

In the High Court of Judicature at Madras

Dated: 15.06.2015

Coram

The Honourable **Mr.JUSTICE R.SUDHAKAR**

and

The Honourable **Ms.JUSTICE K.B.K.VASUKI**

Tax Case (Appeal) Nos.1222 and 1225 to 1228 of 2007

Commissioner of Income Tax
Chennai

.... Appellant in the above T.C.(A)s)

Vs.

M/s.Shriram Investments Ltd.
Mookambika Complex,
4 Lady Desika Road,
Mylapore, Chennai - 600 004.

.... Respondent in the above T.C.(A)s)

APPEALS under Section 260A of the Income Tax Act against the order dated 21.04.2006 in I.T.A.No.126/Mds/2004, 327/02, 1899/03, 127/04 and 804/03 on the file of the Income Tax Appellate Tribunal Madras 'B' Bench, Chennai.

For Appellant : Mr.J.Narayanasamy

Standing Counsel for Income Tax

For Respondent: Mr.R.Sivaraman

COMMON JUDGMENT

(Judgment of the Court was delivered by R.SUDHAKAR,J.)

All the above Tax Case (Appeals) are filed by the Revenue as against the order of the Income Tax Appellate Tribunal raising a common issue. The key issue that needs to be decided in the above appeals is the manner in which the Additional Finance Charges (AFC) also known as Overdue Charges (ODC) has to be taxed in the light of Section 145 of the Income Tax Act, which provides the method of accounting.

2. The brief facts of the case are as follows:

The assessee is a engaged in the business of hire purchase financing, leasing and investments. The assessment years in question are 1997-98 (T.C.(A)No.1228 of 2007), 1997-98 (T.C.(A)No.1226 of 2007) 1998-99 (T.C.(A)No.1225 of 2007), 1999-2000 (T.C.(A) No.1222 of 2007) and 2000-2001 (T.C.(A) No.1227 of 2007). In all these assessment years, the assessee was accounting AFC on accrual basis in the books of accounts maintained for the purpose of the Companies Act, whereas, for the purpose of Income Tax, it was accounted on cash basis. The Assessing Officer was of the view that

the respondent/assessee was following mercantile system of accounting and therefore, it was bound to show income arising out of AFC on accrual basis and therefore, additions on account of AFC was made in respect of each year. The Assessing Officer was also of the view that AFC should be included in the head 'profits and gains of business or profession' and therefore, subjected to tax. The Assessing further held that the AFC is an income accrued consequent on the failure on the part of the person concerned to pay the Equated Monthly Instalments (EMI). Further, since the assessee – company had shown the said amount, namely AFC in the profit and loss account maintained for the purpose of Companies Act, that amount should be reflected for the purpose of income tax as well.

3. Aggrieved by the said order of the Assessing Officer, the assessee preferred appeals before the Commissioner of Income Tax (Appeals). The Commissioner of Income Tax (Appeals) deleted the addition on the ground that the assessee was entitled to show the income arising out of AFC as and when the said income is received. In other words, the Commissioner of Income Tax (Appeals) rejected the stand of the Assessing Officer that if the assessee was following mercantile system of accounting, it was bound to show the income

arising out of AFC even though the said amount was not actually received.

4. Aggrieved by the order of the Commissioner of Income Tax (Appeals), the Revenue pursued the matter before the Tribunal primarily contending that in the books of accounts maintained for the purpose of Companies Act, the assessee has shown the AFC as income and therefore, the assessee cannot plead that for the purpose of income tax, it will show only the actual AFC amount received as towards income, more so, in a case where the assessee is admittedly following mercantile system of accounting. If it had accrued for the purpose of profit and loss account submitted in terms of the Companies Act, AFC should be deemed to have accrued for the purpose of income tax. On this premise, the case was urged before the Tribunal.

5. The Tribunal, however, placed much emphasis on the earlier decision of the Tribunal on the assessee's own case in respect of the assessment year 1996-97 in I.T.A.No.1222/MDS/1998 and also relying upon the decision of the Tribunal in the Case of ***Annamalai Finance Ltd. V. Additional CIT in I.T.A.Nos.99 to 103 (Mds)/2002***, which

was later on upheld by this Court in the decision reported in **[2005] 275 ITR 451 (CIT V. Annamalai Finance)**.

6. On the core issue that there is no prohibition under the Income Tax Act barring the assessee from maintaining the records as well as accounts, one for the purpose of income tax and the other for the purpose of compliance with the other Act, viz., Companies Act or Central Excises and Salt Act, the Tribunal, referring to Section 115J, 115JA and 115JB, came to hold that wherever such a situation arises, special provision has been made.

7. The Tribunal placing much reliance on the decision of this Court in the case of **Annamalai Finance Ltd. (supra)**, held that the amendment to Section 145 of the Income Tax Act did not have any effect on the issue under consideration, namely, for the assessment year 1997-98 onwards, as the scope of such amendment was considered by this Court in the above-said decision, in which case also, the assessment year involved is 1997-98, which is post amendment. The Tribunal, therefore, came to hold that AFC is an income arises only at the time of actual receipt. Holding so, the Tribunal dismissed the appeals answering the issue in favour of the assessee and against the

Department.

8. As against the said order of the Tribunal, the Revenue is before this Court.

9. Mr.J.Narayanasamy, learned Standing Counsel appearing for the Revenue argued in extenso as follows:

In order to explain the nature of the Department's claim on the tax on AFC, he suggested an illustration as follows:

If the assessee had financed a sum of Rs.1,20,000/- at the rate of interest at 20% per annum, the instalment will be Rs.10,000/- per month; in case of default on the monthly instalment, the assessee charges Rs.1,000/- as AFC or ODC. The assessee is reporting the monthly instalment of Rs.10,000/- on mercantile system of accounting in terms of Section 145 of the Income Tax Act. However, the assessee should have accounted the said Additional Finance Charges of Rs.1,000/- in the mercantile system of accounting; on the contrary, the assessee accounted the said AFC on cash/receipt system pleading that the recovery of AFC was doubtful and uncertain. The assessee was reporting AFC as income for the purpose of the Companies Act in the same year. However, for the purpose of income tax, the assessee

is not maintaining or following mercantile system and has not offered AFC for assessment on mercantile basis. In view of the specific provisions of Section 145 of the Income Tax Act, the assessee ought not to have followed cash system of accounting for this transaction. Having opted to mercantile system of accounting, the AFC become liable to tax as in the case of EMI. In effect, as and when EMI falls due, AFC also falls due and when the EMI accrues as income, the assessee is not entitled to claim that AFC should be excluded for the purpose of tax. It is not correct for the assessee to plead that AFC should be subjected to tax as and when the assessee received the same and not on the basis of accrual in the event of default of EMI.

10. The next contention of the learned Standing Counsel appearing for the Revenue is that the decision in the case of ***Annamalai Finance Ltd. (Supra)***, on which reliance has been placed by the Tribunal stands distinguished on facts, inasmuch as the assessee during the assessment year did not account the AFC in the books of accounts maintained under the Companies Act as well as under the Income Tax Act; therefore it stands on a different footing. Insofar as the present assessment years are concerned, the assessee had accounted AFC under the Companies Act, but it did not account

the same for the purpose of income tax. This distinguishing factor, therefore, makes the earlier order passed by this Court inapplicable to the facts of the present case.

11. He further submitted that what applied to the assessment year 1996-97 would not apply to the subsequent year, namely, 1997-98, in view of the amendment by the Finance Act, 1995, with effect from 01.04.1997, where under, Section 145 of the Income Tax Act clearly mandates that the computation of income should be either cash or mercantile system of accounting regularly employed by the assessee and in accordance with sub-section (2) of Section 145 of the Income Tax Act.

12. The further contention of the learned Standing Counsel appearing for the Revenue is that the concept of real income as contended by the assessee cannot be applied to the present case, since there is no material shown by the assessee that AFC income is impossible of realisation; in any event, the assessee is entitled to claim it as bad debts in the subsequent years if the AFC is not realisable.

13. In support of his contention, learned Standing Counsel

placed reliance on the decisions reported in **[2010] 320 ITR 577 (SC) (Southern Technologies Ltd. v. Joint Commissioner of Income-tax); [2010] 321 ITR 546 (Commissioner of Income Tax & Anr. v. United Breweries Ltd.) and (2012) 210 Taxman 62 (Madras)** to state that if the assessee had not received the said AFC, the same could be claimed as bad debts in the subsequent year.

14. Countering the arguments of the learned Standing Counsel appearing for the Revenue, Mr.R.Sivaraman, learned counsel appearing for the assessee/respondent submitted that Additional Finance Charges is an enabling penal provision in the agreement entered into between the parties. It is the additional burden on the borrower who is not prompt in repaying the borrowed money and the interest thereon in the form of Equated Monthly Instalments. AFC is only a mechanism to ensure recovery of the amount lent by the assessee. He further submitted that when a normal EMI itself has not been paid by the defaulter and there is an uncertainty attached to that recovery, the additional burden, namely recovery of AFC, cannot be certain. He also submitted that technically, AFC does not accrue or arise to be recognised as income if there is default in EMI payments. It is well settled that when there is uncertainty in income, the same

cannot be treated as income. As per the provisions of Income Tax Act, when an amount is uncertain of being received cannot be taxed as income till it is realised. He further submitted that AFC does not partake the character of income and there is no bar in the Income Tax Act that the profit and loss account and balance sheet prepared under the Companies Act will have to be followed for the purpose of Income Tax Act for computation of income.

15. In support of his contention, he relied on the decision of this Court reported in **[2005] 275 ITR 451 (CIT V. Annamalai Finance)**, to submit that when the instalment itself is overdue and is not collected, it is uncertain to recover the AFC. He further submitted that the decisions relied on by the learned Standing Counsel are distinguishable on facts, as they are dealing with bad debts. In the present case, there is no claim of deduction of bad debts.

16. Heard learned Standing Counsel appearing for the Revenue and the learned counsel appearing for the assessee and perused the materials placed before this Court.

17. Before going into the merits of the case, the provision, viz.,

Section 145 of the Income Tax Act, which is necessary for the disposal of the case reads as follows:

Post amendment:

"Method of accounting.

145. (1) *Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.*

(2) *The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assesseees or in respect of any class of income."*

Pre-amendment:

'145. *Method of accounting.—(1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with the method of accounting regularly employed by the assessee :*

Provided *that in any case where the accounts are correct and complete to the satisfaction of the Assessing Officer but the method employed is such that, in the opinion of the Assessing Officer, the income cannot properly be deduced therefrom, then the computation shall be made upon such basis and in such manner as the Assessing Officer may determine :*

Provided further that where no method of accounting is regularly employed by the assessee, any income by way of interest on securities shall be chargeable to tax as the income of the previous year in which such interest is due to the assessee :

Provided also that nothing contained in this sub-section shall preclude an assessee from being charged to income-tax in respect of any interest on securities received by him in a previous year if such interest had not been charged to income-tax for any earlier previous year.

(2)Where the Assessing Officer is not satisfied about the correctness or the completeness of the accounts of the assessee, or where no method of accounting has been regularly employed by the assessee, the Assessing Officer may make an assessment in the manner provided in section 144."

18. It is seen from the records that the assessee, which is a non-banking financial company entered into a lease agreement with its customers. One of the clauses in the agreement provides for if the monthly instalments (EMI) have not been paid, it would carry additional finance charges (AFC) in the prescribed rate. The assessee maintain its accounts with respect to the AFC charges under cash/receipt system for the purpose of Income Tax. In the event of

default in payment of instalments due on the due dates, the lessee or the hirer is bound to pay AFC, otherwise, called as ODC and this claim is penal in nature imposed as a measure to ensure prompt payment of EMI. Hence, the said clause was incorporated to ensure recovery. The assessee in this case is following mercantile system insofar as EMI is concerned. The provision of Section 145 is not deviated. Insofar as AFC charges are concerned, the amount is shown on cash/receipt basis for tax purpose. The question is whether such a method is opposed to law.

19. In an identical circumstance, this Court had an occasion to consider the issue in respect of overdue charges, in the case of ***Commissioner of Income Tax V. M/s.Annamalai Finance Ltd.*** reported in ***[2005] 275 ITR 451*** While dealing with the issue whether on the facts and in the 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, this Court held as follows:

" 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.”

(emphasis supplied)

20. The facts in the above-said decision was that during the assessment years in question, the Assessing Officer during the course of reassessment found that the assessee had changed the method of accounting from mercantile system to cash system for overdue charges alone and held that the same is not permissible. Accordingly, the Assessing Officer added the overdue charges to the income of the assessee, which was upheld by the first Appellate Authority. On appeal by the assessee, the Tribunal reversed the same in assessee's favour. On appeal by the Revenue, this Court accepted the plea of the assessee, thereby dismissed the Revenue's appeal holding that when the instalments itself is overdue and is not collected, there is no basis for making out a case that additional overdue charges would be collectible with certainty. It is not an income accrued for the purpose of tax.

21. In the above-said decision reported in **[2005] 275 ITR 451 (CIT V. Annamalai Finance)**, this Court following the decision of the Calcutta High Court reported in **(2003) 263 ITR 129 (Hela**

Holdings Pvt. Ltd. v. CIT) wherein, the Calcutta High Court had laid down certain general principles regarding tax avoidance and tax evasion, held that the Revenue was not in a position to demonstrate or satisfy that due to the change of accounting method adopted by the respondent/assessee, which is permissible in law, the Revenue suffered any loss.

22. It is pertinent to note that the provisions of Section 145 of the Income Tax Act, namely, method of accounting had also came up for consideration before this Court in the above-said decision and it would be relevant to point out that the assessment years in that case were 1992-93 and 1998-99, i.e., pre-amendment as well as post amendment to Section 145 of the Income Tax Act, was considered. In that case, the change of method of accounting in respect of AFC or ODC from mercantile system of accounting to cash system of accounting was upheld by the Tribunal and by this Court. We find the legal issue has been resolved in facts identical to the present case.

23. We find that what has been decided by this Court in the earlier decision is the manner in which the AFC charges should be treated for the purpose of income tax. We have extracted in the

earlier portion of this order that it has been held that in respect of AFC, there is an element of uncertainty and therefore, it has to be treated as income only on receipt. There is no departure on the part of the assessee from the mercantile system of accounting insofar as the income that arises from EMI. Once the issue has been resolved by this Court that AFC or ODC partakes the character of uncertain income, it cannot be brought within the purview of taxable income, unless and until it comes to the hands of the assessee. The department has accepted that proposition of law in the above cited case. No appeal is also filed as conceded by the learned Standing Counsel for the revenue.

24. We find no reason to depart from the said view, which has also been accepted by the Department. The real income theory propounded by the Department would be applicable only if there is a justification to come to the conclusion that AFC has become income in the hands of the assessee. When it has already been held otherwise in the above-said decision and the Department having accepted such a principle, we find no reason to depart from that view in the present case.

25. The reliance placed by the learned Standing Counsel appearing for the Revenue on the decisions reported in **[2010] 320 ITR 577 (SC) (Southern Technologies Ltd. v. Joint Commissioner of Income-tax); [2010] 321 ITR 546 (Commissioner of Income Tax & Anr. v. United Breweries Ltd.) and (2012) 210 Taxman 62 (Madras)** are distinguishable on facts in the following manner:

25.1. In the case of **M/s.Southern Technologies Ltd vs Joint Commissioner of Income Tax** reported in **[2010] 320 ITR 577 (SC)**, while dealing with the concept of real income theory, the Supreme Court held as follows:

Theory of "Real Income"

An interesting argument was advanced before us to say that a provision for NPA, under commercial accounting, is not an "income" hence the same cannot be added back as is sought to be done by the Department. In this connection, reliance was placed on "Real Income Theory".

We find no merit in the above contention. In the case of Poona Electric Supply Co. Ltd. v. Commissioner of Income-Tax, Bombay City I, 57 ITR 521 at page 530, this is what the Supreme Court had to say:

"Income Tax is a tax on the "real income", i.e., the

profits arrived at on commercial principles subject to the provisions of the Income Tax Act. The real profit can be ascertained only by making the permissible deductions under the provisions of the Income Tax Act. There is a clear distinction between the real profits and statutory profits. The latter are statutorily fixed for a specified purpose".

To the same effect is the judgment of the Bombay High Court in the case of Commissioner of Wealth-Tax, Bombay v. Bombay Suburban Electric Supply Ltd. 103 ITR 384 at page 391, where it was observed as under: "Income Tax is a tax on the real income, i.e., profits arrived at on commercial principles subject to the provisions of the Income Tax Act, 1961. The real profits can be ascertained only by making the permissible deductions".

The point to be noted is that the IT Act is a tax on "real income", i.e., the profits arrived at on commercial principles subject to the provisions of the IT Act. Therefore, if by Explanation to Section 36(1)(vii) a provision for doubtful debt is kept out of the ambit of the bad debt which is written off then, one has to take into account the said Explanation in computation of total income under the IT Act failing which one cannot ascertain the real profits. This is where the concept of "add back" comes in. In our view, a provision for NPA debited to P&L Account under the 1998 Directions is only a notional expense and, therefore, there would be

add back to that extent in the computation of total income under the IT Act."

25.2. A plain reading of the above-said decision reveals that it is a case of bad debts. The facts in the above decision is that the assessee had made provision for NPA for the financial year ending 31.3.1998 under the directions of the RBI and claimed deduction. Accordingly, the profit and loss account was debited and corresponding amount was shown in the balance-sheet. The Assessing Officer disallowed the same and add back to the taxable income. On appeal, the Tribunal held that the assessee was entitled to deduction under Section 36(1)(vii), but the said view was not accepted by the High Court. On appeal, the Supreme Court held that provision for NPA in terms of the directions of Reserve Bank of India did not constitute "expense" on the basis of which deduction could be claimed by the non-banking financial companies under Section 36(1)(vii) of the Act. In this decision, the Supreme Court held that the amount has to be written off as per the provisions of the Income Tax Act and not by the application of real income theory.

25.3. The facts in the present case are distinguishable. Here, the assessee has not recognised the AFC as income for the purpose of

Income Tax Act until it is received. But for the purpose of companies Act, the assessee has accounted it. The provisions of the Companies Act require it to be so. Section 145 of the Income Tax Act provides that the income has to be computed either under cash system or under mercantile system. Whatever is termed as income will certainly fall within mercantile system on accrual. It is important to note that collectability is different from accrual. Under the mercantile system of accounting, interest/hire charges, income (EMI) accrues with time. In such cases, interest charged and debited to the account of the borrower as income is recognized under the accrual system. But in cash/receipt system, it is not so. AFC as has been held is clouded in uncertainty and on actual receipt becomes income.

25.4. In the decision reported in **[2010] 321 ITR 546 (Commissioner of Income Tax & Anr. v. United Breweries Ltd.)** , the High Court of Karnataka while dealing with the bad debts held that the deduction of bad debts was not regulated by real income theory. The facts in the said decision was the assessee in the course of activity of manufacture and sale of beer furnished guarantee for repayment of certain loans and advances taken by its subsidiary companies from banks. On failure to repay the amount by the subsidiary companies,

the assessee had to reimburse the same. The assessee claimed that the said expenditure qualified for deduction. The Assessing Officer as well as the First Appellate Authority rejected the request of the assessee, but the Tribunal reversed the findings of both the Authorities. On appeal, one of the issues raised before the Karnataka High Court was whether the Tribunal was correct in holding that the amount should be excluded on the principle of real income. The High Court answered the issue in favour of the Revenue.

25.5. In the present case, there is no claim of deduction of bad debts. The claim of AFC, which is in penal nature, is uncertain of recovery and hence, the same is not recognized as income accrued till it is realized.

25.6. In the decision reported in **(2012) 210 Taxman 62 (Madras) (The United Nilagiri Tea Estates Co. v. Deputy Commissioner of Income Tax)**, this Court dealt with the issue whether interest income, which it did not realise after some time, has to be taxed on accrual basis in terms of Section 145.

25.7. The facts in the above-said decision was the assessee

therein advanced certain amount in May 1995 to a company went into liquidation and subsequently it received interest till August 1996. The assessee company created contingency reserve, but did not write off principal amount till 2007. Subsequently, in the liquidation proceedings against the defaulting company, the assessee received certain amount. The Assessing Officer assessed the income holding that since the assessee had not written off the principal amount as well as interest on accrual basis. This was set aside by the Commissioner of Income Tax (Appeals). On appeal, the Tribunal reversed the same. On further appeal, this Court also held that the concept of real income would be applicable irrespective of whether the accounts are maintained in cash system or in the mercantile system. If the accounts are maintained in the mercantile system, it is necessary to see whether the income could be said to have really accrued taking probability or improbability of realisation in realistic manner.

25.8. In the above-said decision, the claim is related to normal interest which was received upto certain period and defaulted thereafter. In that case, the assessee created contingency reserve and did not write off the principal amount. Therefore, in the absence of specific plea or claim by the assessee, there was no improbability or

realisation of interest income or for that matter, even the principal. This Court held that under the mercantile system of accounting, accrual had occurred and therefore it has to be treated as income.

25.9. In the above-said decision, in the absence of any material to suggest as to the improbability or impossibility of the realisation of the amount even for accrual, this Court confirmed the order passed by the Tribunal.

26. In the present case, the AFC is in penal nature. This Court held that what is to be looked at to test the real income is the chances or probabilities of realisation and whether there was a real accrual of income to the assessee company. This Court further held that even in mercantile system, if the amount has actually accrued, the said income has to be taxed. The said accrual has to be taken in a realistic manner. The observation of this Court in the above-said decision would make it clear that the decision of this Court in the case of ***Annamalai Finance (supra)*** on the theory of actual receipt of AFC as income stands fortified.

27. In the light of the above, we hold that the decisions relied

on by the learned Standing Counsel appearing for the Revenue are distinguishable on facts.

28. It is to be noted that in the instant case, the Revenue is not in a position to show that due to the change of accounting method, the Revenue suffered loss. Admittedly, there is no finding to that effect in the assessment order. We also find that the change in method of accounting has not caused any loss to the Revenue, because AFC on receipt by the assessee-company has been offered to tax. Accordingly, we hold that the change of method of accounting of overdue charges from the mercantile basis to cash system insofar as AFC does not create any income, but the method of accounting only recognizes income.

29. The decision relied on by the learned counsel appearing for the assessee reported in **[2005] 275 ITR 451 (CIT V. Annamalai Finance)** was followed by this Court in another decision in respect of the same assessee for the assessment year 1997-98 reported in **[2009] 319 ITR 196 (Mad.)**, which is a post-amendment to Section 145 of the Act and held in favour of the assessee. Therefore, there is no distinction insofar as the present case is concerned.

30. The facts in the above-said decision, as narrated in the above -decision are as follows:

"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."

31. Therefore, it would not be proper for the Department to contend that post amendment to Section 145 of the Income Tax Act, the change in the method of accounting adopted by the assessee should be re-looked. In the light of the decision of this court in the case of **Annamalai Finance (supra)**, we find no justification or good reason why we should reject the claim of the assessee. We have no

hesitation to hold that collection and accrual of AFC happen simultaneously in the present case as and when received, as has been held by this Court. Hence, AFC cannot be treated as income on accrual basis.

32. The various contentions raised by the learned Standing Counsel appearing for the Department, more particularly the contention that the assessee should follow mercantile system for AFC does not merit consideration.

33. In the light of the above, following the decision of this Court reported in **[2005] 275 ITR 451 (CIT V. Annamalai Finance Ltd.) and [2009] 319 ITR 196 (Mad.) (CIT V. Annamalai Finance Ltd.)**, we hold that the terms of the agreements, which enable the assessee to demand overdue charges (AFC) is only an enabling provision and the recovery of overdue charges is not certain and is taxable on cash receipt basis and not accrual basis.

34. We, therefore, hold that the Tribunal was right in upholding the order of the Commissioner of Income Tax (Appeals) deleting the additions made towards Additional Finance Charges, also known as

Overdue charges.

In the result, the issue is answered in favour of the assessee and against the Revenue. Consequently, the above Tax Case (Appeals) are dismissed. No costs.

Index :Yes/No
Internet :Yes
sl/sasi

(R.S.,J) (K.B.K.V.,J)
15.06.2015

To

The Registrar,
Income Tax Appellate Tribunal Madras 'B' Bench,
Chennai.

R.SUDHAKAR,J.
AND
K.B.K.VASUKI,J.

Sl/sasi

T.C.(A) Nos.1222 and 1225 to 1228 of 2007

15.06.2015