



Tax Case (Appeal) No.640 of 2013

**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.640 of 2013

The Commissioner of Income Tax,  
Chennai.

... Appellant

vs.

M/s.Mahindra Holidays and Resorts India Ltd.,  
M/s.Subbaraya Aiyar Padmanabhan & Ramamani,  
Advocates, 75A Dr.Radhakrishnan Salai,  
Mylapore, Chennai – 600 004.

... Respondent

**Prayer:** Appeal under Section 260-A of the Income Tax Act, 1961  
against the order of Income Tax Appellate Tribunal, Madras “A” Bench,  
Chennai, dated 25.05.2012 passed in I.T.A.No.1761/Mds/2011.

For Appellant

: M/s.V.Pushpa  
Senior Standing Counsel

For Respondent

: Mr.R.Vijayaraghavan,  
for M/s.Subbaraya Aiyar  
Padmanabhan & Ramamani



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## **J U D G M E N T**

**WEB COPY** The Appeal has been filed by the Revenue, being aggrieved by the order dated 25/05/2012 passed by ITAT, Chennai, which dismissed their appeal in ITA No:1761/Mds/2011.

### **2. The brief facts leading to this appeal are as below:-**

The assessee is in the business of selling time-share units. It provides holiday facilities in its notified resort to its members for a week every year in the specified apartment, a specified number of years, for which membership fees is collected either in full or in instalments. The assessee offered 60% of the fees received from the members as income in the year in which the members admitted and the balance 40% equally spread over the tenure of membership. The Assessing Officer, after examining various clauses of the membership agreement taxed the entire membership fee received as income of that year. He concluded that no extra expenses would be incurred in the subsequent years for providing facilities to customer, in view of the fact that as per the Time-share agreement, the assessee collect charges for upkeep and maintenance of the resorts and equipments separately as annual charges each year. He also observed that the assessee has claimed entire expenses incurred during the year but had deferred a portion of the income received which is against the concept



of matching principle. According to Assessing Officer, loss which is neither suffered nor incurred in the accounting year is not deductible against the actual receipts of the year.

3. Being aggrieved, like the assessment orders of the earlier years, this assessment order was also tested before the Commissioner of Income Tax (Appeals). The Appellate Authority, namely the Commissioner of Income Tax (Appeals) *vide* order dated 25.08.2011, following his earlier order passed for the Assessment Year 2006-07, dismissed the assessee's appeal upholding the view of the Assessing Officer. Thus, the computation of income taxing the entire membership fee received as income in the year was confirmed. Insofar as the expenditure of Rs.1,60,16,762/- for construction pending allocation, the case of the assessee was accepted by the Commissioner of Income Tax (Appeals) and allowed in favour of the assessee.

4. Against the order of the Commissioner of Income Tax (Appeals), which partly allowed and partly dismissed the appeal by the assessee, the revenue filed appeal against the portion of the order in favour of the assessee in respect of expenditure claimed. The Income Tax Appellate Tribunal took up the Revenue Appeal as ITA No.1761/Mds/2011. The assessee went on appeal



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against the dismissal of its claim in respect of deferred income. The assessee's appeal was taken on file as ITA No.1613/Mds/2011. Both appeals were heard up together and *vide* common order dated 25.05.2012, the ITAT dismissed both the appeals.

5. Before the Income Tax Appellate Tribunal, in support of its appeal, the Revenue relied on the contra order of the ITAT passed in ***Sterling Holiday Resorts (India) Ltd*** reported in [295 ITR (AT)], along with few more judgments which has rejected the plea of deferred income. After distinguishing those judgments on facts, the ITAT held that the subsequent decision of the Special Bench rendered in the assessee's own case being a decision of a larger bench, same has to be followed. Accordingly, the appeal filed by the Revenue was dismissed.

6. Not satisfied with the reasoning stated for the dismissal, the Revenue has filed the present appeal under Section 260A of the Income Tax Act, raising the following substantial question of law:-

***1. Whether on the facts and in the circumstances of the case, the Tribunal was right in deleting the Addition made by Assessing Officer on***



*account of Advance receipt of time share membership fee?"*

*2. Whether the amount received on account of time share unit is to be taxed in the year of receipt or spread over for the balance during the tenure of membership even though the assessee is following mercantile system of accounting and when the income has accrued?"*

7. There is no dispute in respect of the core fact that the assessee company is engaged in selling time-share to the members and it is collecting membership fees either upfront or in instalments, for the purpose of providing accommodation and resort facilities to the members for a specific period.

8. The contention of the Department is that the entire receipt towards membership fees is liable to be taxed on the same year and there is nothing in the Act to permit the assessee to treat part of the income as deferred income and not to offer it for taxation.

9. On the contrary, the case of the assessee is that considerable portion of the receipt from the customers is set apart for providing agreed



facilities over a period of 25 or 33 years, as the case may be. The members have agreed to pay annual maintenance charges for the maintenance of the resort but it does not mean that maintenance of the resort alone would be sufficient for the fulfilment of the obligation towards members.

**10.** To answer the questions of law, it is necessary first to examine the clauses of the agreement. Hence, the Clauses in the Membership Rules, which is relevant for consideration are extracted below:

**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 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.*

*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.*

Thus from the above clause, it is clear that the membership fees is collected for the assured accommodation for a week in a year at any of the specified Resort of the assessee Company and allied facilities for the period mentioned.

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

*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. Thereafter, AMC is payable every year before the 30th April for the period 1st April to 31<sup>st</sup> 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.*

*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.”*

**11.** 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 for a week every year over a period extending beyond the year of payment.

**12.** 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.

**13.** 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) In **Indian Molasses Co. (P) Ltd vs. Commissioner of Income Tax**

WEB 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 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 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, 15<sup>th</sup> 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 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 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 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.*

*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 10<sup>th</sup> July 2013***, the High Court dismissed appeal of the Revenue, making the following observation:



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*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 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 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. 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 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)*

(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 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 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 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.”*

**14.** 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.

**15.** 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."*

16. 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.



17. 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. 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 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 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.”*

**18. 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.*



19. 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?*

**20.** 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.”*

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."*

**21.** 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.

**22.** 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 given legal sanctity. 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.



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**23.** Accordingly, the substantial questions of law are answered against the appellant/Revenue.

**24.** As a result, *Tax Case (Appeal).No.640 of 2013 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/No.

To,  
1. The Income Tax Appellate Tribunal, Chennai.



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Tax Case (Appeal) No.640 of 2013

**Dr. G.JAYACHANDRAN, J.**  
**&**  
**SHAMIM AHMED, J.**  
bsm

Pre-Delivery judgment made in  
Tax Case (Appeal) No.640 of 2013

28-04-2026