



## REPORTABLE

\* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ **ITA Nos. 514/2006, 439/2007, 980/2007, 14/2008, 409/2009, 193/2010, 1112/2008 & 598/2010**

**ITA Nos.1093/2008, 1142/2008, 1204/2008, 1099/2008, 627/2009, 1153/2010**

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*Reserved On: 19<sup>th</sup> October, 2010*  
*Pronounced On: 29<sup>th</sup> October, 2010*

1) **ITA No.514 of 2006**

**Commissioner of Income Tax** . . . Appellant

through : Ms. Prem Lata Bansal, Advocate

VERSUS

**Dinesh Kumar Goel** . . . Respondent

through: Mr. C.S. Aggarwal, Sr. Advocate  
with Mr. Prakash Kumar,  
Advocates.

2) **ITA No.439 of 2007**

**Commissioner of Income Tax** . . . Appellant

through : Ms. Prem Lata Bansal, Advocate

VERSUS

**Dinesh Kumar Goel** . . . Respondent

through: Mr. C.S. Aggarwal, Sr. Advocate  
with Mr. Prakash Kumar,  
Advocates.

3) **ITA No.980 of 2007**

**Commissioner of Income Tax** . . . Appellant

through : Ms. Prem Lata Bansal, Advocate

VERSUS

**FIITJEE LTD.** . . . Respondent

through: Mr. C.S. Aggarwal, Sr. Advocate  
with Mr. Prakash Kumar,  
Advocates.

4) **ITA No.14 of 2008**

**Commissioner of Income Tax** . . . Appellant

through : Ms. Prem Lata Bansal, Advocate

VERSUS

**FIITJEE LTD.** . . . Respondent

through: Mr. C.S. Aggarwal, Sr. Advocate  
with Mr. Prakash Kumar,  
Advocates.

5) **ITA No.409 of 2009**

**Commissioner of Income Tax** . . . Appellant

through : Ms. Prem Lata Bansal, Advocate

VERSUS

**FIITJEE LTD.** . . . Respondent

through: Mr. C.S. Aggarwal, Sr. Advocate  
with Mr. Prakash Kumar,  
Advocates.

6) **ITA No.193 of 2010**

**Commissioner of Income Tax** . . . Appellant

through : Ms. Prem Lata Bansal, Advocate

VERSUS

**FIITJEE LTD.** . . . Respondent

through: Mr. C.S. Aggarwal, Sr. Advocate  
with Mr. Prakash Kumar,  
Advocates.

7) **ITA No.112 of 2008**

**Commissioner of Income Tax** . . . Appellant

through : Ms. Prem Lata Bansal, Advocate

VERSUS

**FIITJEE LTD.** . . . Respondent

through: Mr. C.S. Aggarwal, Sr. Advocate  
with Mr. Prakash Kumar,  
Advocates.

8) **ITA No.598 of 2010**

**Commissioner of Income Tax** . . . Appellant

through : Ms. Prem Lata Bansal, Advocate

VERSUS

**FIITJEE LTD.** . . . Respondent

through: Mr. C.S. Aggarwal, Sr. Advocate  
with Mr. Prakash Kumar,  
Advocates.

*Reserved On: 20<sup>th</sup> October, 2010*  
*Pronounced On: 29<sup>th</sup> October, 2010*

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9) **ITA No.1093 of 2008**

**Deputy Commissioner of Income Tax** . . . Appellant

through : Ms. Suruchi Aggarwal, Advocate

VERSUS

**CURLS & CURVES INDIA LTD.** . . . Respondent

through: Dr. Rakesh Gupta, Advocate.

10) **ITA No.1142 of 2008**

**Commissioner of Income Tax** . . . Appellant

through : Ms. Suruchi Aggarwal, Advocate

VERSUS

**Rajni Dargan** . . . Respondent

through: Dr. Rakesh Gupta, Advocate.

11) **ITA No.1204 of 2008**

**Commissioner of Income Tax** . . . Appellant

through : Ms. Suruchi Aggarwal, Advocate

VERSUS

**Rajni Dargan** . . . Respondent

through: Dr. Rakesh Gupta, Advocate.



**12) ITA No.627 of 2009**

**Commissioner of Income Tax** . . . Appellant

through : Ms. Suruchi Aggarwal, Advocate

VERSUS

**CURLS & CURVES INDIA LTD.** . . . Respondent

through: Dr. Rakesh Gupta, Advocate.

**13) ITA No.1153 of 2010**

**Deputy Commissioner of Income Tax** . . . Appellant

through : Ms. Suruchi Aggarwal, Advocate

VERSUS

**VLCC Health Care Ltd.** . . . Respondent

through: Dr. Rakesh Gupta, Advocate.

**14) ITA No.1099 of 2008**

**Commissioner of Income Tax** . . . Appellant

through : Ms. Suruchi Aggarwal, Advocate

VERSUS

**Rajni Dargan** . . . Respondent

through: Dr. Rakesh Gupta, Advocate.

**CORAM :-**

**HON'BLE MR. JUSTICE A.K. SIKRI**  
**HON'BLE MR. JUSTICE SURESH KAIT**

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

**A.K. SIKRI, J.**

1. In all these appeals, similar questions of law are raised. At the same time, we would like to discuss them separately after stating the legal principles, which would govern the fate of these appeals.



For this purpose, the appeals can be put into two categories.

the first category, the appeals are, viz., ITA Nos.514/2006, 439/2007, 980/2007, 14/2008, 409/2009, 193/2010, 1112/2008 and 598/2010 which would be taken together as they belong to the same assessee. Remaining appeals would be taken together in the other category, in which the assessees belong to the same group. We first take up the discussion in respect of ITA No.514 of 2006 and other connected matters wherein the legal proposition would also be explained.

**ITA Nos.514/2006, 439/2007, 980/2007, 14/2008, 409/2009, 193/2010, 1112/2008 and 598/2010**

2. The assessee in these cases running an institute under the name M/s FIITJEE and is the sole proprietor of these concerns. M/s FIITJEE is a coaching institute where students are admitted for getting coaching and preparing them for appearing in entrance examination conducted by engineering institutes. The assessee is following mercantile method of accounting. From these students, total fee of the entire course, which may be of two years duration, is initially taken at the time of admission of the students.
3. For the assessment year in question, i.e., 1997-98, the assessee filed his return on 29.10.1997 declaring the total income of ₹3,42,620. This return was processed under Section 143 (1) (a) of the Income Tax Act (hereinafter referred to as 'the Act') on 01.01.1998 at the aforesaid income. Thereafter, notice under Section 143(2) of the Act was issued to the assessee on 26.10.1998. It so happened that a couple of months before, i.e., on 18.08.1998, a search operation was carried out at the business



and residential premises of the assessee by the Income Tax Authorities. Thereafter, the assessee filed a revised return of income on 31.03.1999 declaring a loss of ₹58,39,070.

4. One of the items of income shown in the return was tuition fees. In the original return filed by the assessee on 29.10.1997, he had shown the income from tuition fee at ₹1,99,70,106. In the revised return, however, he claimed deduction to the tune of ₹55,45,834 from the aforesaid amount stating that “fees received in Financial Year 1996-97 to be carried forward to 1997-98 as it was related to Financial Year 1997-98”. This claim on the basis that receipt of the tuition fee from the students did not belong to Financial Year 1996-97 alone as part of the fee, which was taken in advance related to Financial Year 1997-98 as well. On this premise, it was stated that the deduction to this extent be allowed in this year, which would be shown as receipt in the next year. The Assessing Officer (AO) did not permit this deduction on the premise that when the assessee was following mercantile method of accounting, income becomes taxable whenever it falls due, irrespective of the fact that when the same is actually received by the assessee. He took note of the fact that as per the brochure issued by M/s FIITJEE, students were required to deposit the fees for the whole module of course at the time of registration itself. From this, he concluded that “fees becomes due at the time of ₹55,45,834 was due during the Financial Year 1996-97”.
5. Since in these appeals, we are concerned with this issue alone, other aspects of the assessment order are not taken note of.



6. The assessee preferred appeal before the CIT(A) and submitted that the aforesaid amount of ₹55,45,834, though received in Financial Year 1996-97, it was only a 'deposit' made by the students which was taken as advance money in the hands of the assessee and had not accrued in that year, but was accrued to in the next year. It was also submitted that even when the money had been received, the services against this money is yet to be rendered/provided by the assessee to these students, which was to be done in the Assessment Year 1998-99 and therefore, receipt of this amount could not be treated as 'income' in the hands of the assessee in the Assessment Year in question. This contention of the assessee impressed the CIT (A) and by accepting the same, the CIT (A) deleted the addition. The following discussion in the order of the CIT (A) needs to be extracted, which depicts the amount of the CIT (A) and the reasons for arriving at the aforesaid conclusion:

"I agree with the AR that the receipt was without acquiring the right to receive it as income, as services had yet to be rendered and it would be in the nature of advance. Only when the services were rendered, it will become income in the hands of the appellant. In case of Calcutta C. Ltd. Vs. CIT 37 ITR 1 the assessee dealt in land and property and carried on land developing business. The whole development was not carried out when the plot was sold. The appellant credited Rs.43,692 and also estimated Rs.24,809 as the expenditure for development to be carried out. There was no actual disbursement of the expenditure. It was held by the Hon'ble Supreme Court that

"inasmuch as the liability which had thus accrued during the accounting year was to be discharged at a future date, the amount to be expended in the discharge of that liability would have to be estimated in order that in the mercantile system of accounting, the amount could be debited before it is actually disbursed.

In case of E.D. Sasson & Co. Ltd. Vs. CIT (supra) it was held that if income has accrued to the assessee, it is certainly by



him in the sense that he has contributed to its production and the parenthood of the income can be traced to hm. But in order that the income can be said to have accrued to or earned by the assessee it is not only necessary that the assessee must have contributed to its accruing or arising by rendering services or otherwise. Unless and until his contribution or parenthood is effective in bringing into existence a debit or a right to receive the payment, it cannot be said that any income has accrued to him. The AO has pointed out that the students had to pay the amount before the course started in lumpsum but it does not detract from the fact that the receipt by the appellant has not yet become income since services are yet to be rendered. Otherwise the estimated expenditure for services to be rendered will have to be allowed as held by the Hon'ble Supreme Court on (sic. in) Calcutta Co. Ltd. (supra). I agree with the AR that in regard to the amount of ₹55,45,384 the services were yet to be rendered and hence it could only be treated as an advance and it had not yet become the income of the appellant. The action of the appellant omitting the above amount is therefore upheld.”

7. It was now the turn of the Department to feel aggrieved by this part of order of the CIT (A). The Department accordingly approached the next higher forum, i.e., the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') and filed the appeal challenging the aforesaid deletion of addition made by the AO. The Department was, however, unable to convince the Tribunal.
8. After indepth deliberations, the Tribunal has found favour with the order of the CIT (A) and affirming the same, the appeal of the Department has been dismissed by the Tribunal. The Tribunal, in the process, noted one additional fact, viz., the Consumer Forum, Chandigarh had decided a case filed by the student for refund of unexpired period fee when he had left the course after few months of joining the institute. It was held that since the services were not rendered for the second year for which fee had already be paid in advance, the assessee should refund one year's fee to the said



student (this decision of the Consumer Court, Chandigarh has been upheld by the Supreme Court as well). The Tribunal, thus, observed as under:

“8.....Any receipt by an assessee without acquiring the right to receive it as income would be only in the nature of an advance and cannot partake of the character of income unless the services are rendered or required part of the contract is performed. The fee received at the time of admission of a student cannot be said to be non-refundable in as much if no service of coaching is provided to the student, the assessee is statutorily liable to refund the amount under the Consumer Protection Act, 1986”

9. Still not satisfied, the Department has come up to this Court by filing the instant appeals, which have been admitted on the following question of law:

“Whether ITAT was legally correct in holding that fee received by the respondent assessee at the time of admission of the students is an “advance” and no “income” accrued to the assessee for purposes of the Income Tax Act, 1961?”

10. During the course of arguments before us, counsel for both the parties were at *ad idem* to the extent that the case was governed by the principles laid down by the Supreme Court in the case of ***E.D. Sasson & Co. Ltd (supra)***. Their discord is on the applicability of the principles to that judgment of the facts of this case. We may, therefore, first state the principle of law laid down by the Supreme Court in the aforesaid judgment.
11. Section 5 of the Act gives the ‘scope of total income’. Sub-Section (1) thereof, with which we are concerned, reads as under:

“(1) Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which - (a) Is



received or is deemed to be received in India in such year by or on behalf of such person; or

(b) Accrues or arises or is deemed to accrue or arise to him in India during such year; or

(c) Accrues or arises to him outside India during such year.”

As is clear from reading of Clause (b) above, 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 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. Following discussion in this judgment would demonstrate the principle which we have highlighted above:



“37. Mukerji J. has defined these terms in Rogers Pyatt Shellac & Co. v. Secretary of State for India 1 I.T.C. 363 :

"Now what is income? The term is nowhere defined in the Act..... In the absence of a statutory definition we must take its ordinary dictionary meaning - 'that which comes in as the periodical produce of one's work, business, lands or investments (considered in reference to its amount and commonly expressed in terms of money); annual or periodical receipts accruing to a person or corporation" (Oxford Dictionary). The word clearly implies the ideal of receipt, actual or constructive. The policy of the Act is to make the amount taxable when it is paid or received either actually or constructively. 'Accrues,' 'arises' and 'is received' are three distinct terms. So far as receiving of income is concerned there can be no difficulty; it conveys a clear and definite meaning, and I can think of no expression which makes its meaning plainer than the word 'receiving' itself. The words 'accrue' and 'arise' also are not defined in the Act. The ordinary dictionary meanings of these words have got to be taken as the meanings attaching to them. 'Accruing' is synonymous with 'arising' in the sense of springing as a nature growth or result. The three expressions 'accrues,' 'arises' and 'is received' having been used in the section, strictly speaking 'accrues' should not be taken as synonymous with 'arises' but in the distinct sense of growing up by way of addition or increase or as an accession or advantage; while the word 'arises' means comes into existence or notice or presents itself. The former connotes the idea of a growth or accumulation and the latter of the growth or accumulation with a tangible shape so as to be receivable. It is difficult to say that this distinction has been throughout maintained in the Act and perhaps the two words seem to denote the same idea or ideas very similar, and the difference only lies in this that one is more appropriate than the other when applied to particular cases. It is clear, however, as pointed out by Fry L.J. in Colquhoun v. Brooks (1888) 21 Q.B.D. 52 , [this part of the decision not having been affected by the reversal of the decision by the House of Lords (1889) 14 App. Cas. 493 that both the words are used in contradistinction to the word "receive" and indicate a right to receive. They represent a stage anterior to the point of time when the income becomes receivable and connote a character of the income which is more or less inchoate.

One other matter need be referred to in connection with the section. What is sought to be taxed must be income and it cannot be taxed unless it has arrived at a stage when it can be called 'income.'"



38. The observations of Lord Justice Fry quoted above by Mr. Mukerji J. were made in *Colquhoun v. Brooks* (1888) 21 Q.B.D. 52 while construing the provisions of 16 and 17 Victoria Chapter 34 section 2 schedule 'D'. The words to be construed there were 'profits or gains, arising or accruing,' and it was observed by Lord Justice Fry at page 59 :

"In the first place, I would observe that the tax is in respect of 'profits or gains arising or accruing.' I cannot read those words as meaning 'received by.' If the enactments were limited to profits and gains 'received by' the person to be charged, that limitation would apply as much to all Her Majesty's subjects as to foreigners residing in this county. The result would be that no Income-tax would be payable upon profits which accrued but which were not actually received, although profits might have been earned in the kingdom and might have accrued in the kingdom. I think, therefore, that the words 'arising or accruing' are general words descriptive of a right to receive profits."

39. To the same effect are the observations of Satyanarayana Rao J. in *Commissioner of Income-tax, Madras v. Anamallais Timber Trust Ltd.* [1950]18ITR333(Mad) and Mukherjea J. in *Commissioner of Income-tax, Bombay v. Ahmedbhai Umarbhai & Co., Bombay* [1950]181ITR472(SC) where this passage from the judgment of Mukerji J. in *Rogers Pyatt Shellac & Co. v. Secretary of State for India* 1 I.T.C. 363 , is approved and adopted. It is clear therefore that income may accrue to an assessee without the actual receipt of the same. If the assessee acquires a right to receive the income, the income can be said to have accrued to him though it may be received later on its being ascertained. The basic conception is that he must have acquired a right to receive the income. There must be a debt owed to him by somebody. There must be as is otherwise expresses *debitum in presenti, solvendum* in future; See *W. S. Try Ltd. v. Johnson (Inspector of Taxes)* [1946]1 A.E.R. 532 , and *Webb v. Stenton and Others, Garnishees* 11 Q.B.D. 518 . Unless and until there is created in favour of the assessee a debt due by somebody it cannot be said that he has acquired a right to receive the income or that income had accrued to him."

12. Ms. Prem Lata Bansal, learned counsel for the Revenue, emphatically submitted that the effect that the moment agreement (s) with students were signed and they were called upon to pay the fee, right to receive the fee had been acquired by



the assessee. It was for this reason that every student admitted to the course is under obligation to pay the entire fee for the whole course at the time of admission itself. Thus, it conferred upon the assessee 'right to receive the money' in the form of fee at that stage and the conditions of Section 5 of the Act were fulfilled, as it would be inferred that the income has accrued. She submitted that there was a distinction between the executor contract and executed contract and even if the contract was not executed at that time in the sense that the services are yet to be provided, the money received would be the income at the hands of the assessee. In support of her argument, she referred to the judgment of the Madras High Court in the case of ***Lakshminarayana Films Vs. Commissioner of Income Tax [244 ITR 344 (AP)]*** and particularly impressed upon the following discussion:

"7. We have considered the rival submissions made by the assessee as well as the Revenue. The fact remains that the assessee had leased out the dubbing rights of its abovesaid picture for Tamil and Malayalam to Jay Films and Cine Link Service by agreements dated May 25, 1974, and August 27, 1974, respectively. It is equally not in dispute that the assessee had shown an income of Rs. 25,80,000 in the return presented by the assessee for the relevant assessment year regarding the sale of Telugu version of the above-said picture. A perusal of the agreement dated August 27, 1974, by Sri Lakshminarayana Films, represented by its partner, Sri N.S. Moorthi, with Jay Films, represented by its managing partner, Sri A.T. Abraham, would disclose that Jay Films had agreed to pay royalty of Rs. 45,000 for acquiring Malayalam dubbing rights of the abovesaid film and Sri Lakshminarayana Films had agreed to lease out the abovesaid Malayalam dubbing rights of the abovesaid picture for the abovesaid royalty of Rs. 45,000 on August 27, 1974. It is also evident from a perusal of the abovesaid agreement that a sum of Rs. 10,000 was paid by demand draft dated June 21, 1974, Rs. 7,500 was paid by cheque dated June 26, 1974, Rs. 7,500 was paid by cheque dated July 26, 1974 and Rs. 7,500 was paid by cheque dated August 27, 1974, which the assessee had



acknowledged. Another sum of Rs. 7,500 was also agreed to be paid by cheque on or before August 27, 1974, the date of the agreement. There was a balance of Rs. 5,000 on the date of agreement, which Jay Films had agreed to pay at the time of taking delivery of the prints from the assessee. If the abovesaid facts contained in the agreement dated August 27, 1974, are considered, it is evident that the assessee had already received a sum of Rs. 40,000 out of Rs. 45,000 and agreed to receive the balance amount of Rs. 5,000 at the time of delivery of the prints. It is also evident from one of the clauses of the agreement that the agreement with the abovesaid method of payment was offered by Jay Films and the said offer was accepted by the assessee on August 27, 1974, itself. Therefore, there was offer and acceptance and the same was completed on the date of the agreement dated August 27, 1974, so far as the dubbing rights of the abovesaid picture in Malayalam. Simply because the assessee has not received the balance of Rs. 5,000 which was to be paid to the assessee at the time of the delivery of the print, it cannot be said that there was no conclusion of the contract by offer and acceptance on August 27, 1974, since the offer of Jay Films was accepted by the assessee on August 27, 1974, itself by postponing the payment of Rs. 5,000 to the time of delivery of the print.

8. The Revenue has brought to the notice of this court the decision of Union of India v. Chaman Lal Loona and Co., : [1957]1SCR1039 , wherein the apex court was pleased to hold as follows (head note) :

"The distinction between the two classes of contracts, where the consideration is either executed or executory is that an executed consideration consists of an act for a promise. It is the act which forms the consideration. No contract is formed unless and until the act is performed, e.g., the payment for a railway ticket, but the act stipulated for exhausts the consideration, so that any subsequent promise, without further consideration, is merely a *nudum pactum*. In an executed consideration the liability is outstanding on one side only ; it is a present as opposed to a future consideration. In an executory consideration the liability is outstanding on both sides. It is in fact a promise for a promise, one promise is bought by the other. The contract is concluded as soon as the promises are exchanged. In mercantile contracts this is by the most common variety. In other-words, a contract becomes binding on the exchange of valid promises, one being the consideration for the other. It is clear, therefore, that there is nothing to prevent one of the parties from carrying out his promise at once, i.e., performing his part of the contract whereas the other party who provides the consideration for the act of or detriment to the first may not carry out his part of the bargain simultaneously with the first party."



13. She also referred to the judgment of the Jodhpur Bench of the Rajasthan High Court in the case of **Suraj Prakash Soni Vs. Assistant Commissioner of Income Tax [303 ITR 366]** which is to the same effect.
14. Mr. C.S. Aggarwal, learned Senior Counsel for the assessee, on the other hand, submitted that the two authorities below, viz., CIT (A) as well as the Tribunal had considered the facts of the case at greater detail and had rightly opined that till the services were rendered, there was no right to receive the fee. He argued that the amount that the tuition fee which pertained to the Financial Year 1996-97 was only a '**deposit and advance**' and not an income at the hands of the assessee, as the services against the said advance were yet to be provided, which could be rendered by the assessee only in the year 1996-97 and therefore, income qua those receipts would accrue only in that year. He also emphasized the matching concept highlighted by the Tribunal as well as by the CIT (A) submitting that these were only receipts and the taxable income would be only after deduction of expenses, which were to be incurred by the assessee for rendering the services and that happened only in the succeeding year, i.e., Financial Year 1996-97. Further, he also submitted that the Department was taking a wrong view that the fee was non-refundable and irrecoverable, which contention was proved to be wrong in view of the judgment of the Consumer Court, Chandigarh.



15. After considering the respective submissions, we are not in position to take a view different from what is taken by the Tribunal in the instant case. In the facts of this case, it is apparent that at the time of admission, the students are required to deposit the whole fee of the entire course, but that would only remain a '**deposit**' or '**advance**' and it cannot be said that this fee had become 'due' at the time of deposit. Fee is charged in advance for the entire course, presumably because of the reason that there should not be any default in making the said by the students during the period of course. Interestingly, the AO in his assessment order has himself stated that "**students were required to deposit the fee for the whole module of course at the time of registration itself**". The AO has used the expression '**deposit**'. In the very next breadth, he draws the conclusion that this would mean that the fee had become '**due**'. Thus, the AO knew the significance of the expression '**deposit**' viz-a-viz 'due', though he committed the mistake in treating the said deposit as the fee becoming due. When we applies the principles of law laid down in ***E.D. Sasson & Co. Ltd (supra)*** and ***Calcutta C. Ltd. (supra)***, it becomes apparent that the fee was not due at the time of deposit. The services in respect of Financial Year 1997-98, for which also the payment was taken in advance were yet to be rendered. Therefore, applying the principle in the case of ***Calcutta C. Ltd. (supra)***, this could only be treated as advance otherwise it would lead to an anomaly situation, highly derogatory to the assessee, which is not intended in law, viz., even when the very amount received, expenses are to



be deducted to arrive at the net income and those expenses a yet to be incurred (which may be incurred in the next financial year), the entire receipts become income which would be exigible to much higher tax. It is for this reason, the following principle was enunciated by the Supreme Court in **Calcutta C. Ltd.** (**supra**):

“The expression “profits or gains” in section 10(1) of the Income-tax Act has to be understood in its commercial sense and there can be no computation of such profits and gains until the expenditure which is necessary for the purpose of earning the receipts is deducted therefrom – whether the expenditure is actually incurred or the liability in respect thereof has accrued even though it may have to be discharged at some future date.”

16. We may also, at this stage, usefully refer to another judgment of the Apex Court in the case of **Commissioner of Income Tax, Bombay City II Vs. Shri Goverdhan Ltd. [69 ITR 675]** in the following terms:

“It is, however, well-established that the income may accrue to an assessee without actual receipt of the same and if the assessee acquires a right to receive the income, the income can be said to have accrued to him though it may be received later on, on its being ascertained. The legal position is that a liability depending upon a contingency is not a debt *in praesenti* or *in futuro* till the contingency happens. But if it is a debt the fact that the amount has to be ascertained does not make it any the less a debt if the liability is certain and what remains is only a quantification of the amount: *debitum in praesenti, solvendum in futuro.*”

17. The judgments cited by the learned counsel for the Revenue do not concern the issue, which we are dealing with these appeals.
18. We, thus, answer the question in the affirmative and as a consequence, dismiss these appeals.



**ITA Nos.1093/2008, 1142/2008, 1204/2008, 627/200**  
**1153/2010 & 1099/2008**

19. In all these appeals, the assessees which belong to the same group, are in the same business activities, viz., beauty and slimming which operates under the brand name of VLCC. They have various centres in Delhi and outside. Clients come to them spanning over a period of time and attend different sessions for beauty treatments and/or for the purposes of weight loss, etc. The clients pay entire fee in advance for a beauty and slimming package. The assessees have given many franchisees for which purpose MoUs are executed with Joint Venture Partners (JVP). These MoUs, laid down various terms regarding investment in machinery, interior, rent of the place, franchisee fee, etc. The centres are managed by the assessee and operating surplus is calculated every month which is then distributed between the assessee and the JVP in the ratio 60:40 or 50:50. The sales of the centre are included in the accounts of the assessee. Part of the sale on which services remain to render and which is to be rendered in the succeeding year, those sales are shown as “unexecuted packages” at the end of the year by the assessee. It means that the assessee treats the said receipt for which services yet to be rendered and are going to be rendered in the next Assessment Year as advance and is not shown as income exigible to tax.
20. The question, thus, remains the same, viz., whether the sale of unexecuted packages is an income accrued/arising in the financial



year in which it is received or it belongs to the next year, i.

whether there was right to receive this amount when the agreement is signed. Therefore, we are of the opinion that the circumstances in which the advance fee is charged for the services to be rendered are almost the same as in the case of M/s. FIITJEE noted above. When the question of application of principle of law arises, there is hardly any difference between the two, which would persuade us as to take a view what is taken in the aforesaid cases of M/s. FIITJEE. We would, however, like to give some additional reasons in support of our conclusion. These are based on the submissions made by the learned counsel for the assessee, Dr. Rakesh Gupta, which have also appealed to us.

21. Section 145 of the Act deals with the method of accounting and states that in case of business income, *inter alia*, the same is to be computed in accordance with the cash or mercantile system of the company. Sub-section (2) thereof authorizes the Central Government to notify in the Official Gazette from time to time accounting standards to be followed by any class of assessees or in respect of any class of income. Central 211 of the Companies Act, on the other hand, prescribes the form and contents of balance sheet and profit and loss account, which are to be maintained by the companies under the said Act. Sub-section (2) casts a duty on a company to give true and fair view of a profit and loss of a company for the financial year in its profit and loss accounts. Sub-section (3A) adheres to the accounting standards for preparing profit and loss balance sheet. Sub-section (3C) defines "accounting standards as under:



“(3C) For the purposes of this section, the expression "accounting standards" means the standards of accounting recommended by the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949 as may be prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards established under sub-section (1) of section 210A :

Provided that the standard of accounting specified by the Institute of Chartered Accountants of India shall be deemed to be the Accounting Standards until the accounting standards are prescribed by the Central Government under this sub-section.”

22. A conjoint reading of the aforesaid provisions of the Income Tax Act and the Companies Act shows that those assesseees, which are companies and showing income, *inter alia*, under the head “business or profession” have to follow the accounting standards prescribed. The Government of India has notified accounting standards in exercise of its power under Section 145(2) of the Act, which are dated 29.05.1996. Accounting Standard – I relates to the disclosure of accounting policy and puts an obligation on the assessee to disclose all significant accounting policies adopted in the preparation and presentation of financial stages. Para 6 thereof denies certain expression which accrued in Paras 1 to 5. Clause (b) whereof spells out the definition of accrual in the following manner:

“(b) “Accrual” refers to the assumption that revenues and costs are accrued that is, recognized as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the period to which they relate;”



From the above, that the term 'accrual' relates to revenue **earned** or cost **incurred**. Two things follow from this, viz., unless the revenue is earned, it is not accrued. Likewise, the expenses unless are incurred, cost in respect thereof cannot be treated as accrued. Secondly, it recognizes the matching concept, viz., receipts are to be matched income to arrive at the net income, which would then be exigible to tax. In the case of **Commissioner of Income Tax Vs. Woodward Governor India (P) Ltd. [312 ITR 214]**, the Supreme Court, *albeit*, in other context, explained this concept. The principle laid down would be relevant even for our purpose and therefore, we extract the same:

"14. In the case of **M.P. Financial Corporation v. CIT** reported in 165 ITR 765 the Madhya Pradesh High Court has held that the expression "expenditure" as used in Section 37 may, in the circumstances of a particular case, cover an amount which is a "loss" even though the said amount has not gone out from the pocket of the assessee. This view of the Madhya Pradesh High Court has been approved by this Court in the case of **Madras Industrial Investment Corporation Ltd. v. CIT** reported in [1997]225ITR802(SC). According to the *Law and Practice of Income Tax by Kanga and Palkhivala*, Section 37(1) is a residuary section extending the allowance to items of business expenditure not covered by Sections 30 to 36. This Section, according to the learned Author, covers cases of business expenditure only, and not of business losses which are, however, deductible on ordinary principles of commercial accounting. (see page 617 of the eighth edition). It is this principle which attracts the provisions of Section 145. That section recognizes the rights of a trader to adopt either the cash system or the mercantile system of accounting. The quantum of allowances permitted to be deducted under diverse heads under Sections 30 to 43C from the income, profits and gains of a business would differ according to the system adopted. This is made clear by defining the word "paid" in Section 43(2), which is used in several Sections 30 to 43C, as meaning actually paid or incurred according to the method of accounting upon the basis on which profits or gains are computed under Section 28/29. That is why in deciding the question as to whether the word "expenditure" in Section 37(1) includes the word "loss" one has to read Section 37(1) with Section 28, Section 29 and Section 145(1). One more principle needs to be kept in mind. Accounts regularly maintained in the course of business are



to be taken as correct unless there are strong and sufficient reasons to indicate that they are unreliable. One more aspect needs to be highlighted. Under Section 28(i), one needs to decide the profits and gains of any business which is carried on by the assessee during the previous year. Therefore, one has to take into account stock-in-trade for determination of profits. The 1961 Act makes no provision with regard to valuation of stock. But the ordinary principle of commercial accounting requires that in the P&L account the value of the stock-in-trade at the beginning and at the end of the year should be entered at cost or market price, whichever is the lower. This is how business profits arising during the year needs to be computed. This is one more reason for reading Section 37(1) with Section 145. For valuing the closing stock at the end of a particular year, the value prevailing on the last date is relevant. This is because profits/loss is embedded in the closing stock. While anticipated loss is taken into account, anticipated profit in the shape of appreciated value of the closing stock is not brought into account, as no prudent trader would care to show increase profits before actual realization. This is the theory underlying the Rule that closing stock is to be valued at cost or market price, whichever is the lower. As profits for income-tax purposes are to be computed in accordance with ordinary principles of commercial accounting, unless, such principles stand superseded or modified by legislative enactments, unrealized profits in the shape of appreciated value of goods remaining unsold at the end of the accounting year and carried over to the following years account in a continuing business are not brought to the charge as a matter of practice, though, as stated above, loss due to fall in the price below cost is allowed even though such loss has not been realized actually. At this stage, we need to emphasise once again that the above system of commercial accounting can be superseded or modified by legislative enactment. This is where Section 145(2) comes into play. Under that section, the Central Government is empowered to notify from time to time the Accounting Standards to be followed by any class of assesseees or in respect of any class of income. Accordingly, under Section 209 of the Companies Act, mercantile system of accounting is made mandatory for companies. In other words, accounting standard which is continuously adopted by an assessee can be superseded or modified by Legislative intervention. However, but for such intervention or in cases falling under Section 145(3), the method of accounting undertaken by the assessee continuously is supreme. In the present batch of cases, there is no finding given by the AO on the correctness or completeness of the accounts of the assessee. Equally, there is no finding given by the AO stating that the assessee has not complied with the accounting standards.”

23. We may refer to the judgment of the Supreme Court in the case of **Commissioner of Income Tax, Chennai Vs. Bilahari Investment (P) Ltd.** [299 ITR 1] wherein the Supreme Court has



taken various judgments where the matching concept is defined and explained. We may refer to the passage extracted by the Supreme Court from its judgment in the case of **J.K. Industries Vs. Union of India** reported in [2007] 13 SCALE 204 in the following terms:

**82.** Matching Concept is based on the accounting period concept. The paramount object of running a business is to earn profit. In order to ascertain the profit made by the business during a period, it is necessary that "revenues" of the period should be matched with the costs (expenses) of that period. In other words, income made by the business during a period can be measured only with the revenue earned during a period is compared with the expenditure incurred for earning that revenue. However, in cases of mergers and acquisitions, companies sometimes undertake to defer revenue expenditure over future years which brings in the concept of Deferred Tax Accounting. Therefore, today it cannot be said that the concept of accrual is limited to one year.

**83.** It is a principle of recognizing costs (expenses) against revenues or against the relevant time period in order to determine the periodic income. This principle is an important component of accrual basis of accounting. As stated above, the object of AS 22 is to reconcile the matching principle with the Fair Valuation Principles. It may be noted that recognition, measurement and disclosure of various items of income, expenses, assets and liabilities is done only by Accounting Standards and not by provisions of the Companies Act."

24. Even the Institute of Chartered Accountant of India (ICAI) has laid down accounting standards which the companies are supposed to follow. We are concerned Accounting Standard (AS) 9. Relevant portion whereof is extracted below:

**“Introduction**

1. This Statement deals with the bases for recognition of revenue in the statement of profit and loss of an enterprise. The Statement is concerned with the recognition of revenue arising in the course of ordinary activities of the enterprise from
  - the rendering of services, and
  - the use by others of enterprise resources yielding interest, royalties and dividends.



XXX      XXX      XXX

## Definitions

- 4.3 *Proportionate completion method* is a method of accounting which recognizes revenue in the statement of **profit and loss proportionately with the degree of completion of services under a contract.**

XXX      XXX      XXX

## Explanation

### 7. Rendering of Services

- 7.1 **Revenue from service transactions is usually recognized as the service is performed**, either by the proportionate completion method or by the completed service contract method.

- (i) *Proportionate completion method* – Performance consists of the execution of more than one act. Revenue is recognized proportionately by reference to the performance of each act. The revenue recognized under this method would be determined on the basis of contract value, associated costs, number of acts or other suitable basis. For practical purposes, when services are provided by an indeterminate number of acts over a specific period of time, revenue is recognized on a straight line basis over the specific period unless there is evidence that some other method better represents the pattern of performance.
- (ii) *Completed service contract method* – Performance consists of the execution of a single act. Alternatively, services are performed in more than a single act, and the services yet to be performed are so significant in relation to the transaction taken as a whole that **performance cannot be deemed to have been completed until the execution of those acts. The completed service contract method is relevant** to these patterns of performance and accordingly revenue is recognized when the sole or final act takes place and the service becomes chargeable.

(emphasis supplied)”

25. Reading of the aforesaid (AS) 9 makes it clear that revenue is recognized only when the services are actually rendered. If the



services are rendered partially, revenue is to be shown proportionate with the degree of completion of the services. This really clinches the issue in favour of the assessee.

26. Though our discussion on the issue is complete, the parting comments need to be made. The receipts relate to the unexecuted packages, which are not shown in the instant year would be shown in the succeeding year. Rate of tax in respect of companies remains the same in all these years. Therefore, the Revenue does not lose anything, as it would receive the tax on this income in the succeeding year. Still issues are raised and much outcry is made for nothing.
27. In a decision rendered about 50 years ago, the Bombay High Court, speaking through Chief Justice Tendolkar in ***Commissioner of Income Tax, Delhi, Ajmer, Rajasthan and Madhya Pradesh Vs. Nagri Mills Co. Ltd.*** [33 ITR 681] observed as under:

“We have often wondered why the Income tax authorities, in a matter such as this where the deduction is obviously a permissible deduction under the income tax Act, raise disputes as to the year in which the deduction should be allowed. The question as to the year in which a deduction is allowable may be material when the rate of tax chargeable on the assessee in two different years is different; but in the case of income of a company, tax is attracted at a uniform rate, and whether the deduction in respect of bonus was granted in the assessment year 1952-53 or in the assessment year corresponding to the accounting year 1952, that is in the assessment year 1953-54, should be a matter of no consequence to the Department; and one should have thought that the Department would not fritter away its energies in fighting matters of this kind. But, obviously, judging from the references that come up to us every now and then, the Department appears to delight in raising points of this character which do not affect the taxability of the assessee or the tax that the Department is likely to collect from him whether in one year or the other.”

28. In this Court, in its decision dated 06.05.2008 in ITR No.229 of 1988 entitled ***Commissioner of Income Tax Vs. M/s. Vishnu***



**Industrial Gases P. Ltd.** had quoted the aforesaid passage and thereafter remarked that the situation does not seem to have changed over the last fifty years and the Revenue continue to agitate the question whether tax is leviable in a particular year or in some other year. Alas! The aforesaid words of wisdom of Bombay High Court reminded to the Revenue Authorities more than two years ago again have not made any dent on the psyche of the Revenue.

29. In these circumstances, we are constrained to dismiss all these appeals with costs quantified at ₹10,000/- in each appeal. The entire cost shall be paid within a period of two weeks to the Library Fund of the Delhi High Court Bar Association.

**(A.K. SIKRI)  
JUDGE**

**(SURESH KAIT)  
JUDGE**

**OCTOBER 29, 2010**

*pmc*