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**IN THE INCOME TAX APPELLATE TRIBUNAL,
DELHI BENCH "D": DELHI**

**BEFORE SHRI C.L. SETHI, JUDICIAL MEMBER &
SHRI K.D. RANJAN, ACCOUNTANT MEMBER**

ITA No. 3246/D/06
Asstt. year : 2003-04

M/s Urban Improvement Co. (P) Ltd. Vs. Delhi.

Income Tax Officer
Ward 18 (2),
New Delhi.

(Appellant)

(Respondent)

Appellant by : Ms. Rano Jain, CA
Respondent by: Shri Nikhil Choudhary, Sr. DR.

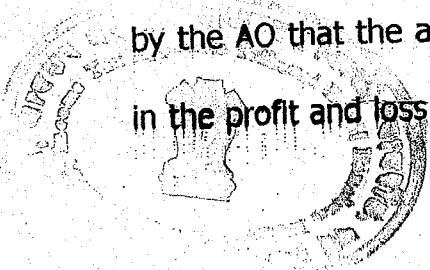
ORDER

C.L. SETHI, JUDICIAL MEMBER

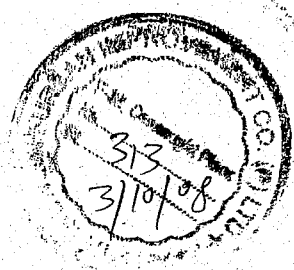
The assessee is in appeal against the order dated 24.8.2006 passed by the CIT (A) in the matter of an assessment made u/s 143(3) of the Income Tax Act 1961 ("the Act"), by the AO for the asstt. year 2003-04.

2. The only issue involved in this appeal is with regard to the assessee's claim of deduction of Rs. 15,66,172/- being the interest paid by the assessee during the year.

3. The assessee company is engaged in the business of land developers. During the course of assessment proceedings, it was noticed by the AO that the assessee had debited the expenses of Rs. 15,66,172/- in the profit and loss account, which was disallowed by the AO by treating



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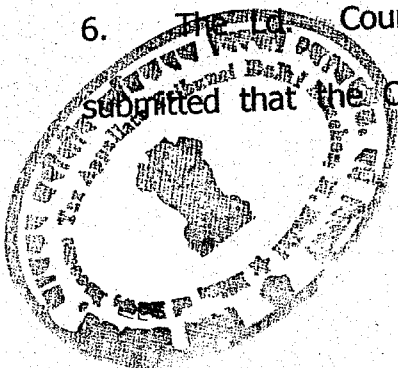


the same to be the prior period expenses. The AO had made a reference to the decision in the case of K. Sankaranarayana Iyer & Sons V CIT (1977) 110 ITR 571 (Madras).

4. On an appeal the CIT (A) has confirmed the AO's action. The CIT (A) has observed that no doubt, the case law relied on by the AO is not applicable to the fact of the present case, but on analyzing the fact of the case it is crystal clear that the resolution passed by the Board of Directors of the company cannot overrule the provisions of section 145 of the I.T. Act and, therefore, the action of the AO in disallowing the interest of Rs. 15,66,172/- was justified. The CIT (A) further observed that the resolution was passed by the Board of Directors of the company to pay interest for the earlier years to the parties though there was no obligation of the assessee company to pay interest to such institutions who had failed to comply the terms and conditions of the agreement. The CIT (A) further observed that mere because a resolution being passed by the Board of Directors of the company, the assessee cannot create a liability in the year under consideration when the assessee was maintaining the books of account on mercantile system.

5. Being aggrieved with the order of the CIT (A), the assessee company preferred this appeal before us.

6. The Counsel for the assessee, Mrs. Rano Jain, CA, has submitted that the CIT (A) has erred in law in taking view that the



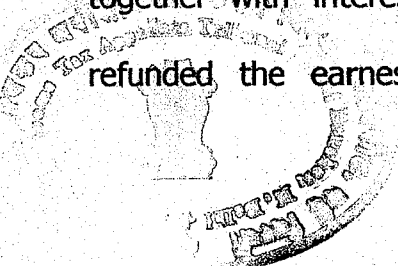
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resolution passed by the Board of Directors of the company overrules the provisions of section 145 of the Act. She further submitted that the liability to pay interest had actually arisen in the year under consideration when the resolution to pay interest was passed by the Board of Directors in this year. She, therefore, submitted that the claim of deduction of interest has been made in accordance with the provisions of section 145 on the basis of mercantile system of accounting being followed by the assessee. She, therefore, submitted that the assessee's claim of deduction of interest paid to the parties was justified.

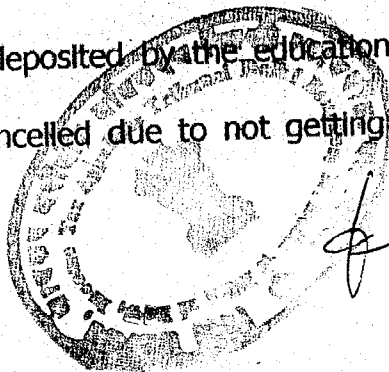
7. The Ld. DR, on the other hand, reiterated the reasons and the basis given by the AO as well as by the CIT (A) in rejecting the assessee's claim.

8. We have considered rival contentions of both the parties and have carefully gone through the orders of the authorities below.

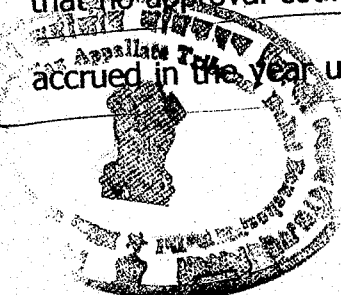
9. In the present case, the assessee company had accepted money by certain educational societies or trusts in pursuance of the memorandum of understanding for construction of Senior Secondary School in Sector C, Greenfields, dated 13th June, 1997. Since the memorandum of understanding could not be materialized, the assessee company decided to refund the earnest money received from educational societies or trusts together with interest @ 7% per annum. The assessee accordingly refunded the earnest money alongwith interest in the year under



consideration as per the resolution taken by the Board of Directors of assessee company dated 8.9.2002. The memorandum of understanding for construction of Senior Secondary School, Sector C, Greenfield provides that in any event the approval to construct school building is declined by Director T & CP, and / or the second party has not been able to obtain the same, the assessee company will refund the entire amount deposited with it as earnest money to the second party with interest @ 7% per annum. It was also provided therein that the second party shall arrange to obtain approval of the Director, T & CP Haryana, Chandigarh within six months which period shall exclude the time taken by the first party in getting the clearance from the Haryana / Central Pollution control Boards. However, the parties may agree upon to extend the said time schedule, and, in event it is found that the second party has not taken any steps and has been negligent in getting the approval, the said period of six months shall not be extended and the amount paid by that time shall be refunded. It is thus clear that the assessee company is obliged to refund the entire amount with interest @ 7% in the event the approval is declined by the Director T & CA and or the second party has not been able to obtain the same. Accordingly, the assessee company had taken a resolution in the Board of Directors meeting to pay interest on earnest money deposited by the educational society / trusts whose agreements were cancelled due to not getting the required approval. The aforesaid

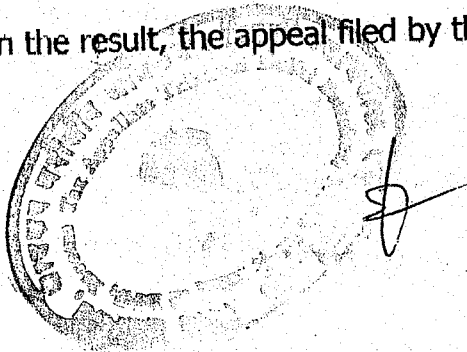


resolution was taken on 8.9.2002. Unless and until the memorandum of understanding is cancelled and the earnest money is not found to be refundable to the educational societies / trusts, the question of paying interest @ 7% per annum in every year from the date of deposit did or could not arise. The assessee's liability to pay interest had accrued only when it is found that the required approval has not been obtained and the assessee made itself liable to refund the entire earnest money deposited with it. In the light of these facts, it is thus clear that the interest paid by the assessee has been crystallized only when the agreement was cancelled and it was decided upon to refund the entire amount alongwith the interest @ 7% per annum. The expenses ,therefore, cannot said to be the expenses pertaining to earlier years mere because the quantification of interest is made from the date of payment of earnest money to the date of the refund of earnest money. It is well settled that expenditure are deductible in respect of liability actually existing in the year in which claim is made. Under the mercantile system, a deduction can be allowed only in the year in which the liability to pay accrues, and it accrues only in the liability crystallized or become ascertained. In the present case, the liability to pay interest has been crystallized or has become ascertained only when assessee decided to refund the earnest money for the reason that no approval could be obtained. Thus, the liability to pay interest had accrued in the year under consideration when the resolution was passed



and not prior to that. ^TThis was a contractual liability and was crystallized and ascertained only when the decision to refund the earnest money was taken alongwith the interest of 7% as was so provided in the memorandum of understanding for construction of senior secondary school. This is not a normal interest payable by the assessee for each year on the amount taken by the assessee but it is the interest payable only in the event the approval is declined by Director, T & CP or the educational trusts / institutions had not been able to obtain the same resulting in refunding the entire amount earlier deposited with the assessee as earnest money alongwith the interest. The assessee's claim is thus admissible in the light of the provisions contained in section 145 of the Act and in the light of the fact that the assessee was following mercantile system of accounting. We, therefore, set aside the order of authorities below and hold that the assessee's claim of deduction of interest amounting to Rs. 15,66,172/- has actually been accrued or crystallized or ascertained in the present year under consideration, and it is thus to be allowed as deduction. The AO shall allow the same and modify the assessment order accordingly.

10. In the result, the appeal filed by the assessee is allowed.



11. This decision was pronounced in the open court on 05th th
September, 2008.

(K.D. RANJAN)
Accountant Member

(C.L. SETHI)
Judicial Member

Dated the 5th September, 2008

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Copy forwarded to :

1. Assessee
2. A.O.
3. CIT (A)
4. CIT
5. DR

DEPUTY REGISTRAR,
ITAT, DELHI BENCHES

सहायक पंजीकार
Assistant Registrar
सावकर अपीलिय अधिकरण
Income Tax Appellate Tribunal
दिल्ली पीठ, नई दिल्ली
Delhi Benches, New Delhi

