

In the High Court of Judicature at Madras

Dated: 28.06.2012

Coram

The Honourable Mrs.JUSTICE CHITRA VENKATARAMAN
and
The Honourable Mr.JUSTICE K.RAVICHANDRA BAABU

Tax Case (Appeal) Nos.169 and 170 of 2005,
2626 of 2006 and 1802 of 2008

Commissioner of Income Tax
Chennai.

.... Appellant in the above T.Cs

Vs.

(M/s.Ashok Leyland Finance Ltd.,
Chennai.)
M/s.Indus Ind Bank Ltd.,
No.34, G.N.Chetty Road,
T.Nagar, Chennai 17.
(name changed vide
memo dated 28.06.2012)

.... Respondent in the above TCs.

APPEALS under Section 260A of the Income Tax Act against the orders dated 27.07.2001, 31.5.2006 and 11.4.2008 made in I.T.A.Nos.2428(Mds)/1994, 2229 (Mds)/1995, I.T.A.No.733/Mds/2003 and I.T.A.No.564/Mds/2007 on the file of the Income Tax Appellate Tribunal, Madras 'A' Bench for the assessment years 1991-92, 1992-93, 1999-2000 and 2003-04.

For Appellant : Mr.T.Ravikumar
Standing Counsel for Income Tax

For Respondent : Mr.S.Ganesh, S.C.
Mr.M.Yogesh Kanna
for M/s.S.R.Sundar

COMMON JUDGMENT

(Judgment of the Court was delivered by CHITRA VENKATARAMAN,J.)

Learned Standing Counsel appearing for the appellant filed a memo dated 28.06.2012 stating that the respondent's name has been changed to M/s.Indus Ind Bank Ltd. Hence, he requests that the respondent's name may be changed to continue with the proceedings. Accordingly, the memo dated 28.06.2012 is recorded.

2. The above Tax Case (Appeals) are admitted by this Court on the following substantial questions of law:

T.C.(A)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?"

T.C.(A)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?"

T.C.(A)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?"

3. The assessment years under consideration are 1991-92, 1992-93, 1999-2000 and 2003-04 in T.C.(A)Nos.169 of 2005, 170 of 2005, 2626 of 2006 and 1802 of 2008 respectively.

4. 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 Income Tax 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 Section 5 of the Income Tax Act thus satisfied in the reporting of the income by following EMI method, it was not open to the Assessing Officer to reject the return. Thus, once the correct income has been deduced from the books of accounts, the Assessing Officer is bound to go by the EMI method and not just by the book results.

5. 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 Income Tax Appellate Tribunal in the case of M/s.Amarpalli Mercantile Pvt. Ltd. V. ACIT reported in 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.

6. Aggrieved by the assessment for the assessment year 1991-92, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals), who, agreeing with the view of the Assessing Officer, 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 Assessing Officer 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 reported in 33 ITR 172 (CIT V. Manomillan & Co.) and 53 ITR 122 (CIT V. A.Krishnaswamy Mudaliar), the Commissioner of Income Tax (Appeals) held that it was necessary that the method of accounting regularly employed by the assessee shall be consistently followed by the assessee. Thus the Commissioner pointed out that the Assessing Officer has the duty to consider whether or not the books disclosed the true state of accounts and correct income to be reduced thereof. The Commissioner of Income Tax (Appeals) 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 Assessing Officer held that the income of the assessee should be computed in accordance with the system regularly employed by the assessee.

7. Rejecting the contention that the assessee was not obliged to follow this method of accounting for the purpose of filing the return, the Commissioner of Income Tax (Appeals) 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 Income Tax Appellate Tribunal.

8. 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.

9. 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.

10. 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 Income Tax Appellate Tribunal in the case of Deputy Commissioner of Income Tax V. Nagarjuna Investment Trust Ltd.) reported in (1998) 62 TTJ (Hyd) (SB) 33. On going through the said decision, the Tribunal held that the facts in that reported decision of the Special Bench of the Tribunal was 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 are 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 Assessing Officer himself had accepted the EMI method, which was, however, interfered with by the Commissioner of Income Tax (Appeals) under Section 263 proceedings; the revision order of the Commissioner of Income Tax (Appeals), was further taken

on appeal before the Tribunal by the assessee, which reversed the order of the Commissioner and restored the order of the Assessing Officer holding that adopting EMI method was in accordance with the contract between the parties. Thus the Tribunal held that the Income Tax 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.

11. It is a matter of relevance to point out that the assessee placed reliance on the circular of the Central Board of Direct Taxes, which, no doubt, was with reference to hire purchase cases. The Tribunal referred to the Central Board of Direct Taxes' circular dated 13.1.1998, which specifically dealt with the hire purchase transactions' taxability with reference to interest element, to ultimately hold that Section 194 A of the Income Tax 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)-I.T.42 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.160/1/96 dated 13.1.1998, the Tribunal agreed with the assessee's case. Aggrieved by this, the Revenue has filed the above Tax Case (Appeals) before this Court.

12. 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 Assessing Officer 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.

13. In this connection, he placed reliance on the decision of the Kerala High Court reported in (2008) 220 CTR (Ker) 286 (Commissioner of Income Tax Vs. Kerala State Financial Enterprises Ltd. & ors.) and the decision reported in (2009) 181 Taxmann 197 (Ker) (Commissioner of Income Tax V. Muthoot Leasing & Finance Ltd). He also placed reliance on the Tribunal's Special Bench, Hyderabad order in the case of Deputy Commissioner of Income Tax V. Nagarjuna Investment Trust Ltd.) reported in (1998) 62 TTJ (Hyd) (SB) 33.

14. 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 has 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.

15. 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.

16. We agree with the submissions made by the learned Senior Counsel appearing for the assessee.

17. 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, were divided equally by number of instalments specified in the contract. Thus the method employed for arriving the monthly instalment is an EMI method and the right of the assessee to receive the hire purchase charges on various due dates are as per the schedule mentioned in the agreement.

18. 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 orders 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 Assessing Officer had committed a serious error in ignoring the EMI method, to adopt SOD method.

19. 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 on 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.

20. In the background of this fact, when we look at the decision of the Special Bench of Hyderabad Income Tax Appellate Tribunal in the case of Deputy Commissioner of Income Tax V. Nagarjuna Investment Trust Ltd.) reported in (1998) 62 TTJ (Hyd) (SB) 33, 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.

21. As far as the reliance placed by the Revenue on the decision of the Kerala High Court reported in (2008) 220 CTR (Ker) 286 (Commissioner of Income Tax Vs. Kerala State Financial Enterprises Ltd. & ors.) 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.

22. As far as Circular No.127 (12)-I.T.2 dated 13.5.1943 is concerned, even though the said circular is issued in the context of hire purchaser's rights, yet, the instructions given are with reference to cases 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.

23. Going by the above-said 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 above-said circular, there is yet another circular issued by the Central Board of Direct Taxes 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.

24. A perusal of the said circular shows the instruction given to the Commissioner 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.

25. 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.

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To

1. The Income Tax Appellate Tribunal, Madras 'A' Bench.
2. The Commissioner of Income Tax (Appeals)-I, Madras.
3. The Assistant Commissioner of Income Tax, Central Circle (II) I,
Madras