(2006) 06 AP CK 0023

Andhra Pradesh High Court

Case No: Referred Case No. 71 of 1995

P.L. Ganapathi Rao and Another		APPELLANT
	Vs	
Commissioner of Income Tax		RESPONDENT

Date of Decision: June 16, 2006

Citation: (2006) 206 CTR 242 : (2006) 285 ITR 501

Hon'ble Judges: G. Chandraiah, J; Bilal Nazki, J

Bench: Division Bench

Advocate: S.R. Ashok, for the Appellant; K.K. Viswanatham, for the Respondent

Judgement

Bilal Nazki, J.

This is a reference made at the instance of the assessee. The facts leading to the reference are that the assessee-firm carried on business in distribution of feature films. It had acquired rights over a film called "Paramanandayya Sishvula Kama" during the year 1974 from its producers M/s. Sri Devi Productions, Tanuku. During the year under consideration the assessee sold the leasehold rights in respect of the said film to M/s. Poorna Financiers and as per the agreement dated December 1, 1984, the consideration was Rs. 4,00,000. This amount had to be paid immediately on execution of the agreement. The agreement stated that the said amount of Rs. 4,00,000 shall be adjusted in five years i.e., Rs. 1,00,000 in the first year. Rs. 90,000 in the second year, Rs. 80,000 in the third year, Rs. 70,000 in the fourth year and Rs. 60,000 in the fifth year. The entire amount of Rs. 4,00,000 had been paid to the assessee in the year under consideration but the assessee had shown only Rs. 1,00,000 as income for that year and Rs. 3,00,000 as a deposit. The Income Tax Officer came to the conclusion that the assessee was following the cash system of accounting and it was not under an obligation to return the deposit under any circumstances to the lessee and the assessee was not entitled to reacquire the leasehold right of the picture during the year of lease and the intention of the assessee in spreading the sum of Rs. 4,00,000 over the period of five years was only to reduce its tax and also to have the benefit of set off of the accrued profits of the

current year against the future losses, if any. On appeal, the Commissioner of Income Tax (Appeals) reversed the decision. The Department filed an appeal before the Tribunal. The Tribunal reversed the order of the Commissioner of Income Tax (Appeals) and restored the order of the Income Tax Officer and made the following observations:

We have considered the rival submissions, the facts and material on record. We are unable to agree with the learned Commissioner of Income Tax (Appeals) in this respect. In repetitive five lease agreements, the assessee had received Rs. 1 lakh as advance which is not refundable in any circumstances. Inter se agreements between the parties that the advances had to be adjusted in 5 years cannot determine the accrual of income for purposes of taxing it. As per the agreements, the assessee had right to receive this Rs. 1 lakh along with Rs. 63,750 which was already taxed and the same is non-refundable. The right of receiving the entire amount is therefore accrued to the assessee when the agreement was made, i.e., during the year under appeal, as already said, only inter se agreement cannot change the character of right and determination of taxability. The order of the learned Commissioner of Income Tax (Appeals) is therefore indefensible and reversed.

2. In these circumstances, a request for reference was made and the following questions have been referred to this court.

1. Whether, on the facts and in the circumstances of the case, the Tribunal is correct in law in holding that the lease amount received in advance by the assessee for leasing out the film for 5 years and to be adjusted towards the yearly lease amount for the next four years is taxable in the year of receipt, i.e. the previous year ending on March 31, 1986, when the assessee was maintaining the accounts on mercantile basis ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal is correct in law in holding that the right of receiving the entire lease amount accrued to the assessee ?

3. The facts are not in dispute. The following facts emerge from the record (1) that there was an agreement between the assessee and lessee and the lessee had taken the leasehold rights for exhibiting the film for five years for a consideration of Rs. 4,00,000 which was paid at the time of execution of the agreement; (2) that in no circumstances the assessee was entitled to return the money ; and (3) that the assessee had not paid any tax on account of Rs. 3,00,000 which, according to him, was a deposit.

4. Learned counsel for the parties have referred to certain judgments, but before going to these judgments, it may be noted that while the Income Tax Officer had given a finding that the assessee was following the cash system of accounting and he was not under an obligation to return the deposit under any circumstances, but on appeal, the Commissioner of Income Tax (Appeals) gave a finding that there was

no justification for the observation of the Income Tax Officer that the assessee was following the cash system of accounting. As a matter of fact, he had stated that in the preceding year itself the Department had accepted the mercantile system being followed by the assessee.

5. The judgment of the Supreme Court reported in COMMISSIONER OF Income Tax, MADRAS Vs. K. R. M. T. T. THIAGARAJA CHETTY and COMPANY., is not applicable to the present case as in the case before the Supreme Court the assessee had become entitled to a commission of Rs. 2,26,850. On March 30, 1942, the assessee wrote to the company requesting that a certain debt, which the assessee owed to the company for a long time past, should be written off. The directors, by their resolution, passed on the same date refused to write off the amount without consulting the general body of shareholders and pending the settlement of the dispute, resolved to keep the sum of Rs. 2,26,850, in suspense without paying it. The High Court came to the conclusion that there was no material for the Tribunal''s finding that the assessee was being assessed on cash basis in previous years but held the sum of Rs. 2,26,850 was not liable to tax. On appeal, the Supreme Court held that the sum of Rs. 2,26,850, was income which had accrued to the assessee and it did not cease to be income by reason of the fact that it was carried to the suspense account by a resolution of the directors and it was therefore assessable to tax. Therefore, in our view, this judgment does not help the assessee, as admittedly the amount of Rs. 4,00,000 received by the assessee was income of the previous year for the purpose of computing tax. The Supreme Court in the same judgment held (page 533):

Lastly, it was urged that the commission could not be said to have accrued, as the profit of the business could be computed only after the March 31, and therefore the commission could not be subjected to tax when it is no more than a mere right to receive. This argument involves the fallacy that profits do not accrue unless and until they are actually computed. The computation of the profits whenever it may take place cannot possibly be allowed to suspend their accrual. In the case of income where there is a condition that the commission will not be payable until the expiry of a definite period or the making up of the account, it might be said with some justification, though we do not decide it, that the income has not accrued, but there is no such condition in the present case. Clauses 7 and 8 of the agreement which relate to the payment of the commission and the calculation of the profits mean no more than this that the commission will be quantified only after certain deductions had been made and not that the commission will not accrue until the profits have been ascertained. The quantification of the commission is not a condition precedent to its accrual. If the profits of the company are said to have accrued on the March 31, upon a parity of reasoning, it must be conceded that the commission also accrued on the same date. The date has as much to do with the accrual of the commission as it has to do with the accrual of the profits.

6. If we apply tile principles laid down in this judgment, we come to a clear conclusion that the amounts received could not be spread over for five years.

7. Learned counsel for the respondent has also referred to a judgment of the Constitution Bench of the Supreme Court reported in Income Tax Officer, A-Ward, Sitapur Vs. Murlidhar Bhagwandas, Lakhimpur Kheri, . This judgment has not laid down any law which could guide us in the present case. This was altogether in a different fact situation. Certain interest on income was brought to tax for the assessment year 1949-50. The Appellate Assistant Commissioner held that the income was received in the previous accounting year and directed that the amount should be deleted from the assessment for the year 1949-50 and included in the assessment for the year 1948-49. In those facts situation, the Supreme Court held (page 343):

It is, therefore, manifest that assessment or reassessment made under the said sections or pursuant to the orders or directions made thereunder must necessarily relate to the assessment of the year under review, revision or appeal, as the case may be.

8. We do not find that this judgment in any way helps the assessee because it was always the question to be decided by the Income Tax Officer and the appellate authority or the Tribunal whether the income received by the assessee in a year could be spread for five years or could be taken as income for the previous year.

9. The judgment of the Supreme Court in Commissioner of Income Tax, Gujarat Vs. Ashokbhai Chimanbhai, was also in a different context whether the words "accrue" and "arise" are used to contradistinguish the word "receive". It was held that when the right to income becomes vested in the assessee, it was said to accrue or arise. According to this judgment, income would be taxable after the right to income accrues or arises and in the case of an agreement which makes profits receivable at or on the happening of a contingency, the fact that the profits are the result of transactions spread over a period which covers a period preceding the happening of that contingency would not make the receipt liable to be paid to persons other than those who are entitled to receive it on the date on which it is actually received or became receivable.

10. In the present case in accordance with the agreement between the assessee and the lessee, the amount of Rs. 4,00,000 became due on the execution of the agreement. There was no mechanism laid down in the agreement by which this amount could be recovered or could be held by way of deposit by the assessee.

11. For these reasons, we do not find any ground to interfere. Therefore the questions framed are answered in favour of the Revenue and against the assessee.