

Tax Case (Appeal) No.1419 of 2010

IN THE HIGH COURT OF JUDICATURE AT MADRAS

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CORAM

**THE HONOURABLE DR JUSTICE G. JAYACHANDRAN
AND
THE HONOURABLE MR.JUSTICE SHAMIM AHMED**

Tax Case (Appeal) No.1419 of 2010

Commissioner of Income Tax-LTU.
Chennai.

... Appellant

vs.

M/s.Mahindra Holidays and Resorts (India) Ltd.,
Mahindra Towers, II Floor,
Chennai – 600 008.

... Respondent

Prayer: Appeal under Section 260-A of the Income Tax Act, 1961
against the order of Income Tax Appellate Tribunal, Chennai “C” Bench,
Chennai, dated 06.07.2010 in I.T.A.No.1705/Mds/2008.

For Appellant

: M/s.V.Pushpa
Senior Standing Counsel

For Respondent

: Mr.Arvind P.Datar,
Senior Counsel,
for Mr.Sandeep Bagmar &
Mr.Rahul Unnikrishnan

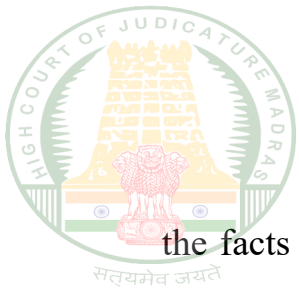


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J U D G M E N T

WEB COPY M/s.Mahindra Holidays & Resorts (India) Ltd., (*MH&RIL in short*) is engaged in business of time-share business. The time-share members are enrolled on payment of membership fees either in full upfront or in 12/24/36 monthly instalments. The members are allowed to occupy and to use the resort facilities for specific period each year over a period of 25 years or 33 years as per the terms of the contract. In the returns filed for assessment year 2003-2004, MH&RIL declared 60% of the money received from its members as revenue for the year of collection and the balance 40% as income deferred to be spread over to the remaining years of the contract period i.e., 25/33 years since the balance is set apart for the expected expenditure to maintain the time share facilities till the tenure of the contract period.

2. The return filed by the Assessee for the Assessment Year 2003-2004 was processed under Section 143(1) and selected for scrutiny. The Assessing Officer issued notice under Section 143(2) to the assessee and explanation sought. The assessee relying on the judgment of the Hon'ble Supreme Court rendered in *M/s.Calcutta Company Ltd -vs- Commissioner of Income Tax reported in (1959) 37 ITR 1*, justified the deferred income concept and contended that gross receipts should not be taxed. However, distinguishing



the facts of the case cited, the assessing officer passed assessment order under

Section 143(3) of the Income Tax Act on 22.03.2006 by concluding that the amounts received by the assessee towards the timeshare subscription from the customers and shown as advance in the balance sheet is to be treated as taxable income of the assessee for that year in entirety.

3. It is also appropriate to mention at this juncture, in the assessment order, the Assessing Officer had also made reference about the similar orders passed by Assessing Officer in respect of the earlier assessment years 1998-1999 to 2002-2003 and same on appeal was reversed by Commissioner of Income Tax (Appeal) and the further appeal by the Revenue without fresh parameter pending before ITAT. [The said appeals I.T.A.Nos:2412 to 2416/Mds/2005, later dismissed by ITAT on 26.05.2010 holding in favour of the assessee. Further, appeals by the Revenue heard together and separate but common order passed today by us in I.T.A.Nos.1465 to 1469 of 2010].

4. Coming back to the case in hand, which is in respect of Assessment Year 2003-2004, the assessee being aggrieved by the assessment order dated 22.03.2006, filed appeal before the Commissioner of Income Tax (Appeal) in ITA No:157/Mds/06-07. The Appellate Authority, while considering the issues

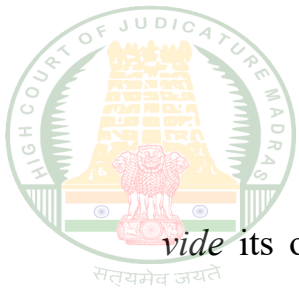


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took note of the fact that the assessee company till the financial year 1999-2000

was applying the deferred income concept/matching principle and declared 40% of the membership fees in the year of sale and the remaining 60% equally spread over the tenure of the contract. From the financial year 2000-2001, the ratio been changed as 60% during the year of sale and 40% equally spread over the tenure of the contract. Following, the dictum laid in ***M/s.Treasure Island Resorts (P) Ltd vs. Deputy Commissioner of Income Tax reported in (2004) 90 ITD 814***, the Appellate Authority in the combined appellate order for the assessment years 1998-99 to 2002-03, Commissioner of Income Tax (Appeal) decided the issues in favour of the assessee upholding the deferred income concept adopted by the assessee. Having held so for the previous financial years, for the same reason, for the assessment year 2003-2004 also the concept of deferred income recognised and, consequentially, the appeal by the assessee was allowed.

5. As against the above order of the Commissioner of Income Tax (Appeal) dated 29.05.2008, the Revenue went before the ITAT on appeal. By the time, the said appeal taken up for consideration, the Appeals of the Revenue in I.T.A.Nos.2412 to 2416 of 2005 in respect of the Assessment Years 1998-1999 to 2002-2003 heard and dismissed by Income Tax Appellate Tribunal,



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vide its order dated 26.05.2010. Therefore, the ITAT observing the said fact,

passed the below order or dismissal.

“3. We find that the same issue had come up before this Tribunal on Revenue’s appeal for assessment years 1998-99 to 2002-03. We also find that the CIT (A) had relied on his own order for the earlier years and for the impugned assessment year as well. On Revenue’s Appeal it was held by this Tribunal that the entire amount of time share membership fee receivable by the assessee at the time of enrolment of a member could not be charged to tax in the initial year and it had to be spread over in the ensuing years. Nothing was brought on record by the Id.D.R to take a different view for the impugned assessment year. Hence, we find no merit in the appeal of the Revenue. It is, therefore, dismissed.”

6. The Revenue appeal under Section 260A of the Income Tax Act, is before this Court for consideration. This Court has admitted the appeal for deciding the following substantial questions of law:-

1. Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in holding that the part of the time share membership fee receivable from the members upfront at the time of enrolment could be deferred, in the absence of any such provision in the Income Tax Act to



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defer revenue, especially when there was a contractual obligation fastened to the receipt to provide the services over the entire period of contract?

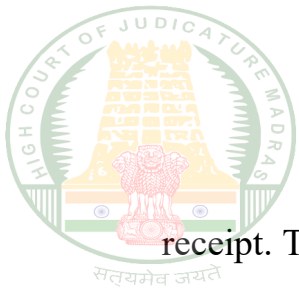
2. Whether on the facts and circumstances of the case the Income Tax Appellate Tribunal was right in holding that Income from membership fee could be deferred to future years on the assumption that some unquantified future liabilities existed?

3. Whether on the facts and circumstances of the case the Income Tax Appellate Tribunal was right in not deciding the basis on which the said receipts referred to in the preceding questions should be treated as deferred income?

4 Whether on the facts and circumstances of the case the Income Tax Appellate Tribunal was right in holding that the membership fee income received by the assessee could be deferred, when the assessee collected annual maintenance charges and utility charges separately for every year from each member over the entire period of the contract, to cover the expenditure incurred over the period of the time share agreement?

7. Submissions on behalf of the Revenue/Appellant:-

i) The prime contention made on behalf of the Revenue is that, under the mercantile system of accounting, the upfront membership fees for time-share units constitute a trading receipt which is fully taxable in the year of



receipt. The Income Tax Act does not recognise 'deferred income' as a category

of receipt. Once a non-refundable debt is created, the same is exigible to tax under Section 5 of the Income Tax Act. In this case, the assessee received the non-refundable membership fees on execution of agreement promising to provide right of occupancy and to enjoy the resort facilities for a specified days in a year and for specific period of years. Therefore, the doctrine of accrual has to be applied regardless of when the service is performed. The 'parenthood' of the income is completed on the performance of the assessee the definitive act of granting the right of occupancy. As per the terms of the contract, the upfront amount is collected as a non-refundable 'entrance fee' for the grant of 'long-term right to use' of the resort facilities. For the actual operational, maintenance and utility expenses such as electricity, water, housekeeping, routine housekeeping, AMC and other utility charges are collected from the members separately. This segregation conclusively establishes that the upfront fee is not meant to meet recurring service costs but constitutes consideration for the vesting of membership rights.

ii) The assessee's method of accounting, insofar as deferring a portion of the membership fee for future obligations while simultaneously claiming 100% of marketing and administrative expenditure in the very same year,

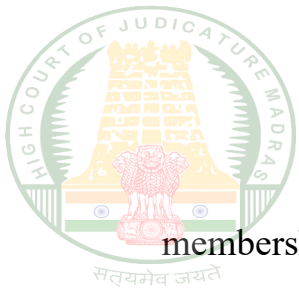


results in distortion and misleading computation of business profits. Such a

method fails to reflect the true and correct income as mandated under Section 145 of Income Tax Act.

iii). Relying on the judgment of the Hon'ble Supreme Court in ***E.D.Sassoon & Co. Ltd vs. Commissioner of Income Tax reported in (1954) 26 ITR 27(SC)***, the learned Senior Standing Counsel for the Department submitted that the 'right to use' the resort facility is the asset sold. The said right gets vested with the member soon after the member gets himself enrolled on payment of membership fees. The consideration received thereof represents income that has accrued *in praesenti*. Hence, the assessee is liable to be taxed in the year of execution of the membership agreement.

iv). Tax is attracted at the point when the income is earned. Taxability of income is not dependent upon its destination or the manner of its utilisation. The deferral of revenue recognised in certain transactions under Accounting Standard (AS-9) cannot override or dilute the charging provisions of the Income Tax Act. Section 4 and 5 of the Income Tax Act gives primacy to the statute over the general accounting principles. The assessee cannot rely upon AS-9 to postpone the incidence of taxation of the non-refundable



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membership fee, when the statutory charging provisions mandate taxation of

income at the point of accrual or receipt. In support of this argument, the

Learned Counsel relies on *Tuticorin Alkali Chemicals & Fertilizers Ltd vs.*

Commissioner of Income Tax reported in [1997] 227 ITR 172 (SC).

v) The assessee claim to defer income to cover future services costs for 25 or 33 years as the case may be, is essentially a provision for a contingent liability. The deferral is not sought against an ascertained present liability. For an hypothetical future costs which may or may not arise, deferred income concept will not apply. Under Section 37 of the Income Tax Act, provisions made towards contingent liability are not allowable deductions.

vi) To buttress this submission, the Learned Counsel for the Revenue rely on the Hon'ble Supreme Court Judgment rendered in *Indian Molasses Co. (P) Ltd vs. Commissioner of Income Tax* reported in [1959] 37 ITR 66 (SC) submitted that '*expenditure*' is the money which has gone out irretrievably and not a sum set aside for a contingency that may or may not arise in future.

vii) To emphasis that the portion of the receipt of the year deducted as deferred income to meet the future obligation is only a provision for contingent



liability, the Counsel for the Revenue illustrates that the assessee's obligation to provide accommodation to the member will arise only if the member opted for accommodation. If he never exercises that option, no expenditure will arise to the assessee. In such circumstances, the matching principle approved in ***Calcutta Company Ltd vs. Commissioner of Income Tax, West Bengal, reported in [1959] 37 ITR 1 (SC)*** and relied by the assessee will not apply, since in *Calcutta Company Ltd.* (cited supra), the assessee had undertaken to a definite, unconditional and irrevocable obligation to construct roads, drains and other infrastructure as an integral part of the sale of the plots. Therefore, the Hon'ble Supreme Court permitted the matching of future expenditure against the current receipts. Contrarily, in the case of time sharing, there is no definite, unconditional or irrevocable obligation on the part of the assessee. The incurring of expenditure is contingent upon multiple factors including the member electing to avail the services of the assessee.

(viii) In addition to the judgments mentioned above, the following judgments were also referred by the Learned Senior Counsel for the Revenue to strengthen his submissions:-

(i). ***Commissioner of Income Tax vs. United Club*** reported in ***[1986] 161 ITR 853 (Pat)***.



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(ii). ***Commissioner of Income Tax vs. Beldih Club*** reported in ***[1986]***

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(iii) ***Commissioner of Income-Tax, U.P-II vs. Bazpur Co-operative Sugar Factory Ltd*** reported in ***[1988] 172 ITR 321 (SC).***

(iv) ***Commissioner of Income-Tax vs. British Paints India Ltd*** reported in ***[1991] 188 ITR 44 (SC).***

(v) ***Commissioner of Income-Tax vs. Southern Cables and Engineering Works*** reported in ***[2007] 289 ITR 167 (Ker).***

8. Submission on behalf of the assessee-M/s.MH & RIL.

i) In response to the above submission made on behalf of the Revenue, the Learned Senior Counsel for the assessee submitted that, the contentions of the revenue bristles with fundamental flaw in understanding and appreciating the terms of the time share agreement. It is incorrect to say that the membership fee is non-refundable. It is also equally incorrect to say, since for maintenance and other facility utilised by the member on his occupation of the resort, the members are charged separately by way of AMC and Utility fee, the membership fee is for the right to use the resort facilities and no other obligation tagged on the assessee, to apply the matching principle. In fact, the portion of the receipt from the member is kept apart to meet out the liability undertaken by

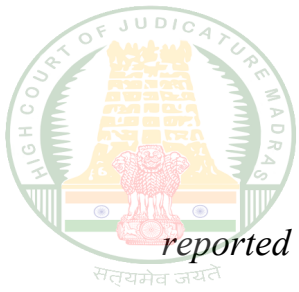


the assessee, which is to be met whether the member opt for occupy the resort

or not. The said liability is certain, irrevocable and any breach will attract legal consequences. The relevant portions of the terms of the agreement read to sustain the above submissions.

ii). As far as the accounting method adopted by the assessee, it is submitted that, law permits matching principle even when the assessee follow mercantile system. Therefore, what actually received or spend is not relevant, what attributable to income alone is relevant. In the instant case, based on trade practice, a portion of the receipt been kept apart as deferred income to match the expenditures for the subsequent years till the end of the agreement period. In the light of AS-9, ICDS clause 6 and Section 43CB which came into effect from 01.04.2017 recognising the straight line method of income computation read with Section 145(2) of the Income Tax Act, it is fallacious to argue that the concept of deferred income is unknown to Income Tax Act.

iii) The Learned Senior Counsel for the assessee referring the dictum of the Hon'ble Supreme Court laid in *Madras Industrial Investment Corporation Ltd vs. Commissioner of Income Tax*, reported in [1997] 225 ITR 802 (SC) and *Rotork Controls India (P) Ltd vs. Commissioner of Income Tax*



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reported in [2009] 314 ITR 62 (SC) submitted that the concept of ‘deferred

income/expenditure’ as well as provision for future expenses legally recognised through the judicial pronouncements. To further persuade, the judgment of High Court of Andhra Pradesh in **Commissioner of Income Tax-II, Hyderabad vs. M/s.Treasure Island Pvt Ltd** and the judgements of Delhi High Court in **Commissioner of Income Tax vs. Dinesh Kumar Goel**, reported in [2011] 331 ITR 10 (Delhi), **Commissioner of Income Tax-III vs. Shyam Telelink Ltd** reported in [2019] 410 ITR 31 (Delhi), confirmed by the Hon’ble Supreme Court in **Principal Commissioner of Income Tax vs. Sistema Shyam Teleservices Ltd** reported in (2019 (108) Taxmann.com 333 (SC) and the judgment of High Court of Gujarat in **Commissioner of Income Tax vs. Winner Business Link (P) Ltd** reported in [2015] 230 Taxman 399 (Gujarat) confirmed by the Hon’ble Supreme Court vide order dated 03.10.2016 were also referred and relied.

9. Heard the submission and examined the contentions carefully. To answer the substantial questions of law, first it is necessary to examine the terms of Time-share agreement (TSA) and then Membership Rules.

The Clauses in the Membership Rules, which is relevant for consideration are extracted below:-



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ENJOYMENT OF CLUB MAHINDRA HOLIDAYS UNLIMITED:

3.1 The Member is entitled to enjoy any Week every year within the allotted Season in the specified Apartment in any of the notified Mahindra Resorts or Mahindra Associate Resorts during the Membership Period.

3.2 Reservation: - The Member can avail the Early Bird Reservation, Assured Holiday Reservation or Regular Reservation for enjoyment of CMHU by giving request for Reservation in the prescribed format provided by MHRIL. The reservation will be done on a first - come - first served basis and subject to availability only. The minimum number of days that can be requested for enjoyment is 3 (three) in case of Purple and Red Seasons and 2 (two) in Case of White and Blue Seasons. Further, in any year, the Member is entitled to enjoy a maximum of 14 days in the allotted Season classification and the balance can be enjoyed only during a different season in the same year except in the case of Blue Season Members, who can use up to 21 days in the Blue Season.

(a) Early Bird Reservation: Early Bird Reservation can be done any time from 1 year to 91 days before the date of commencement of the Holiday requested for by the Member. Under this facility, the Member can reserve maximum of 7 days in any year. A certain



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percentage of the capacity will be earmarked for Early Bird Reservation. At present. 20% of the Capacity is earmarked for Early Bird Reservation, however this may vary from time to time.

This facility will be opened to Members only from 90 days before the expiry of the Waiting Period. Further, if the Member enjoys a Holiday in any year under this facility, he/she/it cannot request for Holiday in the same Mahindra Resorts/Mahindra Associate Resorts in the same year or next year under this facility.

Assured Holiday Reservation: Assured Holiday Reservation Can be done any time from 90 days to 61 days before the date of commencement of the first Holiday period requested for by the Member by giving a choice of three different destinations and three different Holiday periods in the order of preference and in the prescribed format. All three Holiday Periods requested for should be within a period of 12 months from the date of request for reservation. MHRIL shall confirm Holiday in anyone of three destinations for anyone of the three Holiday periods opted for by issuing confirmation voucher to the member. The following conditions shall apply for enjoyment of this facility:

- i). The periods requested for by the Member shall not be overlapping.*
- ii) Each of the periods requested for by the Member shall not exceed 7 days.*



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iii) If the Member enjoys a Holiday in any year under this facility, he / she / it cannot request for Holiday in the same Mahindra Resorts / Mahindra Associate Resorts in the same year or next year under this facility.

iv) Request for Holiday can be only in the allotted season or lower season.

v) The Member cannot avail Holiday Multiplier facility mentioned in Clause 4.1 (c).

In case, MHRIL does not confirm Holiday as mentioned herein before, MHRIL shall provide alternate accommodation with or without kitchenette in any of the opted destinations during any of the periods requested for by the Member. In case MHRIL provides alternate accommodation without Kitchenette, MHRIL shall compensate the Member by providing standard complimentary break-fast every day during the period of Holiday. In case of default to provide alternate accommodation, MHRIL shall pay liquidated damages equivalent to 100% of the rent/tariff applicable for the first Holiday Period and the first Holiday destination requested for by the Member.

10. Thus from the above clause, it is obvious that the membership fees is collected for the assured occupation of the resort during the specified days in the year till the tenure of the agreement.



The Clause 5 deals about the 'Payment', which reads as below:

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5.1 Cost of Membership: Cost of Membership consists Of Cost of Accommodation and Advance payment towards facilities (APF). The Cost of Membership shall be paid by the Member as per the price structure and Schedule of Payments fixed by MHRIL from time to time.

a) Cost of Accommodation: The Cost of Accommodation paid by the Member is exclusively towards accommodation and constitutes 40% of the total Cost of Membership.

b) Advance Payment towards Facilities (APF); The amount paid by the Member as Advance Payment towards Facilities is for. providing facilities viz. Split. Accumulation and Advancing to the Member and constitutes 60% of the total Cost of Membership. The same shall be apportioned equally every year during the Club Mahindra Membership Period.

5.2 Annual Maintenance Charges (AMO); The Member shall pay Annual Maintenance Charges the maintenance and upkeep of the Mahindra Resorts / Mahindra Associate Resorts as may be fixed by MHRIL from time to time. The AMC need not be paid by the Member for the 12 month period following the expiry of the waiting period. Subsequently, after the end of the said 12 month period, the same is payable within 30 days for the period up to the immediately following 31st March.



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Thereafter, AMC is payable every year before the 30th April for the period 1st April to 31st March. The AMC is payable even if the Member does not enjoy his/her/its Holiday during a particular year. Non-payment of AMC will make the Member disentitled to enjoy the Holiday. The outstanding AMC shall be payable by the Member with interest at the rate of 24% per annum from the date/s it/they became due, to the actual date of payment.

5.3 Utility Charges; The Member Shall pay utility charges on a per day 1 night basis as may be levied by MHRIL from time to time towards Utilities (Electricity, Water. Central Air-conditioning, heating, etc.) provided in the Mahindra Resorts / Mahindra Associate Resorts.

Clause 7 of the agreement speaks about MHRIL's Obligations of the

Assessee which reads as below:-

"7.1 In case MHRIL does not provide holiday after issuance of confirmation voucher in the allotted Mahindra Resorts / Mahindra Associate Resorts, MHRIL shall provide alternate accommodation and in the event of default in providing alternate accommodation, MHRIL shall pay liquidated damages equivalent to 100% of the rent/tariff that may be charged by MHRIL to other persons for staying in the allotted Apartment in the allotted destination during the period for which the Confirmation Voucher is issued.



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7.2 The liquidated damages shall be paid by MHRIL to the Member within 30 days of such default.

7.3. Notwithstanding anything stated hereinabove, MHRIL shall not incur any liability to the Member if it is not in a position to fulfil its obligations by reason of any war, civil commotion, force majeure, act of God or any other notification from any Court of Law or Government.”

Thus, the clauses referred above makes it very clear that the fees collected from the members is coupled with obligations which spread over till the end of the agreement period. It is not mere an entrance fees to the resort but it is also right to occupy over a period extending beyond the year of payment.

11. The Clauses of agreement cast responsibility and liability on the assessee Company to provide accommodation facilities to its members. For the facilities extended to the customers during the time-share period, advance subscription fees and the costs of time-share are collected. The money is collected for the assured accommodation, whether the member opt to occupy on the particular day or seeks for exchange facility either in the same resort or in any other resort of the assessee Company. The assessee Company has to ensure



the compliance of accommodation requests. Therefore, this cannot be considered as contingent expenditure. The annual maintenance charge or the charge collected for the enjoyment of the facility while the members or his representative stay in the resort, cannot be interlinked with the receipt of the membership fees.

12. On examination of the line of judgments cited by the Learned Counsels on either side, after excluding the judgments those which are less relevant, the march of law on deferred income and matching principle has evolved as below:-

(i) ***Indian Molasses Co. (P) Ltd vs. Commissioner of Income Tax*** reported in ***[1959] 37 ITR 66 (SC)***:

“19. From these cases, there are deducible certain principles of a fundamental character. The first is that capital expenditure cannot be attributed to revenue and vice versa. Secondly, it is equally clear that a payment in a lump sum does not necessarily make the payment a capital one. It may still possess revenue character in the same way as a series of payments. Thirdly, if there is a lump sum payment but there is no possibility of a recurrence, it is probably of a capital nature, though this is by no means a decisive test. Fourthly, if the payment of a lump sum closes the liability to make repeated and



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periodic payments in the future, it may generally be regarded as a payment of a revenue character Anglo-Persian Oil Co. Ltd. v. Dale [(1932) 1 KB 124: (1931) 16 TC 253] and lastly, if the ownership of the money whether in point of fact or by a resulting trust be still in the taxpayer, then there is acquisition of a capital asset and not an expenditure of a revenue character.

20. Side by side with these principles, there are others which are also fundamental. The income tax law does not allow as expenses all the deductions a prudent trader would make in computing his profits. The money may be expended on grounds of commercial expediency but not of necessity. The test of necessity is whether the intention was to earn trading receipts or to avoid future recurring payments of a revenue character. Expenditure in this sense is equal to disbursement which, to use a homely phrase, means something which comes out of the trader's pocket. Thus, in finding out what profits there be, the normal accountancy practice may be to allow as expense any sum in respect of liabilities which have accrued over the accounting period and to deduct such sums from profits. But the income tax laws do not take every such allowance as legitimate for purposes of tax. A distinction is made between an actual liability in praesenti and a liability de futuro which, for the time being, is only contingent. The former is deductible but not the latter. The case which illustrates this distinction is Peter Merchant



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Ltd. v. Stedeford [(1948) 30 TC 496]. No doubt, that case was decided under the system of income tax laws prevalent in England, but the distinction is real. What a prudent trader sets apart to meet a liability, not actually present but only contingent, cannot bear the character of expense till the liability becomes real.”

(ii) ***Metal Box Company of India Ltd vs. Their Workmen*** reported in

1968 SCC OnLine SC 83, wherein it held as below:

“...The distinction between a provision and a reserve is in commercial accountancy fairly well known. Provisions made against anticipated losses and contingencies are charges against profits and, therefore, to be taken into account against gross receipts in the P. & L. account and the balance-sheet. On the other hand, reserves are appropriations of profits, the assets by which they are represented being retained to form part of the capital employed in the business. Provisions are usually shown in the balance-sheet by way of deductions from the assets in respect of which they are made whereas general reserves and reserve funds are shown as part of the proprietor's interest (see Spicer and Pegler's Book-keeping and Accounts, 15th edition, page 42). An amount set aside out of profits and other surpluses, not designed to meet a liability, contingency, commitment or diminution in value of assets known to exist at the date of the balance-sheet is a reserve but an amount set aside out of profits



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and other surpluses to provide for any known liability of which the amount cannot be determined with substantial accuracy is a provision...”

(iii) ***Tuticorin Alkali Chemicals & Fertilizers Ltd vs. Commissioner***

of Income Tax reported in ***[1997] 227 ITR 172 (SC)***, wherein it held as below:

“29. It is true that this Court has very often referred to accounting practice for ascertainment of profit made by a company or value of the assets of a company. But when the question is whether a receipt of money is taxable or not or whether certain deductions from that receipt are permissible in law or not, the question has to be decided according to the principles of law and not in accordance with accountancy practice. Accounting practice cannot override Section 56 or any other provision of the Act. As was pointed out by Lord Russell in the case of B.S.C. Footwear Ltd. [(1972) 83 ITR 269, the Income Tax law does not march step by step in the footprints of the accountancy profession.”

(iv) ***Treasure Island Resorts (P). Ltd vs. Deputy Commissioner of***

Income Tax reported in ***[2004] 90 ITD 814 (ITAT[Hyd])***, wherein ITAT held as below:-

“47. The learned Departmental Representative pleaded before us that entrance fee is a revenue receipt in the light of the decision of the Patna High Court in the



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case of United Club (supra) and so, the entire membership fee which is on par with such entrance fee has to be taxed in one year. This contention has to be rejected for more than one reason. Firstly, strictly speaking, there is no entrance fee as such in the present case. Secondly, the jurisdictional High Court has held in the case of Secunderabad Club(150 ITR 49) that the entrance fee is a capital receipt. Even as per accounting standard 9, entrance fee is normally capitalized. More basically, the issue in the present case is not whether the membership fee is capital receipt or revenue receipt. The assessee has not disputed that it is a revenue receipt. The only claim of the assessee is that, even if it is a revenue receipt, it cannot be brought to tax in one year and it should be recognized on a rational basis or time basis in the light of accounting standard 9. We see no reason to reject this claim as there is continuing liability to render services either free or at a reduced rate.

48. If the entire membership fee collected is shown in the present assessment year, there would be substantial deficit in future years, when the assessee has to incur expenditure for the provision of various services to the members without matching receipts. This would give a totally distorted picture of the working results of the assessee. While substantial profits will be taxed in the year under appeal, there will be substantial losses in" subsequent years. The revenue may seek such result, but



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we see no reason to allow it.

...

50. Before we conclude, we may mention that there appears to be some incongruity in item 6 of the appendix to the accounting standard 9, which we have extracted hereinabove. While it states that entrance fee is generally capitalised, it proceeds to state that when membership fee permits only membership and all other services are paid for separately, it should be recognized when received. If the membership fee permits only membership it should be on par with entrance fee and so there seems to be some contradiction between the two statements. But the general import of item 6 of the appendix and more particularly of the accounting standard 9 itself is clear. The import of item 6 has to be seen in the light of other illustrations given under other headings of the appendix like installation fees, advertising and insurance agency commission, financial service commissions, admission fees, tuition fees, etc. Reading them all together, the principle is that when service is provided on a continuing basis and the cost relating to the service falls in a different year, revenue should be recognized on a time basis. Going by this general import of item 6 in the appendix and the wording in the body of the accounting standard 9 itself, it is clear that the assessee conformed to the accounting standard 9 and as such, the book results deserve to be accepted.



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51. In the light of the foregoing discussion, we are of the view that the assessing officer is not justified in bringing to tax the entire membership fee collected to tax in the year under appeal. We accordingly set aside the impugned orders of the Revenue authorities on this aspect and direct the assessing officer to modify the assessment accordingly.”

The order of the ITAT was challenged before the Andhra Pradesh High Court. On appeal by the Revenue, in ***Commissioner of Income Tax-II, Hyderabad vs. M/s.Treasure Island Pvt Ltd., I.T.T.A.No.241 of 2012, dated 10th July 2013***, the High Court dismissed appeal of the Revenue, making the following observation:

This appeal is sought to be filed against the judgment and order of the Learned Tribunal dated 30.07.2007 in relation to the assessment year 2002-2003, on the following substantial question of law:

Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the entire membership fee collected in the year under consideration cannot be taxed in that year and has to be deferred to future years?

We have heard the learned counsel for the appellant and gone through the impugned judgment and



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order. The learned Tribunal has decided the matter following earlier decision of the Tribunal in the assessee's own case in ITA Nos. 1189 and 1190/Hyd/04 for the assessment years 1997-1998 and 2001-2002. It is not the case of the Revenue that the orders passed earlier were appealed on the same have been reversed. In view of the consistent findings of the learned Tribunal, which are accepted by the parties, we do not see any reason to interfere with the impugned judgment and order.

Consequently, we dismissed the appeal. No order as to costs."

(v) In ***Godhra Electricity Co. Ltd vs. Commissioner of Income Tax, Gujarat-II, Ahmedabad*** reported in ***[1997] 225 ITR 746 (SC)***, the Hon'ble Supreme Court held as below:

"13. Under the Act income charged to tax is the income that is received or is deemed to be received in India in the previous year relevant to the year for which assessment is made or on the income that accrues or arises or is deemed to accrue or arise in India during such year. The computation of such income is to be made in accordance with the method of accounting regularly employed by the assessee. It may be either the cash system where entries are made on the basis of actual receipts and actual outgoings or disbursements or it may be the



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mercantile system where entries are made on accrual basis, i.e., accrual of the right to receive payment and the accrual of the liability to disburse or pay. In CIT v. Shoorji Vallabhdas and Co. [(1962) 46 ITR 144 (SC)] it has been laid down:

“... Income tax is a levy on income. No doubt, the Income Tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a ‘hypothetical income’, which does not materialise.”

14. This principle is applicable whether the accounts are maintained on cash system or under the mercantile system. If the accounts are maintained under the mercantile system what has to be seen is whether income can be said to have really accrued to the assessee company. In H.M. Kashiparekh & Co. Ltd. v. CIT [(1960) 39 ITR 706 (Bom)] the Bombay High Court had said:

“... Even so, (the failure to produce account losses) we shall proceed on the footing that, the assessee company having followed the mercantile system of account, there must have been entries made in its books in the accounting year in respect of the amount to commission. In our judgment, we would not be justified in attaching any particular importance in this case to the fact that the company followed mercantile system of account.



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That would not have any particular bearing in applying the principle of real income in the facts of this case.”

(vi) In the above case, the Hon’ble Supreme Court had also given its explanation on real accrual of income and income accrued for the purpose of book-keeping as below:

“22. The question whether there was real accrual of income to the assessee company in respect of the enhanced charges for supply of electricity has to be considered by taking the probability or improbability of realisation in a realistic manner. If the matter is considered in this light, it is not possible to hold that there was real accrual of income to the assessee company in respect of the enhanced charges for supply of electricity which were added by the Income Tax Officer while passing the assessment orders in respect of the assessment years under consideration. The Appellate Assistant Commissioner was right in deleting the said addition made by the Income Tax Officer and the Tribunal had rightly held that the claim at the increased rates as made by the assessee company on the basis of which necessary entries were made represented only hypothetical income and the impugned amounts as brought to tax by the Income Tax Officer did not represent the income which had really accrued to the assessee company during the



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relevant previous years. The High Court, in our opinion, was in error in upsetting the said view of the Tribunal.

23. In the result, the appeals are allowed, the impugned judgment of the High Court is set aside and the questions referred by the Tribunal for opinion are answered in favour of the assessee company and against the Revenue. But in the circumstances, there will be no order as to costs.”

(vii) In ***Calcutta Company Ltd vs. Commissioner of Income Tax, West Bengal*** reported in (1959) SCC OnLine SC 137, relied by both sides, and also referred the authorities below, it is said,

“The appellant here is being assessed in respect of the profits and gains of its business and the profits and gains of the business cannot be determined unless and until the expenses or the obligations which have been incurred are set off against the receipts. The expression “profits and gains” has to be understood in its commercial sense and there can be no computation of such profits and gains until the expenditure which is necessary for the purpose of earning the receipts is deducted therefrom — whether the expenditure is actually incurred or the liability in respect thereof has accrued even though it may have to be discharged at some future date. (Emphasis Added)



WEB COPY (viii) In **Madras Industrial Investment Corporation Ltd vs.**

Commissioner of Income Tax, reported in **[1997] 225 ITR 802 (SC)**, the case referred by the Learned Counsel for the assessee, the Hon'ble Supreme Court has said:-

“....In the case of Indian Molasses Co. (P) Ltd. v. CIT [(1959) 37 ITR 66 : AIR 1959 SC 1049] this Court considered the meaning of “expenditure” under Section 10(2)(xv) of the Income Tax Act, 1922. The High Court was concerned with sums which were transferred by the Company to trustees to take out an annuity policy on the life of the managing director or the longest life policy in favour of the managing director and his wife. There was a provision in the policy for surrendering the annuity for a capital sum after giving notice. The payment by the Company to the trustees was contingent and the liability itself was contingent. The Court said that expenditure which is deductible for income tax purposes is one which is towards a liability actually existing at the time. Putting aside of money which may become expenditure on the happening of an event is not expenditure. Dealing with what is expenditure, this Court said (p. 78) that “expenditure” is equal to “expense” and “expense” is money laid out by calculation and intention. The idea of spending in the sense of “paying out or away” money is the primary meaning. Expenditure is what is paid out or



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away, something that is gone irretrievably. In the case of Calcutta Co. Ltd. v. CIT [(1959) 37 ITR 1: AIR 1959 SC 1165] decided in the same month, the assessee bought lands and sold them in plots for building purposes. The assessee undertook to develop the plots by laying out roads, providing drainage system, installing lights etc. When the plots were sold the purchasers paid only a portion of the purchase price and undertook to pay the balance in instalments. The assessee undertook to carry out the development of these plots. In the relevant accounting year, the assessee who followed the mercantile system of accounting, actually received in cash only a sum of Rs.29,392 towards the sale price of lands; but it credited in its accounts the sum of Rs.43,692 representing the full sale price of lands and at the same time it also debited an estimated sum of Rs.24,809 as expenditure for the development it had undertaken to carry out even though that amount was not actually spent. The Department disallowed this expenditure. Upholding the claim of the assessee to deduction, this Court said that the undertaking given by the assessee imported a liability on the assessee which accrued on the dates of the deeds of sale though that liability was to be discharged at a future date. It was thus an accrued liability and the estimated expenditure which would be incurred in discharging the same could be deducted from the profits and gains of business. The difficulty in the estimation of liability did not convert the accrued liability into a conditional one. This



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Court said that the expression “profits or gains” in Section 10(1) of the Income Tax Act, 1922 had to be understood in its commercial sense; and there could be no computation of such profits and gains until the expenditure which is necessary for the purpose of earning the receipts is deducted therefrom, whether the expenditure is actually incurred or the liability in respect thereof has accrued even though it may have to be discharged at some future date.

7. Thus “expenditure” is not necessarily confined to the money which has been actually paid out. It covers a liability which has accrued or which has been incurred although it may have to be discharged at a future date. However, a contingent liability which may have to be discharged in future cannot be considered as expenditure.” (Emphasis added)

(ix) In ***Rotork Controls India (P) Ltd vs. Commissioner of Income Tax*** reported in [2009] 314 ITR 62 (SC), the Hon’ble Supreme Court had explained the expression, “provision made by the assessee” used in the Income Tax Act as below:

“22. A provision is a liability which can be measured only by using a substantial degree of estimation. A provision is recognised when: (a) an enterprise has a present obligation as a result of a past event; (b) it is



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probable that an outflow of resources will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision can be recognised.

23. Liability is defined as a present obligation arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits. A past event that leads to a present obligation is called as an obligating event. The obligating event is an event that creates an obligation which results in an outflow of resources. It is only those obligations arising from past events existing independently of the future conduct of the business of the enterprise that is recognised as provision. For a liability to qualify for recognition there must be not only present obligation but also the probability of an outflow of resources to settle that obligation.”

13. Back to the *Metal Box Company of India* cited *supra*, again which has laid down the few principles for deduction on estimated liability and in the light of the introduction of Section 43CB of the Act 2017, we are of the opinion that the appeal is a futile exercise by the revenue to retest a settled proposition of law.



14. To put in nutshell, in *Metal Box Company of India* case cited

supra, the principles postulated are:-

(i) For an assessee maintaining his accounts on mercantile system, a liability already accrued, though to be discharged at a future date, would be a proper deduction while working out the profits and gains of his business, regard being had to the accepted principles of commercial practice and accountancy. It is not as if such deduction is permissible only in case of amounts actually expended or paid;

(ii) Just as receipts, though not actual receipts but accrued due are brought in for income tax assessment, so also liabilities accrued due would be taken into account while working out the profits and gains of the business;

(iii) a condition subsequent, the fulfilment of which may result in the reduction or even extinction of the liability, would not have the effect of converting that liability into a contingent liability; and

(iv) a trader computing his taxable profits for a particular year may properly deduct not only the payments actually made to his employees but also the present value of any payments in respect of their services in that year to be made in a subsequent year if it can be satisfactorily estimated.”



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15. This is in tune with the earlier judgment of the Hon'ble Supreme Court in ***Calcutta Company Ltd vs. Commissioner of Income Tax, West Bengal, reported in [1959] 37 ITR 1 (SC)***, wherein, the Hon'ble Supreme Court has held that the liability on the assessee having been imported, the liability would be an accrued liability and would not convert into a conditional one merely because the liability was to be discharged at a future date. There may be some difficulty in the estimation thereof but that would not convert the accrued liability into a conditional one; it was always open to the tax authorities concerned to arrive at a proper estimate of the liability having regard to all the circumstances of the case.

16. To add more emphasis to our view, we rely on the judgment in ***Commissioner of Income Tax-III vs. Shyam Telelink Ltd reported in [2019] 101 Taxmann.com 218 (Delhi)***, wherein it is held:-

"9. However, we would not like to dispose of the present appeals only on the aforesaid basis, for we find that there is merit in the findings recorded by the Tribunal, accepting the method of accounting followed by the respondent-assessee. The Tribunal in the impugned order has referred to the difference between receipt of an amount and accrual of income. Every receipt is not income, for income is something which the assessee is legally entitled to appropriate to the exclusion of the giver.



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However, the contention of the Revenue that the prepaid amount once paid and received by the assessee was forgone by the subscriber and accordingly appropriated by the respondent-assessee is substantially correct. At the same time, the payment was an advance and was subject to the respondent-assessee providing basic telecom service as promised, failing which the unutilized amount was required to be refunded to the pre-paid subscribers.

10. The respondent-assessee states that they have been following the principles of revenue recognition as per accounting standards. Paragraph 7 of the accounting standards stipulates:

"7. Rendering of services.

7.1 Revenue from service transactions is usually recognised as the service is performed, either by the proportionate completion method or by the completed service contract method.

(i) Proportionate completion method—Performance consists of the execution of more than one act. The Revenue is recognised proportionately by reference to the performance of each act. The revenue recognised under this method would be determined on the basis of contract value, associated costs, number of acts or other suitable basis. For practical purposes, when services are provided by an indeterminate number of acts over a specific period of time, revenue is recognised on a straight



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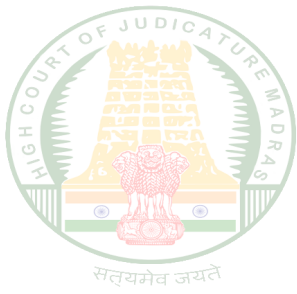


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line basis over the specific period unless there is evidence that some other method better represents the pattern of performance.

(ii) Completed service contract method— Performance consists of the execution of a single act. Alternatively, services are performed in more than a single act, and the services yet to be performed are so significant in relation to the transaction taken as a whole that performance cannot be deemed to have been completed until the execution of those acts. The completed service contract method is relevant to these patterns of performance and accordingly revenue is recognised when the sole or final act takes place and the service becomes chargeable."

Paragraph 7 stipulates that revenue from service transaction can be recognized either by proportionate completion method or by the completed service contract method. The revenue is generally recognized when the service is performed. Proportionate completion method is a recognized accounting method, as per which revenue is recognized proportionately by reference to the performance of each Act. Under this method, the revenue is determined on the basis of contract value, associated costs, number of acts or other suitable criteria. In other words, when services are provided by an indeterminate number of acts over a specific period of time, the revenue is recognized on a straight line basis



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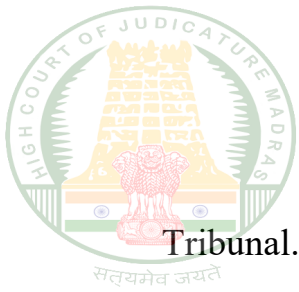
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over the specific period. This is subject to any evidence that some other method would be better and more appropriate for representing the pattern of performance.”

17. In *Commissioner of Income Tax vs. Winner Business Link (P)*

Ltd reported in [2015] 230 Taxman 399 (Gujarat), the Hon’ble Gujarat High Court held that the order of the Tribunal accepting the method of accounting followed by the assessee providing provision for future expenditure proportionate to the degree of completion of the service is valid.

18. The facts of the case is that the assessee company is engaged in the business of providing discount cards to the members on payment of prescribed fees called as membership fees. Being one-time fees and non-refundable valid for specific period from one to thirty years was apportioned over the entire period of their membership. This was not accepted by the Assessing Officer and the entire amount collected as membership fees in the accounting year was treated as receipt of thirty years. The Assessee Company preferred appeal before the Commissioner of Income-Tax (Appeals). The Appellate Authority allowed the assessee appeal and directed the Assessing Officer to follow the method of accounting regularly adopted by the assessee. The order of the Appellate Authority was challenged by the Revenue before the



Tribunal. The said appeal was dismissed by the Tribunal confirmed the order of the Appellate Authority. Thereafter, when this matter came up for consideration before the Gujarat High Court in ***Commissioner of Income Tax vs. Winner Business Link (P) Ltd*** reported in ***[2015] 230 Taxman 399 (Gujarat)***, one of the substantial questions of law framed was:-

Whether the Appellate Tribunal was right in law and on facts in accepting the method of accounting followed by the assessee ignoring the fact that during the regular assessment proceedings for A.Y.1997-98, the method of accounting followed by the assessee was rejected by the Assessing Officer?

19. The High Court of Gujarat answered the above question of law as below:-

“The amount received by way of membership fees was required to be considered as an advance and thereafter as and when the business commenced the amount of liability was required to be taxed over a period of time proportionately. The amount of membership fees would be considered as income from the year the business of the assessee commenced and therefore answer the questions raised in the negative i.e., against the revenue and in favour of the assessee.”



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It upheld the observation of the Tribunal, which says as below:

“When the assessee issued facility cards for number of years, the assessee has received entrance fee as well as membership fee. Entrance fee is recorded in the year of receipt while the membership fee is spread over to the period to which the membership relates. Similarly, the assessee pays insurance premium for the number of years for which the card is issued because the assessee has to provide the accidental insurance for the entire period of the card. Such expenditure is also spread over to the period for which the card is issued. The Revenue has claimed that the receipt of membership fee as well as the expenditure on the commission and the insurance premium is to be recorded in the year in which they are received and paid. The stand of the Revenue is contrary to the definition of accrual as provided in the Accounting Standard specified by the Central Government which is mandatory to be followed by the income tax assessee.”

20. The above order of Gujarat High Court when challenged before the Hon’ble Supreme Court, the Hon’ble Supreme Court, *vide* order dated 03.10.2026, dismissed the appeal of the Revenue, upholding the decision of the Gujarat High Court.



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21. Consistently, Courts in India, as referred to above, have recognised the method of accounting followed by the assessee, deferring portion of the receipts spread over to the period of contract. The said view of the High Courts also been confirmed by the Hon'ble Supreme Court by dismissing the appeal preferred by the Revenue. Therefore, there cannot be a contrary opinion insofar as the method of accounting adopted by the assessee.

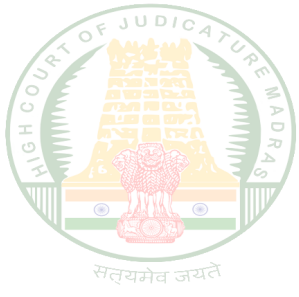
22. Accordingly, the substantial questions of law are answered in negative, against the appellant/Revenue.

23. As a result, *Tax Case (Appeal).No.1419 of 2010 stands dismissed.* There shall be no order as to costs.

(Dr. G.JAYACHANDRAN, J.) & (SHAMIM AHMED, J.)
28-04-2026

Index :Yes.
Neutral Citation :Yes.
To,

1. The Income Tax Appellate Tribunal, Chennai.



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&
SHAMIM AHMED, J.
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Pre-Delivery judgment made in
Tax Case (Appeal) No.1419 of 2010

28.04.2026