



IN THE HIGH COURT OF KARNATAKA

**DHARWAD BENCH**

DATED THIS THE 14<sup>TH</sup> DAY OF DECEMBER 2015

PRESENT

**THE HON'BLE MR.JUSTICE S. ABDUL NAZEER**

AND

**THE HON'BLE MR.JUSTICE P.S.DINESH KUMAR**

**ITA NO.100014/2014 c/w. ITA NO.100013/2014**

IN ITA NO.100014/2014:

BETWEEN

1. THE COMMISSIONER OF INCOME TAX  
C R BUILDING, NAVANAGAR  
HUBLI
2. ASST. COMMISSIONER OF INCOME TAX  
CIRCLE 2(1), HUBLI ... APPELLANTS

(By Sri Y V RAVIRAJ, ADV.,)

AND

KARNATAKA VIKAS GRAMEEN BANK  
HEAD OFFICE, BELGAUM ROAD  
DHARWAD ... RESPONDENT

(By Sri A SHANKAR, ADV.,)

THIS ITA FILED U/SEC.260A OF THE INCOME-TAX ACT, 1961 AGAINST ORDER PASSED IN ITA.NO.112/BANG/2012 ON THE FILE OF THE INCOME TAX APPELLATE TRIBUNAL, BANGALORE BENCH "C", THE APPEAL FILED BY THE ASSESSEE FOR THE ASSESSMENT YEAR 2008-09 IS DISMISSED.

IN ITA NO.100013/2014:

BETWEEN

1. THE COMMISSIONER OF INCOME TAX  
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KARNATAKA VIKAS GRAMEEN BANK  
HEAD OFFICE, BELGAUM ROAD  
DHARWAD ... RESPONDENT

(By Sri A SHANKAR, ADV.)

THIS ITA FILED U/SEC.260A OF THE INCOME-TAX ACT, 1961 AGAINST ORDER PASSED IN ITA.NO.226/BANG/2012, DATED 28.11.13 ON THE FILE OF THE INCOME TAX APPELLATE TRIBUNAL, BANGALORE BENCH "C", THE REVENUE APPEAL FOR THE ASSESSMENT YEAR 2008-09 IS HEREBY DISMISSED.

THESE ITAs HAVING BEEN HEARD AND RESERVED FOR JUDGMENT, THIS DAY *P.S.DINESh KUMAR.J.*, PRONOUNCED THE FOLLOWING:-

**JUDGMENT**

Though these two appeals are listed for admission, with consent of learned Counsel for the parties, they are taken up for final disposal.

2. Both appeals have been presented by the Revenue challenging the common order dated 28.11.2013 passed by the Income Tax Appellate Tribunal, Bengaluru Bench "C" in ITA No.112/BANG/2012 and ITA No.226/BANG/2012 raising the following substantial questions of law:-

1. *Whether on the facts and circumstances of the case and in law the Tribunal was right in deleting the addition made by the assessing authority u/s.41(1) of the Income Tax Act, towards the unclaimed 'stale draft and pay orders', and as such there was cessation of liability on an amount of Rs.58,31,581/-?*

2. *Whether on the facts and circumstances of the case and in law the Tribunal was right in upholding the depreciation claimed by the assessee at Rs.17,59,00,087/- on investments on government securities "held to maturity" when such securities were held as a investments and not as 'stock-in-trade'?*

3. Briefly stated the facts of the case are, assessee is a Regional Rural Bank registered under the Schedule of Reserve Bank of India. It caters to the needs of Agricultural and Cottage Industry sectors. It makes investment in Government and other securities. For the assessment year 2007-08, assessee declared a taxable income of Rs.94,26,91,495/-. Assessment was completed and an income of Rs.112,45,33,700/- was assessed against the returned income of Rs.94,26,91,495/- by disallowing Rs.17,59,00,087/- claimed towards

depreciation on investment; Rs.87,224/- claimed under Section 14A; Rs.23,040/- towards Commission on Locker Rent; and Rs.58,31,851/- towards Stale Drafts and Pay Orders.

4. For the assessment year 2008-09, the assessee filed its income declaring an income of Rs.93,25,06,010/- as per revised return. Assessment for the said period was also completed and the income was determined at Rs.102,66,57,128/- by disallowing Rs.2,47,52,075/- deduction claimed under Section 36(1)(viia); Rs.6,74,91,000/- towards deductions claimed under Section 36(1)(viii); Rs.68,478/- claimed under Section 14A; Rs.2,61,911/- claimed under loss of sale of assets; Rs.13,94,212/- claimed as exemption towards tax on Stale Drafts;

Rs.1,82,112/- claimed towards Commission paid to Pigmy Agents; and Rs.1,330/- towards Locker Rent.

5. Assessee challenged both assessment orders for the years 2007-08 and 2008-09 before CIT(Appeals) Hubballi. Commissioner by Order dated 30.11.2011 allowed the said appeals in part by deleting disallowance claimed towards depreciation on investment and Locker Rent in respect of assessment year 2007-08 and deductions claimed under Section 36(1)(vii), 36(1)(viii) and Loss on Sale of Assets for the assessment year 2008-09.

6. Aggrieved by the Order passed by CIT (Appeals), both Revenue and Assessee preferred appeals before the Tribunal. Assessee presented ITA No.112/BANG/2012 for the year 2007-08 and

ITA No.113/BANG/2012 for the year 2008-09. Revenue presented ITA No.226/BANG/2012 for the year 2007-08 and ITA No.227/BANG/2012 for the year 2008-09. All the four appeals were disposed of by the common impugned order.

7. Tribunal, by the impugned order upheld the contentions of assessee and deleted the addition made by the assessing authority:

- (i) under Section 41(1) of the Income Tax Act, 1961 ('Act' for short) towards unclaimed 'Stale Drafts and Pay Orders' whereunder assessing authority had disallowed a sum of Rs.58,31,851/-;
- (ii) disallowance of Rs.17,59,00,087/- towards depreciation on investment.

8. Challenging the order passed by the Tribunal by raising substantial questions of law stated supra, Revenue has preferred these appeals.

9. Heard Sri Y.V. Raviraj, learned Counsel for the appellants and Sri A.Shankar, learned Counsel for respondent-assessee.

10. Addressing arguments in support of the questions of law raised by the Revenue, Sri Y.V. Raviraj, learned Counsel submitted that the Tribunal fell in error in reversing the concurrent findings of the assessing authority and the First Appellate Authority namely, the CIT (Appeals) with respect to disallowance of 'Stale Drafts and Pay Orders' and deleting the sum of Rs.58,31,851/- added by the assessing authority under Section 41(1) of the Act. He strenuously contended that



admittedly, the said amount came into the hands of the assessee as the purchasers of DD/Pay Orders had not claimed/encashed them. Therefore, the assessing authority was right in coming to the conclusion that the said amount which remained unclaimed in the hands of the assessee was 'profit' chargeable to tax under Section 41(1) of the Act. He further contended that the Tribunal misguided itself by placing reliance on the Judgments rendered by Co-ordinate Benches of the Tribunal in the case of *Canara Bank* (ITA No.390/BANG/2011 dated 8.6.2012) and *Vijaya Bank* (ITA No.455/BANG/2011 dated 22.6.2012). He further contended that the Judgments of the Tribunal on this issue are unsustainable in law in as much as, on the face of it, the unclaimed amount had remained in the

hands of the assessee and chargeable to tax under Section 41(1) of the Act.

11. In support of the second question of law, namely, the depreciation on Investments in Government Securities "*held to maturity*", learned Counsel for the Revenue contended that the Tribunal grossly erred in rejecting its appeal by confirming the order passed by the CIT (Appeals). He submitted that Reserve Bank of India (RBI) is the Controlling Authority of all Banks and has laid down clear guidelines for Classification of Securities held in the following manner:-

- (i) Held to maturity;
- (ii) Available for sale; and
- (iii) Held for trading.

12. He further contended that it is mandatory for the Banks to strictly comply with the guidelines issued by the RBI from time to time. Admittedly, assessee had written off a sum of Rs 17,59,00,087/- by claiming depreciation on investments by showing it as 'Loss on Valuation of Securities'. The said figure was arrived at by the assessee on the premise that the market value of the securities held as on 31.3.2007 was less than the cost of securities. Accordingly, the assessee had written off the same in its Books of Accounts on the principle of "Cost or Market Value, whichever is less applicable to the valuation of closing stock". Learned Counsel strongly assailing the correctness of assessee's claim on depreciation, submitted that the same runs counter to the CBDT's instruction No.17/2008 dated 26.12.2008, which was correctly applied by

the assessing authority. He further submitted that the securities were admittedly "*held to maturity*" and therefore could not have been subjected to depreciation. The reasoning adopted by the First Appellate Authority as also the Tribunal defeats the logic in as much as the concept of "*held to maturity*" would lose its sanctity and relevance if the assessee is permitted to claim depreciation having declared the securities under the said nomenclature. He contended that the classification "*held to maturity*" displays a glowing description that the assessee would get back the realizable value of security only upon its maturity. Consequently, the assessee was not entitled for the benefit of depreciation as was rightly held by the assessing authority.

13. With the above submissions, learned Counsel for the Revenue prayed for allowing these appeals.

14. Per contra, learned Counsel for the assessee Sri A. Shankar, strongly supporting the impugned order submitted that both questions of law raised by the Revenue are wholly untenable. Issues involved in these appeals are no more *res integra*. Amplifying his contentions, reiterating the grounds urged before the Tribunal, he submitted that the amount which remained in the hands of the Bank pursuant to a draft or a pay order becoming stale is not an income in the hands of the assessee. He adverted to Section 41(1) of the Act and contended that by no stretch of imagination, the amount which had remained in the hands of the assessee could be considered to fall within the

definition of 'profit chargeable to tax' under the said provision. According to him, the said amount is a liability which the Bank will have to discharge as and when a claim is lodged by the holder/payee of a draft/pay order. The amount held by the assessee is governed by the guidelines issued by the RBI in that behalf. The sum and substance of his argument is that the amount which had remained in the Bank pursuant to a draft/pay order becoming stale cannot be construed as 'profit chargeable to tax'. In support of his contentions, he placed reliance on the judgment of the Hon'ble Supreme Court in the case of *Commissioner of Income Tax v. T.V. Sundaram Iyengar & Sons Limited* reported in (1996) 222 ITR 344.

15. With regard to the second question of law namely, the depreciation claimed in respect of the investments in Government Securities "*held to maturity*", he contended that the assessee is consistently following a particular method of accounting namely 'at cost or market value, whichever is lower'. He placed reliance on the judgment of the Hon'ble Supreme Court in the case of *United Commercial Bank v. Commissioner of Income Tax* reported in *ITR 240 355 (SC)* and submitted that the Apex Court has held therein that preparation of balance sheet in accordance with the statutory provisions would not in any way disentitle an assessee in submitting Income Tax returns on the real taxable income in accordance with the consistent method of accounting adopted by the assessee. He further submitted that this judgment

of the Hon'ble Supreme Court has been followed by a Division Bench of the Principal Bench of this Court in *ITA No.172/2009 (The Karnataka Bank Limited v. the Assistant Commissioner of Income Tax)* disposed of on 11.3.2013. Thus, the contention of assessee is that although assessee had declared the securities as "*held to maturity*", in view of the authoritative pronouncement of the Apex Court, assessee was entitled to claim depreciation as was rightly held by the CIT (Appeals) and confirmed by the Tribunal by the impugned order. Accordingly, he prayed for dismissal of these appeals.

16. We have bestowed our careful consideration to the rival contentions urged by the parties and perused the material papers and the judgments relied upon by the learned Counsel for the assessee.



17. Re-question with regard to 'stale drafts and pay orders'.

It is not in dispute that the sum of Rs.58,31,581/- had remained in the hands of the assessee upon the drafts and pay orders issued by the Bank having been rendered stale. The assessing authority sought to categorise the said sum within the meaning of 'profit chargeable to tax' under Section 41(1) of the Act. Section 41(1) reads as follows:-

*"41.(1) Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee (hereinafter referred to as the first-mentioned person) and subsequently during any previous year,-*

*(a) the first-mentioned person has obtained, whether in cash or in any*

*other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by such person or the value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly chargeable to income-tax as the income of that previous year, whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not; or*

*(b) the successor in business has obtained, whether in cash or in any other manner whatsoever, any amount in respect of which loss or expenditure was incurred by the first-mentioned person or some benefit in respect of the trading liability referred to in clause (a) by way of remission or*

*cessation thereof, the amount obtained by the successor in business or the value of benefit accruing to the successor in business shall be deemed to be profits and gains of the business or profession, and accordingly chargeable to income-tax as the income of that previous year.”*

18. A careful perusal of the above provision leads us to infer that Section 41(1) can be pressed into service when an allowance or deduction is sought to be made in respect of loss, expenditure or trading liability is incurred by the assessee. In the instant case, the sum of Rs.58,38,581/- has remained with the assessee owing to the fact that the payees or holders of the draft/pay orders had not encashed them. The language employed by the legislature being unambiguous, it would be incongruous to construe the said sum as either a

loss, expenditure or trading liability incurred by the assessee. While dealing with a situation of unclaimed amount, the Hon'ble Supreme Court in the case of *T.V. Sundaram Iyengar*<sup>1</sup>, has held as follows:-

*“12. We are unable to uphold the decision of the Tribunal. The amounts were not in the nature of security deposits held by the assessee for performance of contract by its constituent. As it appears from the facts of the case, the amounts were depleted by adjustments made from time to time. The CIT(A) found that the assessee wrote back the amounts to its P&L a/c because the various trading parties did not claim these amounts for a long time. The amounts represented credit balances in the name of the trading parties and was taken to its P&L a/c. The CIT(A) held that these amounts were not*

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<sup>1</sup> (1996) 222 ITR 344

*revenue receipts but were of capital nature. The provisions of s.41(1) were not attracted in the facts of this case because the assessee's liability to pay back the amounts to its customers had not ceased. The Tribunal agreed with this view."*

*(underlining is by us)*

19. The Tribunal adverting to the above ruling has rightly deleted the sum of Rs.58,38,581/- added by the assessing authority by holding it as unsustainable in law.

20. Re-depreciation claimed on securities "held to maturity".

The assessee's claim on depreciation of Rs.17,59,00,087/- and consequential write off in the Books of Accounts was disallowed by the assessing authority on the premise that the securities categorised and accounted as "*held to*

*maturity*” were indeed investments and could not be considered as stock-in-trade.

21. Learned Counsel for the assessee is right in his submission that the issue with regard to the question as to whether an assessee would be entitled to claim depreciation in the given circumstances stands covered by the judgment in the case of *United Commercial Bank*<sup>2</sup>, wherein the Hon’ble Supreme Court has held as under:-

*“In our view, as stated above, consistently for 30 years, the assessee was valuing the stock-in-trade at cost for the purpose of statutory balance sheet, and for the income-tax return, valuation was at cost or market value, whichever was lower. That practice was accepted by the Department and there was no justifiable reason for not accepting the*

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<sup>2</sup> ITR 240 355 (SC)

*same. Preparation of the balance-sheet in accordance with the statutory provision would not disentitle the assessee in submitting the income-tax return on the real taxable income in accordance with the method of accounting adopted by the assessee consistently and regularly. That cannot be dis-carded by the departmental authorities on the ground that the assessee was maintaining the balance-sheet in the statutory form on the basis of the cost of the investments. In such cases, there is no question of following two different methods for valuing its stock-in-trade (investments) because the bank was required to prepare the balance-sheet in the prescribed form and it had no option to change it. For the purpose of income-tax as stated earlier, what is to be taxed is the real income which is to be deduced on the basis of the accounting system regularly maintained by the assessee and that was done by the assessee in the present case.*

*In the result, the appeal is allowed. The impugned order passed by the High Court is set aside. The question referred by the Tribunal are answered in favour of the assessee and against the Revenue.”*

*(underlining is by us)*

22. Admittedly in the instant case, assessee was following the method of accounting namely, “at cost or market value, whichever is lower”. Further, it is not in dispute that this practice was accepted by the Revenue throughout. Thus, in the light of the above pronouncement of the Hon’ble Supreme Court, notwithstanding the preparation of the balance sheet and describing the security under a particular nomenclature in compliance with the directions/instructions issued by the RBI, the assessee would be lawfully entitled to submit the tax returns on the real taxable income in



accordance with the method of accounting consistently and regularly adopted.

23. In the light of above discussions, we are of the considered view that the questions of law raised by the Revenue do not merit any consideration. Appeals fail and accordingly stand dismissed without any orders as to costs.

**Sd/-  
JUDGE**

**Sd/-  
JUDGE**

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