

(1984) 11 PAT CK 0032

In the Patna High Court

Case No : Taxation Case No. 38 of 1976

Commissioner of Income Tax

APPELLANT

Vs

Bihar State Agro Industries Development Corpn.

RESPONDENT

Date of Decision : 08-11-1984

Acts Referred:

Income Tax Act, 1961 — Section 256(1)

Citation : (1985) 49 CTR 356 : (1986) 158 ITR 96 : (1985) 22 TAXMAN 282

Hon'ble Judges : Uday Sinha, J; Nazir Ahmad, J

Bench : Division Bench

Advocate : B.P. Rajgarhia and S.K. Sharan, for the Appellant; Kashi Nath Jain and G.C. Bharuka, for the Respondent

Judgement

Uday Sinha, J.—In this reference u/s 256(1) of the Income Tax Act, 1961, the following question has been referred to this court:

"Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that the interest on hire purchase was to be assessed on the basis of realisation and not on the accrual basis ?"

2. This reference relates to the assessment year 1969-70. The facts, in brief, are that the assessee is a Government Corporation. It sells tractors and other agricultural implements on cash payment basis as also on hire-purchase basis. In respect of the sales effected on hire-purchase basis, the buyers are liable to pay interest on the price remaining due. In regard to the interest which fell due during the year ending March 31, 1969, the assessee credited it in part to the hire-purchase interest suspense account. A small part thereof was taken to the profit and loss account. The total interest which had fallen due in the year in question was Rs. 16,65,327. Out of that, a sum of Rs. 71,820 was credited by the assessee to the profit and loss account and Rs. 15,93,703 was transferred to hire-purchase "interest suspense account". According to the assessee, a sum of Rs. 71,820, which had been transferred to the profit and loss account, was the only sum which had actually been received by the assessee during the

assessment year. Upon these facts, the assessee claimed that it was following the cash system of accounting and, therefore, the sum of Rs. 71,820 alone was liable to be added to the taxable figure. The Income Tax Officer was, however, of the view that the system of accounting followed by the assessee was the mercantile system of accounting and, therefore, the entire sum which had fallen due from the hire-purchase instalments was to be taken as the income of the assessee. He, therefore, included the amount shown in hire-purchase interest account as the total income of the assessee. The assessee, being aggrieved, appealed to the Appellate Assistant Commissioner (hereinafter called "AAC"). The Appellate Assistant Commissioner in regard to the interest suspense account held that the assessee had to be assessed on accrual basis and not on realisation basis. He thus concurred with the view of the Income Tax Officer.

3. The assessee being aggrieved by the order of the Appellate Assistant Commissioner in regard to his verdict on the interest suspense account filed an appeal to the Tribunal. The Tribunal found that a similar question had been considered by it in the preceding year and in that year also, the hire-purchase interest suspense account had not been included in the total taxable income. The Tribunal, as in the previous year, held that the assessee was following the cash system of accounting as it was acting on the basis of realisation. The Tribunal took into account the fact that the assessee was a Government undertaking and, therefore, there would be no intention to avoid any tax on any income. In the view of the Tribunal, the system followed by the assessee was a reasonable system. For those reasons, the Tribunal held that the assessee was not following the mercantile system of accounting and the sum of Rs. 15 lakhs odd could not be added to the taxable amount. The Revenue being aggrieved by the order of the Tribunal applied for a reference to it in terms of Section 256(1) of the Income Tax Act. The Tribunal referred the question for our opinion as mentioned earlier.

4. The question which falls for consideration is : whether the assessee was following the mercantile system of accounting or it was the cash system of accounting. If the assessee was following the cash system of accounting, the sum Rs. 71,000 odd alone could be added to the taxable income, but if mercantile system of accounting was being followed, the Tribunal would not be justified in allowing the assessee's appeal.

5. The crucial matter in which the Tribunal went wrong is that the sum of Rs. 15 lakhs odd due to the assessee from purchasers had been shown as interest accrued to it during the accounting year. It is, therefore, obvious that the assessee was following the accrual system of accounting, i.e., mercantile system of accounting and not realisation basis, i.e., cash system of accounting. Learned counsel for the assessee submitted that the fact that the sum of Rs. 15 lakhs odd had been put in the suspense account made it absolutely clear that the same had not been realised and, therefore, it is obvious that the assessee was following the realisation basis or cash basis of accounting. Reliance was placed by the Revenue upon the Supreme Court decision in COMMISSIONER OF Income Tax,

MADRAS Vs. K. R. M. T. T. THIAGARAJA CHETTY and COMPANY., . That was a case where the assessee was entitled to a commission of Rs. 2,26,850 during the accounting year ending March 31, 1942. On March 30, 1942, the assessee wrote to the company of which the assessee was the managing agent that the 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, the directors resolved to keep the said sum in suspense without paying it. The said sum was debited as a revenue expenditure of the company and was allowed as deduction in computing the profits of the company for the purpose of Income Tax. The question arose whether the assessee was liable to pay tax on the said sum. The Department held in those circumstances that the assessee followed the mercantile method of accounting and not cash accounting. The Tribunal, however, took a different view. It held that the assessee was being assessed on cash basis in previous years and that the income had not accrued to the assessee and, therefore, the said sum should be excluded from taxation as not having been received in the accounting year. On a reference, the High Court held that the said sum was rightly excluded from taxation, as it had not been received in the accounting year. On those facts, the matter went up to the Supreme Court. It was urged on behalf of the assessee before the Supreme Court that the commission could not be subjected to tax when it was not more than a mere right to receive. The Supreme Court observed as follows (p. 533):

"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."

6. The same was the view of the Supreme Court in *Morvi Industries Ltd. Vs. Commissioner of Income Tax (Central) Calcutta*, .

7. The case of *James Finlay and Co. Vs. Commissioner of Income Tax*, , has also been relied upon by the learned standing counsel. In this case also, the assessee was following the mercantile system of accounting. It used to credit the interest to its profit and loss account. It was urged before the Revenue that the assessee had decided to change its method of accounting in respect of interest which was doubtful of recovery and such interest was thenceforth credited to a suspense account. Question arose whether the method of accounting had changed from mercantile system to cash system. It was contended before the High Court that the interest credited to the suspense account could not form part of the assessee's real income. A Bench of the Calcutta High Court rejected the stand of the assessee holding that the alteration in book-keeping and transfer of amounts to the suspense account could not be termed as a change in the method of accounting. It was observed by Sabyasachi Mukharji J. that the claim for interest not having been given up, the amounts in question were includible in the total income of the assessee for the relevant assessment year.

8. The Kerala High Court in *State Bank of Travancore Vs. Commissioner of Income Tax*, also took the view that where interest on advances by the bank considered doubtful of recovery were credited to a separate account shown as interest suspense account, they must be assessed as income of the assessee on accrual basis.

9. The above cases do lend support to the stand of the Revenue. The Tribunal, in the instant case, did not hold as a fact that the assessee was following the cash system of accounting. It did observe that the assessee had followed the basis of realisation for paying Income Tax on interest. The question, however, is whether there was any basis for that conclusion of the Tribunal. The Tribunal failed to take note of the fact that while the sum of Rs. 71,000 odd were being credited on realisation basis, the balance sum transferred to suspense account could have been shown only if that had accrued to the assessee during the assessment year. The fact that it was transferred to a suspense account is indicative of the fact that the assessee took the sum of rupees fifteen lakhs odd as having accrued to it. It is thus obvious that the assessee was working on accrual basis. If that were not so, there would be nothing to transfer to the suspense account. The conclusion of the Tribunal, therefore, that the assessee was following the realisation basis of accounting and not the accrual basis was legally unsound. Upon the facts asserted by the assessee itself, it is obvious that it was following the mercantile system of accounting. The sums transferred to the suspense account would, therefore, necessarily have to be included in the income of the assessment year.

10. Learned counsel for the respondent assessee submitted that the Tribunal had held as a fact that the assessee was following realisation basis of accounting. That would be a finding of fact with which this court in a reference application could not interfere. I regret, the finding of the Tribunal that the assessee was acting on realisation basis would not be a pure question of fact. In fact, upon the facts asserted by the assessee, it would indicate mercantile system of accounting. That would be a pure question of law. It is obvious that the assessee was proceeding on accrual basis and not on realisation basis. If the hire-purchase interest had not been transferred to suspense account and only Rs. 71,000 odd had been credited to the profit and loss account, it could be said that realisation basis of accounting was being followed. The fact that certain sums were transferred to the suspense account itself shows that such interest had accrued to the assessee. The inference, therefore, is inescapable that accrual system of accounting or mercantile system of accounting was being followed.

11. Learned counsel for the respondent assessee endeavoured to distinguish the Supreme Court and the Calcutta High Court cases by contending that in all those cases, it was admitted by the assessee that it was following the mercantile system of accounting which was not conceded in the present case. The above cases are indistinguishable from the instant case before us. In all those cases, the assessee was claiming that in regard to the disputed sums, the cash

system of accounting should be held to have been followed. Their stand was not accepted on the facts and circumstances of those cases. The same is the position in the instant case in regard to interest on hire-purchase. The assessee is claiming that the cash accounting system must be held to have been followed. On undisputed facts, we have not the least doubt that the assessee was following the mercantile system of accounting on the basis of accrual and not on realisation basis.

12. In my view, therefore, the Tribunal was not justified in holding that the interest on hire-purchase was to be assessed on realisation basis. The answer to the question referred to this court must be in the negative. The reference is disposed of accordingly. There shall be no order for costs.

Nazir Ahmad , J.

13. I agree.