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THE HIGH COURT OF DELHI AT NEW DELHI

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Judgment reserved on: 10.01.2012

Judgment delivered on: 07.02.2012

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**ITA Nos. 216/2011, 398/2011,
403/2011, 404/2011 & 680/2011**

CIT

..... APPELLANT

Vs

VIRTUAL SOFT SYSTEMS LTD.

..... RESPONDENT

Advocates who appeared in this case:

For the Appellant: Ms. Rashmi Chopra, Advocate

For the Respondent: Mr. S. Krishnan, Advocate

CORAM :-

HON'BLE MR JUSTICE SANJAY KISHAN KAUL

HON'BLE MR JUSTICE RAJIV SHAKDHER

RAJIV SHAKDHER, J

1. The captioned appeals lay challenge to a common judgment of the Income Tax Appellate Tribunal, Delhi Bench, New Delhi (in short the Tribunal) passed on 19.02.2010. The only point raised in the captioned appeals is: whether an assessee's leased rental income could be allowed to be reduced by taking recourse to lease equalization charges.

2. It is relevant to note that before the Tribunal the assessment years (in short AY) in issue were: AYs 1996-97 to 2000-01. Thus, the Tribunal, by virtue of the impugned judgment dealt in all with five (5) appeals being ITA Nos. 117, 118, 119, 120 & 2292/Del/2006&04. In so far as the first appeal

was concerned, that is, the one relating to 1996-97, the challenge before the Tribunal was laid vis-a-vis the order dated 26.03.2004, passed by the Commissioner of Income Tax (in short CIT) under Section 263 of the Income Tax Act, 1961 (in short the I.T. Act). The issue on merits was the same as indicated hereinabove by us. As regards the remaining four (4) appeals, what was challenged before the Tribunal was a common order of the Commissioner of Income Tax (Appeals) [in short the CIT(A)] dated 15.09.2003 pertaining to AY 1997-98 to 2000-01. In these appeals as indicated in the judgment of the Tribunal, there were two issues raised. The first issue, pertained to the validity of the re-assessment proceedings carried out in the case, while the second issue, on merits, was the same as indicated above by us.

3. It is in this factual background that the Tribunal, in the first instance, dealt with the issue on merits and, having come to the conclusion that the contention of the assessee had to be sustained, the validity of the order passed in AY 1996-97 under Section 263 of the IT Act or, the validity of the re-assessment proceedings, in so far as, the remaining four assessment years were concerned, was not examined, as they had become, according to the Tribunal, “of academic interest”.

4. It is in this background that the Revenue has come up in appeal to this court.

ASSESSMENT YEAR 1996-97

4.1 In respect of AY 1996-97, the original assessment was completed, on 30.03.1999, under Section 143(3) of the IT Act. The said assessment was set aside by CIT(A). Consequently, an order under Section 143(3) read with Section 152 of the IT Act was passed on 19.03.2002. This order led to a determination of, a negative income, qua the assessee, which was, pegged at (-) Rs 11,02,255. The said order of assessment dated 19.03.2002, was set

aside by the CIT in exercise of its power under Section 263 of the IT Act vide order dated 26.03.2004. By this order the CIT, directed inclusion of a sum of Rs 33,77,830/- in the assessee's income, on account of lease rental. Consequent thereto, the assessee was issued a notice under Section 143(2) of the IT Act and, after hearing the representative of the assessee, the total assessable income of the assessee was re-computed, by the order dated 09.03.2005 as follows.

Income as per Order u/s 250/143(3)	
dated 19-03-2002	(-) 11,02,255/-
Add: Lease Rental	<u>33,77,830/-</u>
Total Assessable income	<u>22,75,575/-</u>

4.2 The assessee's income was thus assessed at Rs. 22,75,575/-, interest was also levied under Section 234B and Section 234C of the IT Act; orders were also issued for initiation of penalty proceedings under Section 271(1)(c) of the IT Act.

4.3 The assessee being aggrieved, impugned the substantive order of the CIT dated 26.03.2004 passed under Section 263 of I.T. Act in appeal before the Tribunal, which culminated in the impugned judgment.

ASSESSMENT YEAR 1998-99 TO 2000-01

4.4 In so far as the remaining four assessment years were concerned the assessing officer appears to have passed separate orders of even date, i.e., 28.01.2005. A perusal of the order would show that a common thread flows through the said assessment orders.

4.5 The assessment's were re-opened for the said years, by the assessing officer, after taking recourse to the provisions of section 147/148 of the IT Act.

Notices were issued to Show Cause as to why lease equalization charges debited to the profit and loss account should not be disallowed and, thereupon added to the assessee's income.

4.6 The assessee, filed his reply and objected to the assessment being reopened as, according to it, there was no reason to believe that income had escaped assessment. On merits, the assessee had submitted that it had relied upon the Guidance Note dated 20.09.1995 (in short the Guidance Note) issued by the Institute of Chartered Accountants of India (in short ICAI), in respect of, Accounting for Leases. It was also submitted that the Central Government on 25.01.1996, had already issued an Accounting Standard qua Section 145 of the IT Act, which mandated that accounting policy of the assessee should be such so as to represent true and fair view of the affairs of the assessee's business.

4.7 The assessing officer, however, rejected the submission of the assessee, and came to the conclusion that the taxable income of the assessee had to be determined as per the IT Act and, that the said Guidance Note of the ICAI only provided guidelines for preparation of financial statements for the purposes of accounting. This apart, the assessing officer relied upon the order of the CIT(A) dated 27.07.2004 passed in the assessee's own case, for AY 2001-02. The sum and substance of the order passed by the CIT(A), in AY 2001-02, was that the lease equalization charge, was a notional charge on the profits of an assessee. The said lease equalization charge, represented an amount set aside out of profits of the assessee to equalize the imbalance between lease rental and depreciation created over a period of time. The lease equalization charge was thus, a provision, and not an expense incurred by the lessor, i.e., the assessee. This provision was similar to that made for depreciation. Therefore, a mere provision made for gauging the profitability of a business venture could not be claimed as a deduction under the IT Act. It may be worthwhile to note

that eventhough the order of the CIT(A) denied to the assessee the deduction, it recognized the fact that lease equalization charge was a provision for additional depreciation, crafted to reflect true and correct picture of the profitability of the assessee. Relying on the order of the CIT(A), for the AY 2001-02, the assessing officer, disallowed the sum attributed to lease equalization charges, and consequently, added the same to the assessee's income. The disallowance, in each of the assessment years is as follows: (i) AY 1997-98 Rs. 67,02,745/-; (ii) AY 1998-99 Rs. 66,50,755/-; (iii) AY 1999-00 Rs. 1,65,12,077/- and (iv) AY 2000-01 Rs.1,14,47,407/-

4.8 The assessment orders were carried in appeal to the CIT(A). The CIT(A) in respect of the aforementioned four assessment years passed a common order dated 15.09.2005. The CIT(A), in so far as re-opening of the assessment proceedings was concerned came to the conclusion that since, in the first instance, no definitive finding with regard to lease equalization charges had been given, it could not be said that there was a change of opinion on the part of the assessing officer. The CIT(A) held, that based on a consideration of the facts, the assessing officer had come to the conclusion that the lease equalization charges had been wrongly claimed as deduction and hence, there was occasion to initiate proceedings under Section 147 read with Section 148 of the IT Act. The CIT(A), was thus of the view, that the assessing officer's action of re-assessment had to be sustained.

4.9 On the merits, the CIT(A) followed his own order dated 27.07.2004 passed in the assessee's case in AY 2001-02 and sustained the addition. He briefly held that, the Guidance Note issued by the ICAI itself, indicated that income of the assessee had to be determined as per the prevalent tax laws, and that the Guidance Note was evolved only for the purposes of finalization of the accounts of the assessee. As noticed by us above, the assessing officer had followed the order of the CIT(A) for AY 2001-02.

5. The assessee being aggrieved by both the order of the CIT dated 26.03.2004 passed under Section 263 of the IT Act pertaining to AY 1996-97, and the common order passed by the CIT(A) dated 15.09.2003 vis-à-vis AY 1997-98 to 2000-01, preferred appeals to the Tribunal. The Tribunal, by the impugned judgment dated 19.02.2010, allowed the appeals of the assessee, on merits.

6. The revenue being aggrieved, has preferred the captioned appeals before us. In these appeals, the predecessor bench had framed the following common questions of law by an order dated 06.07.2011.

- (a) Whether on the facts and circumstances of the case, the ITAT erred in law and on merits in allowing the deduction of lease equalization charges from lease rental income?
- (b) Whether the Guidance Note issued by ICAI for presentation of accounts would override the statutory provisions of the Income Tax Act, 1961?

6.1 By a subsequent order passed on 10.01.2012, the second question of law was reformulated with the consent of counsels for the assessee and revenue. The reformulated question of law reads as follows:

- (b) Whether in determination of the real income of the assessee recourse can be taken by the assessee to the Guidance Note issued by ICAI.

SUBMISSION OF COUNSEL

7. Before us arguments on behalf of the revenue were advanced by Ms Rashmi Chopra, while on behalf of the assessee submissions were made by Mr S. Krishnan.

7.1 Ms Rashmi Chopra, in her submissions largely relied upon the orders passed by the assessing officer and the order of the CIT(A) dated 15.09.2003. It was Ms Chopra's submission that the assessee could not take recourse to the

Guidance Note issued by the ICAI qua Accounting for Leases in determination of its income, and therefore in that regard, whether a particular deduction ought to be allowed or disallowed, one would only have to look to the provisions of the IT Act. Ms Chopra contended that, the debit made to the profit and loss account by the assessee in the AYs under consideration towards lease equalization charge was rightly disallowed by the assessing officer as, there was no provision in the IT Act for such a deduction. Ms Chopra, further submitted that, in any event, there had been no determination whatsoever by the assessing officer, as to whether the lease transactions in issue could be categorized as a finance lease. Ms Chopra stated that the issue pertaining to this aspect of the matter was pending in another appeal being ITA No. 142/2007, titled CIT vs Goodwill India. For these reasons, Ms Chopra argued that the view taken by the Tribunal, was erroneous and ought to be reversed.

7.2 On the other hand, Mr Krishnan contended that, regard may be had to the fact that the assessee was entitled to change its accounting policy which it had done, by taking recourse to the provisions of the Guidance Note issued by the ICAI, while accounting for lease transactions. The method of accounting which the assessee had followed was based what has been provided in paragraphs 11 and 22 of the Guidance Note. Mr Krishnan submitted that, the courts had accepted the recommendations issued by the ICAI from time to time, with respect to the manner and mode of reflecting transactions in books of accounts, in a number of judgments, pronounced by both the High Courts' as well as the Supreme Court. In this regard he placed reliance on the judgment of this court in the case of ***CIT vs Woodward Governor India Pvt. Ltd. (2007) 294 ITR 451 (Delhi)*** and the Judgment of the Supreme Court in the case of ***Collector of Central Excise Etc. Vs Dai Lchi karkaria Ltd (1999) 156 CTR 172 (SC)***.

7.3 Mr Krishnan, further submitted that, what is provided in the Guidance Note stands transcended into an Accounting Standard (in short ‘A.S.’) issued by the ICAI, in 2001.

7.4 In this regard Mr Krishnan placed reliance on A.S. 19 issued by the ICAI. Mr Krishnan, also placed reliance on two judgments of different benches of the Tribunal in the case of ***Indian Railways Finance Corporation Ltd. Vs JCIT (Delhi Tribunal) ITA Nos. 699, 359, 3357 & 2109/Del/04*** and ***JCIT vs Pact Securities & Financial Ltd 86 ITD 115 (Hyd.)***. The latter being extensively referred to in the former judgment of the Tribunal.

7.5 It was Mr Krishnan’s contention that lease equalization charge was nothing but a method of adjusting the depreciation claimed in the books of accounts to enable the assessee to represent its real income by adopting an accounting methodology which, even though not mandatory, had surely the seal of approval of a professional body, such as, the ICAI. Mr Krishnan submitted that the Tribunal, had rightly come to the conclusion that the lease equalization charge could not be disallowed and hence, could not be added to the assessee’s income on the ground that there was no provision in the IT Act as, over the entire lease period of the asset, the debits and credits made in the profit and loss account would square off with each other. In other words the ultimate effect of such a charge was reduced to a naught.

7.6 Reliance was also placed by Mr Krishnan, on the provisions of Section 211(3C) of the Companies Act, 1956 (in short Companies Act), to contend that the ICAI was mandated with the task of formulating A.Ss from time to time for acceptance by the Central Government.

REASONS

8. Having heard the learned counsels for the parties and perused the record, what emerges is as follows: However, before we proceed further, we

may indicate that, we would be answering the questions of law framed; in the reverse order, in as much as, the second question would be answered first and then, we would take up the other question of law.

8.1. The foremost aspect which, thus arises for consideration in this case is: whether the method of accounting employed by the assessee to determine the real income evidently derived from lease of assets, could be given a go-by. In determining its income and its presentation, the assessee took recourse to the Guidance Note, issued by the ICAI, on Accounting For Leases. The ICAI's publication on the subject indicates that the Guidance Note on accounting of leases was issued by it, for the first time, in 1988, which was, then revised in 1995. The hiatus between the date when it was first issued, and its revision, appears to be on account of an interim order granted by the Madras High Court in a case, which was, disposed of on, 14.07.1995. It appears that the case was dismissed as withdrawn.

8.2 We may also note that our discussion is prefaced by the fact that on 01.04.2001, the ICAI did publish A.S. 19 in respect of leases. The said A.S. 19, is applicable, in respect of, assets leased during accounting periods commencing on or after 01.04.2001. The periods, which are under consideration, in the present appeals, are prior to 01.04.2001.

9. In this background what is required to be considered is whether the books of accounts could be rejected by the assessing officer merely for the reason that recourse to the Guidance Note was taken by the assessee. In this regard, we would be required to examine the provisions of Section 145 of the I.T. Act. Section 145 of the I.T. Act adverts to the method of accounting followed by an assessee. Sub-section (1) of Section 145 provides that income chargeable under the head "profits and gains of business or profession" or "income from other sources" shall be computed either on cash basis or on

mercantile system, whichever method being regularly employed by the assessee. This provision is, however, subject to the Central Government notifying A.S. in respect of any class of assessee or class of income. Sub-section (3) of Section 145, empowers the assessing officers to disregard the books of accounts submitted by the assessee only if he is not satisfied with: the correctness or completeness of the accounts of the assessee or, the method of accounting employed by the assessee or on account of A.S. notified under sub-section (2), not being particularly followed by the assessee. In this particular case, the assessing officer has disregarded, in substance, the method of accounting followed by the assessee qua lease rentals without basing it on the grounds provided in Section 145 of the IT Act. The fact that the assessee justified its method of accounting, by taking recourse to the Guidance Note issued by the ICAI in that behalf, was disregarded, on what we would term as, a disjointed reading of the provisions of the said Guidance Note. Both the assessing officer as well as the CIT(A) have adverted to paragraph 2 of the Guidance Note to come to, what we consider an erroneous conclusion in as much as they have held that in determining as to whether deduction on account of lease equalization charges ought to be allowed or not, what has to be borne in mind is ultimately the provisions of the IT Act. In our view, such an observation in paragraph 2 of the Guidance Note is really saying the obvious. Therefore, even if this Guidance Note was silent on this aspect the provisions of the I.T. Act would undoubtedly still apply. Thus, as to what is the impact of provision of para 2 of the Guidance Note will be considered by us as we progress further with our judgment.

9.1 However, what is important at this stage is to first address ourselves to the aspect as to whether the assessing officer could have disregarded the method of accounting followed by the assessee in respect of lease rentals. In our view, the assessing officer could not have do so, as the method of

accounting was based on a guideline commended for adoption by a professional body such as the ICAI. The Guidance Note reflects the best practices adopted by accountants the world over. The fact that, at the relevant point in time, it was not mandatory to adopt the methodology professed by the Guidance Note issued by the ICAI, is irrelevant, for the reason that, as long as there was a disclosure of the change in Accounting Policy in the accounts, which had a backing of a professional body such as the ICAI, it could not be discarded by the assessing officer. This is specially so, since the ICAI is, recognized as the body vested with the authority to recommend A.Ss for ultimate prescription by the Central Government in consultation by the National Advisory Committee of Accounting Standards, for presentation of financial statements. The provisions of section 211(3C) of the Companies Act are quite clear on this aspect. As a matter of fact, the proviso to the said sub-section, quite clearly specifies that till such time the Central Government prescribes the accounting standards the accounting standards issued by the ICAI, shall be deemed to be the relevant accounting standards. The relevant provision reads as follows:

“211(3C) For the purposes of this section, the expression “accounting standards” means the standards of accounting, recommended by the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949 (30 of 1949), as may be prescribed by the Central Government in consultation with the National Advisory Committee on accounting Standards established under sub-Section (1) of Section 201A. Provided that the standards of accounting specified by the Institute of Chartered Accountants of India shall be deemed to be the accounting standards until the accounting standards are prescribed by the Central Government under this sub-section.”

10. In this context it would be important to note that AS1 pertaining to **Disclosure of Accounting Policies** has already been notified by the ICAI as having attained mandatory status for periods commencing on or after

01.04.1991. It is not, the Assessing Officer's case, that the accounting policy with regard to lease rentals was not disclosed by the assessee. The assessing officer seems to have taken umbrage to the change in accounting policy having been brought about only with effect from AY 1996-97. In our view, as long as there was a disclosure of the factum of change in the accounting policy and its effect, in the accounts, no fault could be found with the change in accounting policy merely on account of the fact that it was employed for the first time in AY 1996-97. The change in accounting policy, as noticed by us above, had the imprimatur of a duly recognized professional body, i.e., the ICAI. Therefore, notwithstanding the fact that the opinion of the ICAI was expressed in a Guidance Note which had not attained a mandatory status, would not, in our view, provide a basis to the assessing officer to disregard the books of accounts of the assessee and in effect method of accounting for leases, followed by the assessee.

11. This brings us to the next crucial question as to whether the Tribunal had erred in allowing the deduction on account of lease equalization charges. In order to adjudicate upon this issue, it may be relevant to first understand as to how lease transactions operate in the commercial world. Traditionally, the term lease was confined to an immovable property such as building and/or land. Lease therefore came to be defined as: ***A conveyance of land or of the use of a building or a part of a building from one person (lessor) to another (lessee) for a specified period of time, in return for rent or other compensation. (See Dictionary for Accountants, Eric L. Kolher 1978, 5th edition).*** This traditional view, underwent a change over a period of time when, parties and/or entities entered into lease transactions even qua movable assets, such as, plant, machinery and various other assets, which also included vehicles; to name some of them. The Oxford Dictionary of Accounting (New Edition), 1999 represents that change. The definition of lease contained

therein, is indicative of the shift. For the sake of convenience the definition of lease as appearing in the said dictionary is also extracted hereinbelow:

“Lease: A contract between the owner of a specific asset, the lessor, and another party, the lessee, allowing the latter to hire the asset. The lessor retains the right of ownership but the lessee acquires the right to use the asset for a specific period of time in return for the payment of specific rentals or payments. Statement of Standard Accounting Practice, 21 Accounting for Leases and Hire Purchase Contracts, classifies leases into operating leases and finance leases with differing accounting treatments.”

12. A perusal of the definition would show that a lease represents an arrangement, which more often than not dons a form of a contract, whereby party ‘A’ confers upon party ‘B’ the right to use an asset, for a consideration, which ordinarily is labelled as lease rentals.

12.1 Over a period of time, the transactions stood refined, in the sense, a lessor need not necessarily have created or even bought an asset with his own funds. Therefore, you could have a lease transaction where ‘A’ was the lessor of an asset, which was financed by ‘C’, i.e., a lender, and which, ultimately, was leased to party ‘B’, i.e., the lessee. A lease transaction therefore attained several forms, depending on the comfort level of the parties entering into a transaction and, the purpose with which the transaction was entered into, bearing in mind, the nature of the asset and, the risk bearing capacity of the parties. Therefore, you could today execute a finance lease, or an operating lease, or evolve a sale and lease back arrangement, or a leveraged lease, or even, employ a direct leasing arrangement.

12.2 We do not intend to get into the various forms in which, a lease transaction may be executed by parties, but what is important, is that, all these transactions exhibit a facet by which access is provided to an asset, by separating ownership, risk and the provision of finance to achieve this goal.

Since, we are concerned in this matter with a lease, which is, ordinarily known as, a finance lease, or even capital lease; an attempt would be made to articulate as to what such a transaction would entail.

13. The Guidance Note of the ICAI defines a finance lease as: “***a lease under which the present value of the minimum lease payments at the inception of the lease exceeds or is equal to substantially the whole of the fair value of the lease assets***”.

13.1 As the definition would indicate the lease arrangement of a finance lease is one, whereby the lease rentals are so configured that over a period of time they enable the lessor to recover a substantial portion of the fair value of the assets.

13.2 Therefore, generally the attributes of such a lease are: (a) it is a long term lease; which is ordinarily irrevocable and, the minimum present value of the lease rental decided at the commencement of the lease, which is spread over a period of time, facilitates recovery of a substantial part of the fair value of the leased assets. While fixing the lease rentals and the lease period, the economic life of leased asset is borne in mind. The lease period is normally shorter than the economic life of the asset. The other attribute of such a transaction is that the risk of breakdown or technological obsolescence is transferred to the lessee, who therefore ordinarily would bear the cost of maintenance, repairs and insurance of the leased assets. The ownership, however, is retained with the lessor.

14. The Tribunal, in the captioned cases, has returned a finding of fact after examining transaction at hand that it is a finance lease. Being a final fact finding authority we do not intend to disturb this finding; which in any case cannot be disturbed except on the ground of perversity. The learned counsel for the revenue though, did attempt to argue before us, that there is no

determination by the assessing officer as to whether the lease transactions in issue were in the nature of a finance lease; we tend to disagree as the Tribunal quite categorically in paragraph 9 of the impugned judgment has come to a conclusion that the transactions in issue were in the nature of a finance lease. The relevant portion is extracted hereinafter for the sake of convenience:

“9. As per the guidance notes, operating lease has been defined as lease other than the finance lease. If the entire value of asset was not recovered by the assessee in the case of Goowill India Ltd. (supra) during the period of lease, it cannot be a finance lease and hence guidance notes of the ICAI cannot be applicable to such an assessee. In the present case, in the sample working submitted before us, it is shown that as against amount financed by the assessee of Rs.677,645/-, the assessee has recovered Rs.654,944/- as depreciation and the balance amount of Rs.22,799/- has been explained as residual value of the leased asset. This is only 3.36% of the amount financed and hence it is reasonable claim that this balance amount is residual value. In the case of Goodwill India Ltd. (supra) relied upon by the learned DR of the revenue, as per example noted by the tribunal on page 37 of 306 ITR, against cost of the asset of Rs.100/-, only Rs.66/- was recovered depreciation and the unrecovered amount is 34%. This cannot be said to be residual value. In view of this vital difference in facts, we are of the considered opinion that this Tribunal decision is not applicable in the present case because in the present case, the assessee is recovering full financed amount of the lease asset during the lease period in the form of depreciation and residual value. No defect is pointed out by the learned counsel of the revenue in this chart and it is also not the case of the revenue that the facts of the present case are different than the position depicted in this chart. Since, the facts are different; the Tribunal decision cited by Ld. Counsel of the revenue rendered in the case of Goodwill India Ltd. (supra) is not relevant in the present case. We would also like to point out that in the present case, it is not the case of the revenue that the leases in question are not finance lease as

per the guidelines issued by ICAI. The case of the revenue as per the orders of the authorities below and as per written submissions of learned counsel of revenue before us is that the guidelines of ICAI are not decisive and no deduction is allowable as per any provision of Income Tax Act on account of Lease Equalisation charges and still we have obtained sample working from the assessee by refixing the case for clarification to satisfy ourselves that the leases in question in the present case is finance leases and as per the discussion above, we have noted that in the present case, the leases are finance lease whereas in the case of Goodwill India Ltd. (supra), the lease was not finance lease as per the facts noted by the tribunal in that case.”

(emphasis is ours)

14.1 A perusal of the grounds of appeal would show that there is no averment whatsoever that such a finding of fact recorded by the Tribunal, was perverse. Therefore, we would have to accept that the Tribunal examined the record, and came to a correct conclusion.

14.2 The Tribunal having found that the lease in issue is a finance lease we would be required to consider whether the method employed by the assessee with regard to determination of the real income is a correct method. Paragraph 11 and 12 of the Guidance Note of the ICAI read with the appendix attached to it is, quite instructive in this regard. Therefore, paragraph 2 of the Guidance Note on which great stress is laid on behalf of revenue has to be read with paragraphs 11 and 12. We do not wish to burden the judgment with the extract of the said paragraphs, however, it is sufficient to note that the paragraphs adverts to the following four elements, which arise, for consideration for treatment of the amount received as lease rentals by the lessee, in order to bring to tax what is his real income and, present a true and fair view of the transaction in issue. The four elements which are considered are: lease rentals; the implicit rate of return (IRR); depreciation; and lease equalization charge.

14.3 Lease rental in monetary terms is a sum total of: the financing charge and the amount embedded in it in the form of the capital sum. What the assessee needs to do, while offering for tax income derived from lease is, to separate the financing charge from the amount recovered towards capital, that is, the capital recovery amount. The financing charge is determined by applying the IRR to the net investment made in the asset. The assessee also needs to provide for depreciation, on the capital value embedded in the lease rental. The fourth element which is the lease equalization charge is the result of the adjustment, which the assessee has to make whenever, the amount put aside towards capital recovery is not equivalent to the depreciation claimed by the assessee. The assessee, may claim depreciation based on the provisions of the IT Act or, may even adopt the method of depreciation provided under the Companies Act. In the event, the depreciation claimed is less than the capital recovery, the difference is debited in the profit and loss account in the form of lease equalization charge, and similarly if, for any reason the depreciation claimed is more than capital recovery then, the difference is credited, once again, in the form of lease equalization charge to the profit and loss account. Therefore, the assessee in effect debits or credits its profit and loss account with a lease equalization charge depending on whether or not the depreciation claimed is, less or more than the capital recovery. The capital recovery can be known, as is evident, on deduction of financing charges from the lease rentals. In sum and substance, lease equalization charges is a method of re-calibrating the depreciation claimed by the assessee in a given accounting period. The method employed by the assessee, therefore, over the full term of the lease period would result in the lease equalization amount being reduced to a naught, as the debit and credits in the profit and loss account would square off with each other. Hence, the contention of the revenue that it is a claim in the form of a deduction which cannot be allowed, as there is no provision under the I.T. Act is, in our view, a complete misappreciation of what constitutes a

lease equalization charge. In our opinion, as long as the method employed for accounting of income meets with the rudimentary principles of accountancy, one of which, includes offering only revenue income for tax, we cannot find fault with the assessee debiting lease equalization charges in the AYs in issue, in its profit and loss account. This represents true and fair view of the accounts; a statutory requirement under Section 211(2) of the Companies Act. As explained by us above, the rationale is that over the entirety of the lease period the said debit would work itself out.

15. Therefore, for the reasons given hereinabove, in our opinion, the method of accounting followed by the assessee enabled, it to determine the real income, which was offered for tax in the instant case. The assessing officer, by disallowing the deduction has added to the taxable income of the assessee that, which is not, part of its income, but only an adjustment of the amount claimed as depreciation.

16. Therefore, both questions of law are answered in favour of the assessee and against the revenue. The appeals of the revenue are, accordingly, dismissed.

RAJIV SHAKDHER, J

SANJAY KISHAN KAUL, J

FEBRUARY 07, 2012
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