(2014) 12 AP CK 0032

Andhra Pradesh High Court

Case No: I.T.T.A. No. 135 of 2004

The Commissioner of Income Tax		APPELLANT
	Vs	
Shanker Constructions		RESPONDENT

Date of Decision: Dec. 16, 2014

Acts Referred:

- Income Tax Act, 1961 - Section 145, 260A, 34, 4(1)(b)(i)

Citation: (2015) 371 ITR 320 : (2015) 233 TAXMAN 449

Hon'ble Judges: L.N. Reddy, J; Challa Kodanda Ram, J

Bench: Division Bench

Advocate: Kiranmayee for J.V. Prasad, Advocate for the Appellant; A.V. Shiva Kartikeya, Advocate for the Respondent

Judgement

L. Narasimha Reddy, J.
This appeal under Section 260A of the Income Tax Act, 1961 (for short the Act), is preferred by the Revenue, feeling aggrieved by the order, dated 03.03.2003, passed by the Hyderabad Bench A of the Income Tax Appellate Tribunal (for short the Tribunal), in I.T.A. No. 40/Hyd/2000.

2. The facts that gave rise to filing of the appeal are as under:

3. The respondent is a Civil Contractor. It was awarded a contract by the Hyderabad Municipal Water Supply and Sewerage Board. The terms of the contract provided for deduction of 7.5%, on each bill. Out of this, 5% would be released to the respondent on successful completion of the work and the remaining 2.5%, on expiry of the defect liability period, on finding that no defects in the work are noticed during that period.

4. In its returns, filed for the assessment year 1996-97, the respondent did not include amount representing 2.5% of the bills. According to them, such amount can

be shown as income, only on its being received. The Assessing Officer, however, took the view that since the respondent was following the mercantile system of accounting, the amount of 2.5% of bills can be said to have accrued to it, along with the amount paid under the bills and the same is liable to be treated as income for that year. The respondent filed an appeal before the Commissioner of Income Tax (Appeals). The same was rejected on 29.10.1999. Thereafter, it filed I.T.A. No. 40 of 2000 before the Tribunal. The appeal was allowed and the Revenue has challenged the order of the Tribunal by filing this appeal.

5. Ms. Kiranmayee, learned counsel, representing, Sri J.V. Prasad, learned counsel for the appellant, submits that it is only when the cash system of accountancy is followed by an assessee, that he can reflect the receipts, when the amount is actually received, and in contrast, if mercantile system is followed, the amount deserves to be shown, in the returns of the year, in which it was mentioned in the books of account, irrespective of the date of actual receipt. She contends that 2.5% of the bill amount has already accrued to the respondent, except that the payment thereof is deferred, and that the Tribunal was not justified in taking a different view.

6. Sri A.V. Shiva Kartikeya, learned counsel for the respondent, on the other hand, submits that even where mercantile system is followed, the distinction between the true accrual, on the one hand, and mere entry made in the books, on the other hand, needs to be maintained. Placing reliance upon certain precedents, he submits that an amount can be said to have accrued to an assessee, as income, only when the corresponding right to receive it, arises and not otherwise.

7. Section 145 of the Act gives the liberty, to an assessee to follow either mercantile system or cash system of accounting. The distinction between these two, is too well-known. At the same time, certain niceties involved in understanding the true purport of certain expressions, which are used in the process, present some amount of difficulty.

8. An assessee, who follows the cash system, would be under obligation to pay tax only on the amount received by him, after assessment, in accordance with law. In contrast, an assessee, who follows the mercantile system, would be liable to pay tax on the amounts reflected in the books of account, irrespective of the fact whether he received the amount or not. Same is the case with the deductions and they do not depend upon the actual payments. Two judgments rendered by the Hon''ble Supreme Court, which are almost classics, would be helpful to have a clear idea about the concept. Of course, most of the players in the administration of tax regime are fairly acquainted with it. In Commissioner of Income Tax v. Shoorji Vallabhdas and Co., Sri Hidayatullah, J., explained it as under:

9. 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. Where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account Equally educative and instructive, is the judgment of the Hon''ble Supreme Court in Commissioner of Income tax v. A. Gajapathy Naidu, Chief Justice Sri Subba Rao K., in his inimitable style, explained the distinction between the two, succinctly, by addressing the root of the matter. The discussion was commenced by taking note of Section 4(1)(b)(i) of the Act, as it stood then. The provision reads as under:

10. Subject to the provisions of this Act, the total income of any previous year of any person includes all income, profits and gains from whatever source derived which-.

(b) if such person is resident in the taxable territories during such year,-

(i) accrue or arise or are deemed to accrue or arise to him in the taxable territories during such year.

11. The concentration was on sub-clause (i).

12. The following passage from Rogers Pyatt Shellac and Co. v. Secretary of State for India was taken note of:

..both the words are used in contradistinction to the word receive and indicate a right to receive. They represent a stage anterior to the point of time when the income becomes receivable and connote a character of the income which is more or less inchoate.

13. The Hon''ble Supreme Court proceeded to observe:

Under this definition accepted by this Court, an income accrues or arises when the assessee acquires a right to receive the same. It is commonplace that there are two principal methods of accounting for the income, profits and gains of a business; one is the cash basis and the other, the mercantile basis. The latter system of accountancy brings into credit what is due immediately it becomes legally due and before it is actually received; and it brings into debit expenditure the amount for which a legal liability has been incurred before it is actually disbursed. The book profits are taken for the purpose of assessment of tax, though the credit amount is not realised or the debit amount is not actually disbursed. If an income accrues within a particular year, it is liable to be assessed in the succeeding year. When does the right to receive an amount under a contract accrue or arise to the assessee i.e., come into existence: That depends upon the terms of a particular contract.

14. The problem was explained with the help of an illustration, as under:

When an Income-tax Officer proceeds to include a particular income in the assessment, he should ask himself, inter alia, two questions, namely: (i) what is the system of accountancy adopted by the assessee? and (ii) if it is the mercantile system of accountancy subject to the deemed provisions, when has the right to receive that amount accrued? If he comes to the conclusion that such a right accrued or arose to the assessee in a particular accounting year, he shall include the said income in the assessment of the succeeding assessment year. No power is conferred on the Income-tax Officer under the Act to relate back an income that accrued or arose in a subsequent year to another earlier year on the ground that the said income arose out of an earlier transaction. Nor is the question of reopening of accounts relevant in the matter of ascertaining when a particular income accrued or arose. Section 34 of the Act empowers the Income-tax Officer to assess the income which escaped assessment or was under-assessed in the relevant assessment year.

15. One does not need any further help or material to understand the basics of the concept than this. A clear distinction is maintained between right to receive the amount and acquisition of right, as such. In the present context, the distinction is mostly between the acquisition of a right to receive, on the one hand, and being in a position to claim, on the other hand. On acquisition of a right to receive the amount, the assessee would be in a position to enforce it, and the enforcement may, in a given case take sometime. In the context of mercantile system, the mere acquisition of a right to receive would be sufficient to saddle the assessee, with the obligation to pay tax. Where, however, he is yet to acquire right, but is in a position to claim of such right, the matter stands on a different footing. As observed by the Hon''ble Supreme Court, that would depend upon the terms of a contract. Issues of this nature crop up mostly, when the conditions are contingent in nature.

16. In the instant case, the clause in the contract provided for deduction of 7.5% from each bill. Out of this, 5% would be payable on successful completion of the work and balance 2.5% after the expiry of the defect free period. For instance, if the value of the contract is Rs. 1.00 crore and the amounts are paid under four bills of Rs. 25.00 lakhs each. From each of the first 3 bills, sums representing 7.5% are deducted. On successful completion of the work, the amounts representing 5% deducted from the first three bills, would become payable along with the final bill. However, even from the final bill, 2.5% would be deducted. This amount of 2.5%, which stood deducted from all the four bills, becomes payable, only on expiry of the defect free period. If such period is one year, the amount becomes payable only when no defects whatever are found or noticed, during that period.

17. The controversy, in the instant case, is about the year in which the amount representing 2.5% had accrued to the respondent. It is, no doubt, true that in all the bills, reference was made to these amounts and corresponding entries were made in the books of account. However, the right to receive that amount was contingent

upon there not being any defects in the work, during the stipulated period. It is then, and only then, that the amount can be said to have accrued to the respondent. It is represented by the learned counsel for the respondent that the amount was received by his client in the subsequent assessment year on expiry of the defect free period and that the amount has been brought under the tax.

18. The view taken by the Tribunal accords with the law laid down by the Hon''ble Supreme Court and we do not find any basis to interfere with the order under appeal.

19. The I.T.T.A. is accordingly dismissed. There shall be no order as to costs.

20. The miscellaneous petitions filed in this appeal shall also stand disposed of.