

(2012) 06 MAD CK 0219

In the Madras High Court

Case No : Tax Case (Appeal) No"s. 169 and 170 of 2005, 2626 of 2006 and 1802 of 2008

CIT

APPELLANT

Vs

Ashok Leyland Finance Ltd.

RESPONDENT

Date of Decision : 28-06-2012

Acts Referred:

Income Tax Act, 1961 — Section 145(1), 194A, 263, 5

Citation : (2013) 261 CTR 434

Hon'ble Judges : K. Ravichandra Baabu, J;Chitra Venkataraman, J

Bench : Division Bench

Advocate : T. Ravikumar, for the Appellant; S. Ganesh and M. Yogesh Kanna, for the Respondent

Final Decision : Dismissed

Judgement

Chitra Venkataraman, J.—Learned standing counsel appearing for the appellant filed a memo dt. 28-6-2012 stating that the respondents name has been changed to M/s. Indusind Bank Ltd. Hence, he requests that the respondents name may be changed to continue with the proceedings. Accordingly, the memo dated 28-6-2012 is recorded. The above tax case (appeals) are admitted by this Court on the following substantial questions of law:

Tax Case (Appeal) Nos. 169 and 170 of 2005:

1. Whether in the facts and circumstances of the case, the Tribunal was right in holding that the assessee is justified in following the Equated Monthly Instalment method to account the finance charges for the income tax purposes only ?
2. Whether in the facts and circumstances of the case, the Tribunal was right in holding that the assessee is justified in following Sum of Digits method to account the finance charges to arrive at balance sheet and profit and loss statements only ?

3. Whether in the facts and circumstances of the case, the Tribunal was right in holding that the assessee is justified in following one method of accounting for the income tax purpose to attract lesser tax and other method to show higher income in its balance sheet and profit and loss statement ?

4. Whether in the facts and circumstances of the case, the Tribunal was right in holding that the assessee is justified in changing the method of accounting ?

Tax Case (Appeal) No. 2626 of 2006:

1. Whether in the facts and circumstances of the case, the Tribunal was right in holding that the assessee is justified in following the Equated Monthly Instalment method to account the finance charges for the income tax purposes only ?

2. Whether in the facts and circumstances of the case, the Tribunal was right in holding that the assessee is justified in following Sum of Digits method to account the finance charges to arrive at balance sheet and profit and loss statements only ?

3. Whether in the facts and circumstances of the case, the Tribunal was right in holding that the assessee is justified in following one method of accounting for the income tax purpose to attract lesser tax and other method to show higher income in its balance sheet and profit and loss statement ?

Tax Case (Appeal) No. 1802 of 2008:

Whether in the facts and circumstances of the case, the Tribunal was right in holding that the assessee is justified in following one method of accounting for the income tax purpose to attract lesser tax and other method to show higher income in its balance sheet and profit and loss statement ?

2. The assessment years under consideration are 1991-92, 1992-93, 1999-2000 and 2003-04 in Tax Case (Appeal) Nos. 169 of 2005, 170 of 2005, 2626 of 2006 and 1802 of 2008 respectively.

3. It is seen from the facts narrated that the assessee had entered into agreements to give vehicles on hire purchase basis. In respect of the income received, admittedly, while returning the income under IT Act, the assessee had followed Equated Monthly Instalment (in short, EMI) method, as against the Sum of Digits (in short, SOD) method. In the course of the assessment proceedings, the assessee contended that having regard to the nature of agreement entered into between the assessee and its customer, that the assessee could not enforce collection of amount otherwise than what is due by equated monthly instalments, hence, the method followed by the assessee for the purpose of arriving at its true income could not be faulted with. The assessee further pointed out that on the only test of accrual of income as per s. 5 of the IT Act thus satisfied in the reporting of the income by following EMI method, it was not open to the AO to reject the return. Thus, once the correct income has been deduced from the books of accounts, the AO is bound to go by the EMI method and not just by the

book results.

4. The assessing authority viewed that even though the assessee was free to adopt any method of accounting, the scrutiny of the accounts revealed that the assessee had followed SOD method. Consequently following the decision of the Tribunal in the case of (1993) 45 ITD 386 the assessing authority viewed that the assessee was prohibited from adopting a different method of accounting for the purpose of returning the income.

5. Aggrieved by the assessment for the assessment year 1991-92, the assessee preferred an appeal before the CIT(A), who, agreeing with the view of the AO, pointed out that while section 145(1) leaves the choice to the assessee to adopt any system of accounting, it is, however, open to the AO to compute the income and profits and gains, in the event, the system of accounting employed by the assessee did not reveal the true income. Referring to the decisions in *The Commissioner of Income Tax Vs. Mcmillan and Co.*, and *The Commissioner of Income Tax, Madras Vs. A. Krishnaswami Mudaliar and Others*, the CIT(A) held that it was necessary that the method of accounting regularly employed by the assessee shall be consistently followed by the assessee. Thus the CIT(A) pointed out that the AO has the duty to consider whether or not the books disclosed the true state of accounts and correct income to be reduced thereof. The CIT(A) pointed out that as far as the assessee's case was concerned, it was regularly following the SOD method for recognising the income representing the finance charges in the accounts right from the beginning. Thus recognising the said method alone, which was regularly followed by the assessee since its incorporation, the AO held that the income of the assessee should be computed in accordance with the system regularly employed by the assessee.

6. Rejecting the contention that the assessee was not obliged to follow this method of accounting for the purpose of filing the return, the CIT(A) held that the assessee could not adopt different methods of accounting, one for the purpose of carrying on business and one for the purpose of income tax assessment. Thus the assessee's appeal was rejected. Aggrieved by this, the assessee went on appeal before the Tribunal.

7. Before the Tribunal, the assessee took a definite plea that the nature of transaction entered into by the assessee was pure and simple, a hire purchase and leasing. The assessee admitted that in the books of accounts, it adopted SOD method, however, for the purpose of income tax, the assessee adopted EMI method for income recognition in respect of the finance charges and hire purchase agreement. The Tribunal considered the contention of the assessee in terms of the hire purchase agreement and ultimately came to the conclusion that the question, as to whether the income by way of finance charges under hire purchase agreement entered into by the assessee with its hirers had accrued under SOD method as per the books or under EMI method as per the agreement, has to be seen in the background of the nature of transaction conducted by the assessee. Thus referring to the various clauses in the agreement, ultimately, the

Tribunal came to the conclusion that the assessee had not given any loan or money for purchase of vehicle in question. Thus the transaction was not a loan transaction, but only a hire purchase agreement.

8. It is an admitted fact that the Revenue did not challenge this finding of fact before this Court for the purpose of considering as to which method should be taken in a correct method for the purpose of arriving at the real income of the assessee.

9. Leaving this aside for a moment, if we go through the order of the Tribunal, we find that the Revenue placed reliance on the decision of the Special Bench of Hyderabad Tribunal in the case of Dy. (1998) 65 ITD 17 . On going through the said decision, the Tribunal held that the facts in that reported decision of the Special Bench of the Tribunal were distinguishable one. The Tribunal pointed out to the specific finding of the Special Bench that for import of machinery, the assessee therein had given a loan, hence, essentially it was a finance transaction. In contrast to this, in the present case of the assessee before the Tribunal, which is subject-matter of appeals before us, the Tribunal held that the agreement was essentially one of a hire purchase agreement and the hire purchaser became owner only when he exercised his option finally. In the course of the discussion, it also referred to the order of the Tribunal in the assessee's own case for the assessment years 1989-90 and 1990-91 and pointed out that in that case, the AO himself had accepted the EMI method, which was, however, interfered with by the CIT u/s 263 proceedings; the revision order of the CIT, was further taken on appeal before the Tribunal by the assessee, which reversed the order of the CIT and restored the order of the AO holding that adopting EMI method was in accordance with the contract between the parties. Thus the Tribunal held that the IT authorities had failed to note the difference between the hire purchase transaction and the loan transaction and going by the factual finding that it was only a hire purchase transaction, the Tribunal allowed the appeals filed by the assessee.

10. It is a matter of relevance to point out that the assessee placed reliance on the circular of the CBDT, which, no doubt, was with reference to hire purchase cases. The Tribunal referred to the CBDT circular dated 13-1-1998, which specifically dealt with the hire purchase transactions taxability with reference to interest element, to ultimately hold that section 194A of the IT Act would not be attracted in case of payment of periodical instalment on the hire purchase agreement. Thus in the context of the circular of the Board No. 127(12)-IT-II, dated 13-5-1943 as well as subsequent Circulars, particularly Circular No. 275/9/80-IT(B) dated 25-1-1981 and Circular F. No. 160/1/1996 dated 13-1-1998 ((1998) 144 CTR (St) 37), the Tribunal agreed with the assessee's case. Aggrieved by this, the Revenue has filed the above tax case (appeals) before this Court.

11. Learned standing counsel appearing for the Revenue placing heavy reliance on the views of the assessing authority and pointed out that given the fact that

the assessee, for the purpose of his regular business, had maintained SOD method and that only for purpose of filing the return, had followed EMI method. In the absence of any specific explanation, rightly, the AO rejected the assessee's claim. Given the fact that the assessee had maintained the books of accounts on SOD basis, the grant of the relief based on EMI method is not sustainable.

12. In this connection, he placed reliance on the decision of the Kerala High Court in *Commissioner of Income Tax Vs. Kerala State Financial Enterprises Ltd. and Others*, and the decision in *Commissioner of Income Tax Vs. Muthoot Leasing and Finance Ltd.*, He also placed reliance on the Tribunal's Special Bench, Hyderabad order in the case of *Dy. CIT v. Nagarjuna Investment Trust Ltd.* (supra).

13. Per contra, learned senior counsel appearing for the assessee pointed out that the Revenue had accepted the finding of fact by the Tribunal that the nature of transactions dealt with by the assessee are hire purchase transactions only. The agreement really pointed out equated monthly instalments payable to the assessee. When the Department had not questioned the findings of the Tribunal as to the nature of transaction, the true income in the case of hire purchase transaction could only be arrived at under EMI method. Thus, when the character of transaction had not been challenged and the agreement stands as it is, the terms of payment schedule have to be accepted for the purpose of computing the income. In any event, the Tribunal had rightly considered the effect of the circular dated 13-5-1943, even though this was given in the case of hire purchaser and in the background of this circular, the Revenue's appeals have to fail.

14. Heard learned standing counsel, appearing for the Revenue and the learned senior counsel appearing for the assessee and perused the materials placed before this Court.

15. We agree with the submissions made by the learned senior counsel appearing for the assessee.

16. A perusal of the order of the Tribunal clearly showed that the nature of the business transaction conducted by the assessee was one of a hire purchase giving vehicles on hire purchase and the assessee had not given any finance or loan for the purchase of vehicle. The terms of the agreement thus clearly point out that the hire purchaser shall not have any proprietary right or title until he exercised, in writing, his option to purchase, as provided in the agreement by payment of the whole amount due under the agreement or in term thereof. A reading of the agreement shows that the principal and finance charges for the entire period of contract had been shown separately in the schedule attached to the agreement. The total amount of hire purchase charges, namely, principal and finance charges, was divided equally by number of instalments specified in the contract. Thus the method employed for arriving at the monthly instalment is an EMI method and the rights of the assessee to receive the hire purchase charges

on various due dates are as per the schedule mentioned in the agreement.

17. In the light of the said finding of fact, one has to look at the reasoning of the Tribunal referring to the order of the Special Bench of the Hyderabad Tribunal and the assessee's own case in respect of the previous assessment year. Referring to the earlier order of the Tribunal, which came on reference before this Court and which in turn was also rejected by this Court under judgment dated 12-3-1998, the Tribunal held that the consistency of returning the income for the purpose of income was only on EMI method. This was so ever since the assessee started its business in this field. The Tribunal further pointed out that in loan transaction, only money is really involved, but in a hire purchase transaction, hiring of asset other than money is involved; the title to the property will pass on to the hirer, when all the instalments are paid and when the hire purchaser exercises his option to purchase. Therefore, given the fact that the character of the transaction was pure and simple a hire purchase agreement and that the transaction had not in any manner undergone any change from the one which was the subject-matter of consideration by the Tribunal for the earlier years, in respect of which, reference application filed by the Revenue was dismissed, the Tribunal came to the conclusion that the AO had committed a serious error in ignoring the EMI method, to adopt SOD method.

18. We are in agreement with the reasoning of the Tribunal in this regard that when once the Revenue had accepted the character of the transaction as hire purchase transaction, the income that flows from the transaction has to necessarily follow the treatment that is given under the hire purchase agreement. Secondly, when the Revenue had not disputed the fact that in all the earlier years, the Revenue had treated the income as per the hire purchase agreement on EMI basis, there are no materials available as on record to show that following such method had really resulted in suppression of income, in other words, there was no true reflection of the income that has to be assessed under the Act.

19. In the background of this fact, when we look at the decision of the Special Bench of Hyderabad Tribunal in the case of Dy. CIT v. Nagarjuna Investment Trust Ltd. (supra), on which heavy reliance was placed, we find therein that the facts are totally a different one. The assessee therein financed its customer for purchasing machinery from abroad. Even though the agreement was captioned as hire purchase agreement, a reading of various clauses showed that the assessee had accounted for its finance interest income in relation to hire purchase agreement on SOD method in its books of account, by apportioning each EMI between interest component and principal component, the interest income progressively reduced with the reduction in the outstanding principal amount. Thus, based on the hire purchase agreement that it recognised the SOD method for the purpose of arriving at its real income, rightly, the Tribunal held it otherwise that the income had to be computed only on SOD method. The Tribunal pointed out that in the face of the factual findings herein that the

contract is one of hire purchase agreement, the income had to be arrived at on EMI basis only.

20. As far as the reliance placed by the Revenue on the decision of the Kerala High Court in CIT v. Kerala State Financial Enterprises Ltd. & Ors. (supra) is concerned, we do not find that the said decision would be of any assistance to the Revenue, since those agreements were for financing for purchase of vehicle. In the circumstances, we reject the reliance placed by the Revenue.

21. As far as Circular No. 127(12)-IT-II, dated 13-5-1943 is concerned, even though the said circular is issued in the context of hire purchasers rights, yet, the instructions given are with reference to eases relating to purchase of assets under the hire purchase agreement. The Revenue does not dispute the fact that on entering into the hire purchase agreement, the hire purchaser does not become the owner immediately and hirer vendor is the owner. It also does not dispute the fact that the hire purchaser becomes the owner of the asset only on payment of the whole amount due under the agreement.

22. Going by the abovesaid facts, we do not find that the; reliance placed on by the assessee to the circular dated 13-5-1943 could be called a misplaced one. Apart from the abovesaid circular, there is yet another circular issued by the CBDT dated 13-1-1998, which was given under the Interest-tax Act, 1974, particularly with reference to the hire purchase transactions taxability of hire charges as interest.

23. A perusal of the said circular shows the instruction given to the CIT as to the manner in which the transaction of hire purchase has to be considered. If we apply the same to the facts herein, we find, rightly, the Tribunal adopted the correct approach for arriving at its finding. In the light of the above, we have no hesitation in confirming the order of the Tribunal, thereby rejecting the appeals filed by the Revenue. Accordingly, the above tax case (appeals) stand dismissed. No costs.