IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 02.08.2022

CORAM

THE HONOURABLE MR. JUSTICE R. MAHADEVAN

AND

THE HONOURABLE MR. JUSTICE MOHAMMED SHAFFIQ

T.C.A.Nos.1413 to 1418 of 2008

The Commissioner of Income Tax,
Chennai .. Appellant in all appeals

Versus

M/s. Ashok Leyland Finance Ltd.,
"Sudarshan Buildings",
86, Chamiers Road,
Chennai 600 018. .. Respondent in all appeals

Tax Case Appeals filed under Section 260 A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal "A" Bench, Chennai, dated 31.10.2007 in ITA.Nos.1218, 1104, 1219, 1220, 1105, 1106 / Mds/2005.

For Appellant in all appeals: Mr.T.Ravi Kumar
Standing Counsel

For Respondent in all appeals: Mr. Vijayaraghavan for
M/s.Subbaraya Aiyar

COMMON JUDGMENT

(Judgment of the Court was delivered by R. MAHADEVAN, J.)

Challenging the common order dated 31.10.2007 passed by the Income Tax Appellate Tribunal, relating to the assessment years 1995-96, 2000-01 and 2001-02, the appellant / Revenue has come up with these Tax Case Appeals.

2.On 09.09.2008, this court admitted the aforesaid tax case appeals on the following substantial questions of law:

***TCA.Nos.1413 and 1414 of 2008*:**

> ' *1. Whether on the facts and circumstances of the case, the Tribunal was right in holding that the assessee was entitled to follow Equated Monthly Installment Method of accounting for its profit and loss account and report a higher income from finance charges, but in the computation of income for income tax purpose, return a lesser income from finance charges by following the Sum of Digits Method of accounting?*
>
> *2. Whether on the facts and circumstances of the case, the explanation 3 to 43(1) requires that the assessing officer should record a finding that the purpose of transfer of the assets was reduction of liability to income tax, in the absence of which the value shown by the assessee should be accepted for the purpose of grant of depreciation?*'

TCA.Nos.1415 to 1418 of 2008:

> " *1. Whether on the facts and circumstances of the case,*

the Tribunal was right in holding that the assessee was entitled to follow Equated Monthly Installment Method of accounting for its profit and loss account and report a higher income from finance charges, but in the computation of income for income tax purpose return a lesser income from finance charges by following the Sum of Digits Method of accounting?

2. Whether on the facts and circumstances of the case, the Tribunal was right in restricting the disallowance of interest payable on monies borrowed for investment in shares and administrative expenses at 2% even when the income earned from the equity shares do not form part of total income as per section 10?

3. Whether in the facts and circumstances of the case, the Tribunal was right in holding that the interest charges pertaining to the finance transaction cannot be brought to tax, and that the transaction should be accepted as a lease?"

3.1. When the matters were taken up for consideration, the learned counsel for the appellant / Revenue and the learned counsel for the respondent / assessee in unison, submitted that the first substantial question of law involved in all the appeals, is covered against the Revenue, in the light of the judgment dated 27.02.2019 rendered by a Co-ordinate Bench of this Court in TCA.Nos.1299 and 1300 of 2008 in respect of the assessee's own case relating to the assessment years 1995-96 and 1996-97, the relevant passage of which is usefully extracted below:

7. The Coordinate Bench of this Court in the case of Assessee in the similar set of facts in the case of ***Commissioner of Income Tax Vs. Ashok Leyland Finance Ltd. [(2013) 213 Taxman 0204]****, has held as under:*

"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."

8. It was also observed in the aforesaid Judgment that the Tribunal relied upon the Central Board of Direct Taxes Circular dated 13.01.1998 and allowed the computing of Interest component on the basis of EMI Method. The relevant portion is extracted for ready reference:

"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 13.01.1998, 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 13.05.1943 as well as subsequent Circulars, particularly Circular No.275/9/80-IT(B) dated 25.01.1981 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."

9.The Andhra Pradesh High Court in Sri Chakra Financial Services Ltd. Vs. Commissioner of Income Tax [(2013) 350 ITR 398], after discussing the Madras High Court's aforesaid view held that where there is no indication in the Hire Purchase Agreements reflecting the bifurcation of the EMIs into principal and interest components and in the absence thereof, the common and accepted usage of the Indexing system of accounting in the Hire Purchase trade must be held to be valid as otherwise the rate of interest under the mercantile system in so far as the later EMIs are concerned would be far higher and contrary to the rate prescribed in the assessee's agreements. The difference between the EMI and SOD method was illustratively explained by the Andhra Pradesh High Court in the following manner:

"6. To illustrate the difference in accounting of incomes as per the indexing method and the mercantile system, a hypothetical transaction involving hiring of machinery worth Rs.100/- is taken, on which hire purchase finance charges recoverable in 5 years is Rs.70/-. The following are the amounts of recovery shown in the books of account and in the computation of income as per the return filed.

.....

10.The views of the Madras High Court was discussed by the Andhra Pradesh High Court in the following manner:

"Sri Krishna Kaundinya, learned counsel, sought to draw a distinction between the above decision and the case on hand by placing reliance on ASHOK LEYLAND FINANCE LIMITED V/s. ASSISTANT COMMISSIONER OF INCOME TAX (1979) 59 TTJ (Mad) 736. Therein, a Division Bench of the Madras High Court was dealing with a case which was somewhat similar on facts to the present one. The appellant company before the Madras High Court was also engaged in the business of hire-purchase and lease financing. Its annual

accounts were maintained in so far as finance charges were concerned on the reducing balance method (indexing method). However, the mercantile system of accounting was employed for the return of income as in the present case.

Faced with a situation where two systems were adopted for accounting for the income, the Madras High Court held that the right to receive an amount under a contract accrues or arises depending upon the terms of the particular contract. In other words, income has to be computed even under the accrual system of accounting only on the basis of accrual as provided for in the agreements evidencing the transactions. In short, there can be no accrual of income de hors the terms and conditions of the agreement. Viewed in this light, the Madras High Court held that the technique of accounting followed by the assessee (Reducing balance method or the SOD method) in its books of account for recording the transactions cannot determine the accrual of income.

The Court held that accrual would depend on the terms and conditions of the contract between the parties, but not at the whims of either party. Upon perusing sample copies of the agreements, the Madras High Court held that it was not open to the assessee to adopt the SOD method or the reducing balance method when the agreement was to the contrary.

Examination of the above judgment reflects that the case before the Madras High Court differed from the present one on crucial factual aspects. The Madras High Court found on facts that the terms of the agreement in that case did not permit adoption of the Indexing System of accounting and therefore, use of the said system in the books of accounts was held to be contrary to the terms of the contract itself.

In the present case, however, there is no indication of the assessee's hire purchase agreements reflecting bifurcation of the EMIs into principal and interest components. In the absence thereof, the common and accepted usage of the Indexing system of accounting in the hire purchase trade must be held to be valid as otherwise the rate of interest under the mercantile system in so far as the later EMIs are concerned would be far higher and contrary to the rate prescribed in the assessee's agreements. Further, as the assessee had itself

employed this system of accounting in its books of account, applying the law laid down in SANJEEV WOOLEN MILLS (supra), the Department was bound to accept the same for the assessment proceedings.

Viewed thus, we are of the opinion that the law laid down by the Special Bench of the Income Tax Appellate Tribunal at Hyderabad in NAGARJUNA INVESTMENT TRUST LIMITED (supra) was correct. In the event the hire purchase or leasing agreement did not give the apportionment or bifurcation of the EMIs between the principal and interest components, the interest income in relation to such agreements, recognized on the basis of SOD system of accounting by the assessee in its books of account, represents the 'real income' accrued to the assessee. Reliance placed by the Tribunal on this judgment while allowing the Revenue's appeal in the present case was therefore justified. The substantial question of law is accordingly answered upholding the Revenue's computation of the assessee's income from finance charges and in favour of the Revenue and against the assessee. In consequence, the ITTA is dismissed, but in the circumstances, without any order as to costs."

10. Having perused the aforesaid Judgments, we are of the clear opinion that the later decision of Andhra Pradesh High Court relied on by the learned counsel for the Revenue does not help the case of the Revenue and Andhra Pradesh High Court itself distinguished the facts before it from the Madras High Court decision admittedly, the Assessee has been following the same method of E.M.I for bifurcation of its income into Principal and interest component for all these years in question. The S.O.D method gives higher finance charges (interest) for the initial years and lower finance charges (interest) for the later years, i.e, the Sum of Digits is sum total of the number of years e.g. If the Hire Purchase Agreement is for 10 years, the SOD is 55 (1+2+3+4+5+6+7+8+9+10 = 55). Therefore, total financial charges for the first year would be 10/55, for the second year 9/55, for third year 8/55 and so forth which would clearly give higher financial charges for interest taxable in the first year. This SOD method even though adopted by the Assessee in its Book of Accounts on the basis of Guidelines issued by the Institute of Chartered Accountants of India was not adopted in the Returns of Income filed by it which consistently adopted EMI method for taxability of interest income all these years. Since, for the previous assessment years, this Court has already approved such bifurcation of income and has held that interest

income (Finance charges) on consistently adopted basis of E.M.I. would be taxable in the hands of the Assessee, the mere change of Accounting method in its Book of Accounts on the basis of S.O.D. does not alter the position in the tax in the hands of the assessee. Therefore, the Judgment in the case of Sri Chakra Financial Services Ltd. Vs. Commissioner of Income Tax [(2013) 350 ITR 398] is distinguishable.

11. On the other hand, since in the case of the same Assessee, the Coordinate Bench of this Court has upheld the taxability with regard to interest income on EMI method, which has been consistently followed, there is no reason to take a different view in the matter for the present Assessment years.

12. Therefore, we do not find any merit in these Appeals filed by Revenue and accordingly these Appeals are dismissed and the questions of law are answered in favour of the Assessee and as against the Revenue. No order as to costs."

3.2. In view of the aforesaid decision herein, the first substantial question of law involved in all these cases is also answered in favour of the assessee and against the Revenue.

4.The learned counsel appearing for both sides further submitted that the second substantial question of law raised in TCA Nos.1415 to 1418 of 2008 has already been decided against the assessee and in favour of the Revenue, as per the judgment of a Co-ordinate Bench of this court in ***TC(A).No.2511 of 2006 dated 30.10.2012 in the case of EID Parry v. The Assistant Commissioner of Income Tax, Chennai***. Following the said decision, ***TC(A) No.524 of 2007 (Commissioner of Income Tax v. Tube***

Investments of India Ltd) & TC(A)Nos.1305 and 1306 of 2007 (India Nippon Electricals Ltd v. Deputy Commissioner of Income Tax) came to be decided against the assessee and in favour of the Revenue, vide orders dated 17.12.2014 and 02.02.2015 respectively. Therefore, the second substantial question of law raised in TCA Nos.1415 to 1418 of 2008, relating to disallowance of interest on monies borrowed for investment in shares and administrative expenses at 2%, is also answered against the assessee and in favour of the Revenue.

5. Regarding the second substantial question of law raised in TCA Nos.1413 and 1414 of 2008, with respect to disallowance of depreciation on the leased assets, the third member of the Tribunal has set aside the order and remanded the matter to the assessing officer for fresh consideration, with the following observation:

> *"I find that in the original assessment the assessee had claimed depreciation on suction blower with 10HP squired cage indicator motor and ducting systems bought from M/s.R.M.Machines P.Ltd, Kanpur for Rs.51.50 lakhs and leased out to M/s.Rajinder Pipes Ltd., Mumbai. The Assessing Officer disallowed the assessee's claim on the ground that as per his enquiry, no machinery was actually manufactured by M/s.R.M.Machines P.Ltd. Besides, M/s.Rajinder Pipes Ltd did not reflect in its accounts any plant and machinery acquired either through purchase or by lease during the previous year 1994-95 onwards. The Commissioner (Appeals) confirmed the disallowance. Before the Tribunal, the assessee*

did produce evidence in the form of installation certificate from the lessee, payment vouchers for the leased assets, etc. According to the learned Judicial Member, the factum as to the existence of the machinery was proved beyond the shadow of doubt and no effort was taken by the Revenue to examine the leased assets. No basic enquiry was made in this regard and the claim for depreciation was disallowed on the basis of surmises and suspicion. As such, he allowed the relief on this count, whereas the learned Accountant Member followed the order of the Tribunal rendered for the assessment year 1995-96 in ITA No.1213(Mds)/2000 dated 28.02.2006 in the assessee's own case, wherein the matter was set aside to the assessing officer for fresh adjudication. Having regard to the facts, in my opinion, the issue was rightly set aside to the file of the Assessing Officer for fresh adjudication. I, therefore, concur with the decision of the learned Accountant Member on this count."

In view of the above and as agreed by the learned counsel appearing for both sides, the matter is remanded back to the Assessing Authority, who shall look into the actual transactions, after getting necessary details from the assessee and pass orders afresh, within a period of six months from the date of receipt of a copy of this order, failing which, the claim of the Appellant/Department deserves no consideration. Accordingly, this substantial question of law is answered.

6. In respect of third substantial question of law raised in TCA Nos.1415 to 1418 of 2008, relating to interest charges to the financial transactions, it was observed by the third member of the Tribunal, as follows:

"*The last issue ....relates to the addition made by the Assessing Officer towards interest on transaction treated by the Assessing Officer*

as loan transaction. It was contended on behalf of the assessee that the Revenue authorities were not correct in treating the lease transaction as finance transaction, ex consequenti adding the notional interest on deemed loan transaction. Both the parties agreed that this issue is consequential. Since in the context of M/s.Ganesh Benzoplast, the majority decision is now in favour of the assessee, no addition on this count is possible. However, in the case of M/s.Rajinder Pipes Ltd. I have already agreed with the learned Accountant Member that the issue is to be examined afresh by the Assessing Officer. This issue is consequential and as such, it should be decided accordingly."

Agreeing with the aforesaid findings of the third member of the Tribunal and as agreed by the learned counsel appearing for both sides, we are inclined to remand the matter to the assessing officer for the purpose of proper verification of all the transactions done by the assessee. Accordingly, this substantial question of law is answered and the matter is remanded to the assessing officer for passing orders afresh, after affording due opportunity to the assessee.

7.All these Tax Case Appeals stand disposed of accordingly. No costs.

[R.M.D,J.] [M.S.Q., J.]
02.08.2022

msr
Index : Yes / No

R. MAHADEVAN, J.

and
MOHAMMED SHAFFIQ, J.

msr

To

1.The Income Tax Appellate Tribunal “A” Bench, Chennai,

2.The Commissioner of Income Tax, Chennai

3.The Commissioner of Income Tax (Appeals) VIII, Chennai.

T.C.A.Nos.1413 to 1418 of 2008

02.08.2022