IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

TAX APPEAL NO. 1471 of 2005
With
TAX APPEAL NO. 1472 of 2005
With
TAX APPEAL NO. 1473 of 2005
With
TAX APPEAL NO. 1475 of 2005
With
TAX APPEAL NO. 1476 of 2005
With
TAX APPEAL NO. 1477 of 2005
With
TAX APPEAL NO. 1478 of 2005

FOR APPROVAL AND SIGNATURE:

HONOURABLE MR.JUSTICE KS JHAVERI
and
HONOURABLE MR.JUSTICE K.J.THAKER

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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COMMISSIONER OF INCOME TAX....Appellant(s)

Versus

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UNIQUE MERCANTILE SERVICE PVT. LTD.....Opponent(s)

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Appearance:

MR NITIN K MEHTA, ADVOCATE for the Appellant(s) No. 1

MR BS SOPARKAR WITH MRS SWATI SOPARKAR, ADVOCATE for the Opponent(s) No. 1

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CORAM: **HONOURABLE MR.JUSTICE KS JHAVERI**
and
HONOURABLE MR.JUSTICE K.J.THAKER

Date : 18/12/2014

ORAL JUDGMENT

(PER : HONOURABLE MR.JUSTICE KS JHAVERI)

1. Being aggrieved and dissatisfied with the impugned judgment and order passed by the Income Tax Appellate Tribunal, Ahmedabad Bench (hereinafter referred to as 'the Tribunal'), the revenue has preferred the present Tax Appeals assailing the following orders

Tax Appeal No.	Date of Tribunal's order	ITA (SS) No.	Assessment Year
1471/2005	04/11/04	98/Ahd/2003	1989-90 to 1998-99
1472/2005	04/11/04	347/Ahd/2002	1997-98
1473/2005	04/11/04	240/Ahd/2004	01.04.88 to 17.09.199
1475/2005	04/11/04	2109/Ahd/2003	1998-99
1476/2005	04/11/04	3340/Ahd/2003	2000-01
1477/2005	04/11/04	2558/Ahd/2004	1998-99
1478/2005	04/11/04	2559/Ahd/2004	2001-02

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1.1 These matters were admitted by this Court for consideration of the substantial question of law as to whether the Appellate Tribunal was justified in setting aside the order of the CIT passed under Section 263 of the Income Tax Act, 1961 (hereinafter referred to as 'the Act').

2. The assessee company is engaged in the business of providing facility cards to the members on payment of prescribed fees which is called membership fees which is a one-time fee and is non-refundable. The period of membership varies between one to fifteen years. It is the case of the assessee that the payment of the membership is non-transferable. The accounts of the assessee had been prepared on accrual basis and accordingly it had apportioned the membership fees received from the members enrolled in a particular accounting year over the entire period of their membership.

2.1 The assessment year 1997-98 was the first assessment year in which the Assessing Officer rejected the method of accounting followed by the assessee and he considered the receipt in the year in which the cards were issued and similarly the deduction for expenditure was also allowed in the year in which they were paid irrespective of the number of years for which insurance cover was taken. In the assessment year 1998-99 the Assessing Officer accepted the assessee's method of accounting to be correct. However, the CIT(AP set aside the order of the Assessing Officer u/s 263 of the Act. Similarly, in the other remaining years under consideration in these appeals, the Assessing Officer rejected the assessee's method of accounting. Therefore, the revenue in all these

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appeals appealed before the Tribunal and the Tribunal vide impugned order held that the period/years wherein the Assessing Officer has accepted the assessee's method of accounting was neither erroneous nor prejudicial to the interest of revenue. The order u/s 263 of the Act was also set aside. Being aggrieved by the said order, the revenue is in appeal before us.

3. Mr. Nitin Mehta, learned advocate appearing for the revenue submitted that the Tribunal has committed an error in quashing the order u/s 263 of the Act passed by the CIT and in reaching the conclusion that the assessment order passed by the A.O by accepting the assessee's method of accounting was neither erroneous nor prejudicial to the interests of revenue. He submitted that the Tribunal has ignored the fact that the A.O had not followed the assessment order passed by his predecessor for A.Y 1997-98 wherein the method of accounting followed by the assessee was rejected.

3.1 Mr. Mehta has drawn our attention to the decision of ITAT, Hyderabad Bench which was relied upon by the Tribunal in the case of Treasure Island Resorts (P) Ltd vs. DCIT reported in 84 TTJ 820 considering the facts in both the cases to be similar. He submitted that the facts in both the cases are not identical but altogether different and therefore the decision reached by the Tribunal is factually as well as legally incorrect.

3.2 Mr. Mehta submitted that since discount is given by the shop keepers and insurance facility is provided by the Insurance Company, the assessee does not provide any

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service to the card holders after sale of card and therefore there is no question of providing service on continuous basis for the period of card. He further submitted that by postponing the revenue and two items of expenses, the assessee has claimed all other expenses for sale of cards in the first year and is giving distorted picture of the working results since the expenses have been claimed but the income is postponed. He submitted that in such a scenario, the assessee will be showing loss all throughout.

4. Mr. B.S. Soparkar, learned advocate appearing for the assessee supported the impugned order passed by the Tribunal and submitted that no interference is called for in the same. He submitted that except for the year 1998-99 wherein the Assessing Officer accepted the assessee's method of accounting to be correct and CIT(A) set aside the order of the Assessing Officer u/s 263 of the Act, the CIT(A) allowed in favour of the assessee. He submitted that the method of accounting followed by the assessee is a recognized method and true and fair profit of each assessment year is determined through the same. He further submitted that the assessee company provides various facilities to the card holders/members.

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5. We have heard learned advocates for both the sides and perused the materials on record. The main dispute in all these appeals is with regard to the correctness of the method of accounting of the assessee company for recording the receipt by way of membership fee and the expenses by way of commission and insurance premium. The assessee company is following mercantile system of accounting but the dispute is

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when the assessee has issued the facility card for a number of years, whether the membership fee received for number of years accrues in the year in which the card is issued or whether it should be spread over to the number of years for which the card is issued.

5.1 In this regard it shall be relevant to peruse the Notification No. S.O. 69(E) dated 25.01.1996 wherein the Central Government has notified Accounting Standard-1, more particularly, the expression 'accrual' which has been defined as under:

> "(b) "Actual" refers to the assumption that revenues and costs are accrued, that is, recognized ad they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate;"

5.2 The assessee has accordingly recorded the revenue as well as expenditure in the financial statement of period to which they relate. We find that the Tribunal has rightly observed as under in para 8 as under:

> "... When the assessee issued facility cards for number of years,t he 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 whichthe 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

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> 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."

5.3 We find that the Tribunal has rightly relied upon the decision of Hyderabad Bench in the case of Treasure Island (supra) and concluded as under:

> "The above finding of the ITAT would be squarely applicable to the case under consideration before us as the facts in both the cases are identical. In the case under appeal before us also, the assessee is under an obligation to provide the services on continuous basis for the period for which the card is issued. The assessee has spread over the receipt as well as expenditure as per Accounting Standard – 9 and the same is disclosed by the assessee by way of Note in the audited accounts. If the contention of the Revenue is accepted and the entire memebership fee collected is taxed in the year of receipt then in the subsequent year when the assessee will incur the expenditure there will be loss. That would give distorted picture of the working result of the assessee. In view of the above, we respectfully following the above decision of ITAT, Hyderabad Bench in the case of Treasure Island (P) Ltd (supra) hold that the method of accounting followed by the assessee was proper and correct method and the Assesing Officer has wrongly rejected the same."

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6. In this regard we are supported by the decisions of the Apex Court as well as this Court, Bombay and Delhi High Courts. The Bombay High Court in the case of **Taparia Tools Ltd. vs. Jt. CIT, [2003] 260 ITR 102** has observed that in order to determine the net income of an accounting year, the revenue and other incomes are matched with the cost of resources consumed. Under the Mercantile System of

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Accounting, this Matching is required to be done on accrual basis. Under this Matching concept, revenue and income earned during an Accounting Period, irrespective of actual cash in-flow, is required to be compared with expenses incurred during the same period, irrespective of actual out-flow of cash. It has been further held that the Income Tax Act makes no provision with regard to valuation. It charges for payment of tax, the income which is to be computed in the manner provided by the Act and that it is the duty of the Assessing Officer to deduce a proper taxable income. It is held that the Assessing Officer is required to compute the income in accordance with the method of accounting regularly employed by the assessee and if the system adopted by the assessee does not result in ascertainment of proper profits then, it is the duty of the assessing officer to make appropriate adjustments and deduce true profits.

6.1 The Apex Court in the case of **Rakesh Shantilal Mardia vs. Deputy Commissioner of Income-tax reported in [2012] 210 Taxman 565 (SC)** considering the decision of the Bombay High Court in the case of Taparia Tools Ltd. (supra) has held that matching principle is required to be followed in order of arrive at the real income of the assessee.

6.2 Similarly, in the case of **Commissioner of Income-Tax vs. Dinesh Kumar Goel reported in [2011] 331 ITR 10 (Delhi)**, the Delhi High Court has held as under:

> "... even when the income accrues or arises or is deemed to accrue or arise to the assessee in India during previous year, that is to be taxed in that year. It is important, therefore, that receipt of a

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particular amount in the relevant year should be an "income" under the aforesaid provision. What is the relevant yardstick is the time of accrual or arisal for the purpose of its taxation, viz., in order to be chargeable, the income should accrue or arise to the assessee during the previous year. If income has accrued or arisen, even if actual receipt of the amount is not there, it would be chargeable to tax in the said year. Though the amount may be received later in the succeeding year, the income would be said to accrue or arise if there is a debt owed to the assessee by somebody at that moment. From this, it follows that there must be the "right to receive the income on a particular date, so as to bring about a creditor and debtor relationship on the relevant date". The Court further explained that a right to receive a particular sum under the agreement would not be sufficient unless the right accrued by rendering of services and not by promising for services and where the right to receive is interior to rendering of service, the income, therefore, would accrue on rendering of services."

6.3 This Court has also taken the same view in a recent decision in the case of **Snesh Resort Pvt. Ltd vs. Dy. CIT rendered in Tax Appeal No. 113 of 2004 on 18.11.2014**. This Court has observed as under:

"6.2 Similarly in the case of **Bilahari Investment P. Ltd (supra)** the Apex Court has held that since from the various statements produced, the entire exercise arising out of the change of method from the completed contract method to deferred revenue expenditure was revenue neutral, the completed contract method was not required to be substituted by the percentage of completion method.

7. Considering the aforesaid observations of the Tribunal as well as the decisions relied upon by learned advocate for the assessee, we are of the opinion that the Tribunal has committed an error in

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> passing the impugned order so far as considering the membership fees as income when the assessee had not resumed giving the services of the water park to its members. Under such circumstances, 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. We therefore answer the questions raised in the negative i.e. against the revenue and in favour of the assessee."

7. In view of the aforesaid discussion, we do not find any infirmity in the order passed by the Tribunal. The Tribunal has rightly considered that the method of accounting should be such from which the correct profit of each year can be deducted and that as per the method adopted by the Revenue, the profit in the year in which the card is issued would be more resulting in loss/less profit in the year in which the services will be rendered by the assesseee. We are of the opinion that when the services are rendered partially, revenue is to be shown proportionate to the degree of completion of the service and therefore the assessee was justified in spreading over the amount of membership fee and expenses.

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8. Therefore, the Tribunal is justified in setting aside the order of the CIT passed under Section 263 of the Act. We, accordingly, answer the question of law raised in the present appeals in the affirmative i.e in favour of the assessee and against the revenue. The impugned order passed by the Tribunal is hereby confirmed. Appeals are dismissed accordingly.

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(K.S.JHAVERI, J.)

(K.J.THAKER, J)

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