

IN THE HIGH COURT OF JUDICATURE AT MADRAS

Date:- 02.11.2009

Coram

The Honourable Mr. Justice K. RAVIRAJA PANDIAN

and

The Honourable Mr. Justice M.M. SUNDRESH

Tax Case(Appeal) No.1087 of 2009

The Commissioner of Income-tax,Coimbatore.

... Appellant

..vs..

M/s. Annamalai Finance Ltd.

... Respondent

Tax Case Appeal against the order dated 25.4.2008 passed by the Income-tax Appellate Tribunal, 'D' Bench, Chennai in ITA No.102/Mds/2002.

For Appellant : Mr. T. Ravi Kumar

JUDGMENT

(Judgment was delivered by K. RAVIRAJA PANDIAN, J.)

The Revenue has come forward with this tax case appeal against the order dated 25.4.2008 passed by the Income-tax Appellate Tribunal, 'D' Bench, Chennai in ITA No.102/Mds/2002 relating to the assessment year 1997-98, by formulating the following questions of law:-

(i) Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that overdue charges on accrual basis not accounted the books of account is not to be brought to tax?

(ii) Whether on the facts and circumstances of the case, the Tribunal was right in holding that the additional financial charges (overdue charges) are not to be added as income of the assessee?"

2. The facts, as culled out from the memorandum of grounds, are as follows: During the previous year ended on 31.3.1997, the assessee Company had admitted overdue financial charges on hire purchase and lease transactions on cash basis i.e. on receipt basis and not on accrual basis. In the course of the assessment proceedings, the assessee Company was informed that since it had been following mercantile system of accounting for all incomes and expenses, the same has to be adopted in respect of overdue financial charges as mandated by Section 145 of the Income-tax Act.

3. From the assessment year 1997-98, in the case of Companies, the method of accounting is to be followed strictly the mercantile system of accounting i.e. on accrual basis including that of overdue charges of hire purchase and lease for standard and non-standard assets. The assessee-Company filed the details and it is found that the overdue charges on accrual basis in respect of hire charges and lease in respect of the amount of Rs.82,23,892/- and Rs.24,37,922/- respectively aggregating to an amount of Rs.1,06,61,814/- had not been admitted by the assessee on accrual basis.

4. The assessee had submitted that in respect of overdue charges, the assessee Company, keeping in line with the norms of the Reserve Bank of India as well as the credit rating agency, has been recognising income by way of overdue charges only to the extent of actual collection i.e. the assessee is admitting income only on cash basis. The assessee Company has also placed reliance upon the Accounting Standard 9 of ICAI which lays down that when uncertainties exist regarding determination of the amount or its collectability, the revenue shall not be treated as accrued and hence shall not be recognised until collection.

5. The recognition of revenue on accrual basis presupposes the satisfaction of two conditions viz. the revenue is measurable and that the revenue is collectable without any uncertainty. Taking into account these standards also, the assessee submitted that the overdue on financial charges on hire purchase and lease had been admitted only on cash basis. Rejecting the said submission, the Assessing Officer passed the assessment order.

6. Aggrieved by the same, the assessee filed an appeal before the Commissioner of Income-tax (Appeals), who dismissed the appeal, upholding the finding of the Assessing Officer. The Assessee preferred a further appeal before the Income-tax Appellate Tribunal and the Tribunal allowed the appeal of the assessee, following the judgment of the Division Bench of this Court in assessee's own case reported in VOL.275 (2005) ITR 451 (COMMISSIONER OF INCOME-TAX v. ANNAMALAI FINANCE LTD.) in respect of assessment years 1992-93, 1993-94 and 1994-95. The revenue has filed the present appeal against the order of the Tribunal formulating the questions of law referred to above.

7. Mr. T. Ravi Kumar, learned counsel appearing for the Department submitted that the issue is covered by the decision in respect of assessee's own case decided by the Division Bench of this Court

reported in 275 ITR 451(cited supra), wherein the third question of law was considered, which is as follows:-

"Whether on the facts and circumstances of the case, the Tribunal was right in upholding the action of the assessee in changing the method of accounting of overdue interest alone on a cash basis, when the system of accounting of the assessee was mercantile?"

8. In the said decision, the Division Bench held as follows:-

"It is a settled proposition vide the decision of a Division Bench of the Calcutta High Court in Hela Holdings Pvt. Ltd. v. CIT (2003) 263 ITR 129 that the assessee is entitled to change his regular method of accounting by another regular method. It would be open to the assessee to produce records and show that it had followed such changed accounting method in the subsequent years. In the said decision, the Calcutta High Court also laid down the following general principles regarding tax avoidance and tax evasion, while dealing with the validity of the change in the method of valuation, change in accordance with the accounting practice and change followed in subsequent years. The general principles are :

"(i) the distinction between tax evasion and tax avoidance is still prevalent.

(ii) generally speaking, tax evasion is the result of such things as illegality, suppression, misrepresentation and fraud.

(iii) tax avoidance is the result of actions taken by the assessee, none of which is illegal or forbidden by the law in itself and no combination of which is similarly forbidden or prohibited.

(iv) the permissibility of a tax avoidance, will fall to be decided, when and only when, on the basis of the facts and transactions truly and correctly disclosed by the assessee, a point of law arises, whether on a certain reasonable construction of one part of the taxing statute, as applied to the assessee's case, tax which would otherwise be payable by the assessee, becomes not payable in the case in hand.

(v) when the court is faced with a task of construction in the above manner, the court is not bound to make the construction in favour of the assessee merely on proof by the assessee, that it has entered into no illegality and made no prohibited transaction.

(vi) the court would have to assess, in the facts and circumstances of each case, upon general principles of conscience and justice, whether the arrangement of affairs by the assessee, so as to cause the possibility of a reduction of tax incidence, can fairly be permitted to the assessee, as a genuine and legal means of tax reduction, employed by it in a commercial fair sense, or whether allowing the assessee to earn the reduction, in the facts and circumstances of the

particular case, is opposed to the public policy of not encouraging citizens to engage themselves in dealings and transactions designed primarily for the purpose of non-payment of tax only."

In the instant case, learned counsel for the Revenue is not in a position to demonstrate or satisfy us that due to the change of accounting method adopted by the respondent/assessee, which is permissible in law as per the ratio laid down in (i) CIT v. Matchwell Electricals (I.) Ltd. (2003)263 ITR 227 (Bom) and (ii) Hela Holdings Pvt. Ltd. v. CIT (2003) 263 ITR 129 (Cal), the Revenue suffered any loss or such a change of methodology attracts tax evasion. Concededly, there is no finding to that effect in the assessment order or in the order of the Commissioner of Income-tax (Appeals).

The change of method of accounting of overdue charges from the mercantile basis to cash system, method of accounting, as followed by an assessee, does not create any income; but the method of accounting only recognizes income. Therefore, either to apply the accrual system or cash system, recognition of income is a paramount factor. In the present case, the disputed amount is the overdue charges receivable by the assessee from various parties on the basis of hire-purchase and lease agreements. As per the terms of the agreements, overdue charges are payable by the parties concerned to the assessee when they make defaults in paying the instalments as per the schedule of payments. When the instalment itself is overdue, is not collected, there is no basis for making out a case that the additional overdue charges payable by the parties would be collectible with certainty. The terms of the agreements which enable the assessee-company to demand overdue charges is only an enabling provision and that enabling provision does not guarantee the collection of overdue charges. It only gives a cause of action to the assessee. In such cases it is very difficult to recognize income against overdue charges.

We are, therefore, of the considered opinion that the Tribunal has rightly deleted the additions made towards overdue charges, acknowledging the change of method of accounting of overdue interest alone on cash basis."

9. As the Division Bench judgment squarely covers the issue, both the questions of law formulated by the revenue has been answered affirmatively against the Revenue.Hence the appeal filed by the revenue is dismissed.

To
The Commissioner of Income-tax
Coimbatore