances made to other credit institution [or to any co-operative society engaged in carrying on the business of banking]) accruing or arising to the credit institution in that previous year:*

Provided that any interest in relation to categories of bad or doubtful debts referred to in section 43D of the Income-tax Act shall be deemed to accrue or arise to the credit

institution in the previous year in which it is credited by the credit institution to its profit and loss account for that year or, as the case may be, in which it is actually received by the credit institution, whichever is earlier.]”

12. Then comes the procedure of computation which is provided under Section 6 of the Act. For ready reference, the relevant portion of Section 6 is also reproduced hereunder, viz.,

“6. Computation of chargeable interest.-(1) *Subject to the provisions of sub-section (2), in computing the chargeable interest of a previous year, there shall be allowed from the total amount of interest (other than interest on loans and advances made to [credit institutions] accruing or arising to the assessee in the previous year, a deduction in respect of the amount of interest which is established to have become a bad debt during the previous year:”*

13. The whole dispute would get resolved upon deciding as to the mode of computing interest where the assessee follows cash system vis-à-vis an assessee who follows mercantile system of accounting. The said issue is no longer a res-integra for the reason that the matter has been deliberated and stands decided by the Hon’ble Supreme Court in the case of **Kerala State Industrial**

Development Corpn. Ltd. vs. Commissioner of Income-tax¹,

wherein in paragraph Nos.2 to 4, it has been held as under:

"2. The questions which had been referred to the Kerala High Court in Kerala State Development Corpn. Ltd. v. CIT [2000] 246 ITR 330 for its decision were :

"1. Whether, on the facts and circumstances of the case, on account of incorporation of section 145 of the Income-tax Act, 1961 with effect from October 1, 1991, in section 21 of the Interest Tax Act, 1974, and the overriding effect of section 21 over section 5, by which the interest-tax has to be levied only on the interest income computed, based on the method of accounting regularly employed by the assessee, the Appellate Tribunal was correct in law in concluding that the Assessing Officer has rightly made the computation of the interest on accrual basis, rejecting the cash system of accounting accepted for the assessment under the Income-tax Act, 1961

2. Whether on the facts and circumstances of the case on account of doctrine of incorporation, section 145 of the Income-tax Act, 1961, having been incorporated in section 21 of the Interest-tax Act, 1974, when the assessee maintains books of account on cash system and being assessed under cash system under the Income-tax Act does not the chargeable interest deserve to be computed on cash method and if the intention of the Legislature would have been to tax on

¹ [2003] 259 ITR 51 (SC)

mercantile system, the Legislature in their wisdom would not have included section 145 of the Income-tax Act, 1961 in section 21 of the Interest Tax Act ?"

3. *The High Court decided the first question only against the assessee and in favour of the revenue. The second question was not considered given the High Court's decision on the first question. The High Court, in the impugned judgment has held that the "chargeable interest", in terms of section 5 of the was the total amount of interest accruing in the relevant previous year and, that there was no scope, in the section to read "chargeable interest" as meaning the amount actually received in the relevant previous year.*

4. *It appears to us that in arriving at this conclusion the High Court has overlooked the opening words of section 5 of the Act which make the provisions of the said section "subject to the provisions of the Act." The other provisions of the include section 21 whereunder provisions of certain specified sections and schedules of the Income-tax Act have been made applicable with necessary modifications as if the said provisions referred to the Interest-tax Act instead of Income-tax Act. There is no dispute that at the material time section 145 of the Income-tax Act was incorporated in the Interest-tax Act by virtue of section 21 of that Act. Section 145 of the Income-tax Act permits income chargeable under the Head "Profits and Gains of Business or Profession" or "Income from other sources" to be computed in accordance with either the cash or mercantile system of accounting, as may be regularly employed by the assessee. The assessee, in the case before us, has followed the cash*

system of accounting in respect of the interest income. Learned counsel appearing on behalf of the assessee, therefore, has, in our opinion rightly, contended that section 5 of the Interest-tax Act would in the circumstances allow the calculation or computation of chargeable interest on the basis of amount of interest actually received. It is of significance that the provisions of the Act were amended by Finance Act (No. 2) of 1991, to include credit institutions such as the appellant and at the same time section 145 of the Income-tax Act was also incorporated in the Act.

Even if there were any ambiguity in the matter, the Budget Speech of the Minister of Finance while introducing the Finance Bill, has in paragraph 97 stated (see [1991] 190 ITR (St.) 89, 114):

" . . . The new tax will be levied on the gross amount of interest received by all banks, financial institutions and non-banking financial companies in the corporate sector on loans and advances made in India. . . ."

14. In the light of the aforesaid authoritative decision, it gets settled that if the assessee follows the cash system of accounting, in such circumstances allowing computation of chargeable interest by applying the mercantile system of accounting would not be permissible. It is therefore held that if cash system was prevailing so far as accounting is concerned, the computation of chargeable interest would also have to be on the same basis and vice-versa.

This in other words means that once if an assessee follows the cash system for accounting, the chargeable interest cannot be computed applying the mercantile system of accounting.

15. Further, in the light of the aforesaid legal principles enunciated by the Hon'ble Supreme Court in the case of **Kerala State Industrial Development Corpn. Ltd.** (supra) we are of the considered opinion that the terms of reference made by the ITAT at the behest of Commissioner of Income Tax, stands answered holding that if the assessee follows cash system then chargeable interest also has to be applying the same system. In the same way, applying the provisions of Section 5, the chargeable interest of any previous year of a credit institution shall be the total amount of interest accruing or arising to the credit institution in that previous year. This in other words means that if the interest of previous year is paid in the subsequent year the same would not be put to assessment provided the assessee follows the cash system of accounting.

16. The instant Reference Case stands answered accordingly.

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17. As a sequel, miscellaneous petitions pending if any, shall stand closed. However, there shall be no order as to costs.

**SD/- I. NAGA LAKSHMI
JOINT REGISTRAR**

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SECTION OFFICER

To

1. The Income Tax Appellate Tribunal Hyderabad Bench 'A' Hyderabad
2. The Commissioner of Income Tax, Appeals-II, Hyderabad.
3. The Deputy Commissioner of Income Tax (Assts), Spl. Range - 5, Hyderabad.
4. One CC to Sri. Bokaro Sapna Reddy, Senior SC Income Tax [OPUC]
5. One CC to Sri. R.S. Associates Advocate [OPUC]
6. Two CD Copies

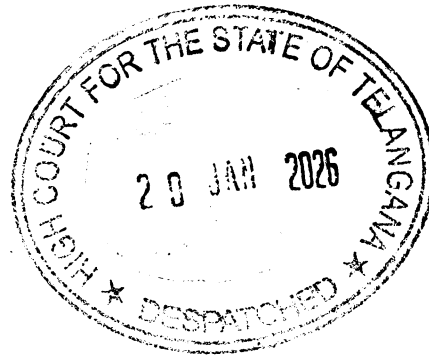
Pr/Sa



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HIGH COURT

DATED: 01/12/2025



ORDER

RC.No.3 of 2003

ANSWERING THE REFERENCE CASE

⑧ MT
31/12/25