Reliance Industrial Infrastructure ... vs Joint Commissioner Of Income Tax on 4 June, 2001

ORDER

J.P. Bengra, V. P.

1. These are appeals by assessee pertaining to asst. yrs. 1994-95, 1995-96 and 1996-97. Since issues involved in these appeals are common and the CIT(A) has also given identical findings in all these years, for the sale of convenience these appeals are being disposed of by a consolidated order.

2. The assessee has raised common grounds relating to rejection of assessee' claim for lease rentals for all these years. The facts of the case are that the assessee is a company incorporated on 20th Sept., 1988. Its main object was to carry on business of setting up and erecting in India and abroad pipelines for transportation of goods like petrol/petroleum products, water, carbon dioxide and such other products as can be conveniently transported through pipeline. The assessee sold an item of plant and machinery called SCADA system on 30th March, 1993, to M/s Reliance Capital & Finance Trust Limited (hereinafter called RCFTL) for a total consideration of Rs. 8,03,38,800. The assessee thereafter entered into a lease agreement with RCFTL and leased back the said SCADA system for a period of 60 months and the total lease rentals were Rs. 10,55,65,200. The said lease agreement is given at pages 1 to 31 of the paper-book. The schedule to the agreement mentions the date of commencement, period, rate of rental and lease management fees for the rental. The first lease agreement was entered into on 30th March, 1993, and as per this agreement each monthly lease rent instalment was for an amount of Rs. 17,59,420. The assessee entered into a supplemental agreement on 5th April, 1993, which provided for amending Clause (iv) relating to the period and schedule of lease rentals and Clause (ii) relating to variation in rentals. The period referred to in the schedule to the agreement dt. 30th March, 1993, was replaced by the supplemental agreement dt. 5th April, 1993. The supplemental agreement extended the period of lease into a 'primary' period of 60 months from the commencement date and a 'secondary' period of 120 months from the end of the primary period. Consequently the lease rentals, which were to end on 7th of March, 1998 under which 60 instalments of Rs. 17,59,420 were to be paid amounting in all to Rs. 10,55,65,200, were extended by 10 further rentals, the first of which was Rs. 80,338 payable on 1st April, 1998, and thereafter nine further instalments of the same amount payable on anniversaries thereof. Certain further provisions were made relating to variation in rentals, on account of change in capital allowances. The assessee recorded the annual lease rental by debiting Rs. 70,83,671 in its books of account. The said amount was worked out as follows :

Current pre-tax lease rentals 17,59,420.00 Total existing lease period 10,55,65,200.00 Add : As per supplemental agreement 8,03,380.00 10,63,68,580.00 Less :

Lease rent for previous period (2 days) March, 1993 1,13,510.00 Total lease rentals for 15 years 10,62,55,070.00 Lease rentals for 1 year 70,83,671.33 Lease rent paid for

1995-96 (17,59,420 x 12) 2,11,13,040 Debited to advance lease rental 1,40,29,369 Debited to lease rent machinery 70,83,671 2,11.13,040 In the return of income, the assessee wrote back the amount of Rs. 79,28,000 and claimed a deduction of Rs. 2,11,13,040. However, the AO has disallowed the difference of Rs. 1,40,29,369 on the ground that the assessee was not entitled to claim the larger amount, if a lower amount had been debited in its books of account. According to the AO a plain reading to the provisions of Section 145(1) of the IT Act, 1961, makes it clear that once the assessee regularly follows a particular method of accounting, it is binding on the IT authorities and it is not open to the assessee to adopt a different basis for income-tax purposes after having made entries in the books of accounts. As per the agreement referred to above in this paragraph, the assessee-company had paid Rs. 2,11,13,040 to M/s Reliance Capital Ltd. towards lease rentals, which is inclusive of lease tax. Clauses 2.2, 2.3, 4, 4.4, 4.9 and schedule of the agreement dt. 30th March, 1993 read as under :

"2.2. The lessee is paying and shall pay to the Lessor, the lease Management Fee and rental as specified in the schedule. The lessee shall pay the instalments of rental regularly and punctually, without any deduction or abatement, irrespective of whether the said properties are in use by the lessee are or working for one or more shifts or not or are under repair or maintenance or replacement for any period whatsoever, without affecting the lessee's obligation to pay the rental for the fixed period and in addition to the right of the lessor specified in Clause 8 hereof, in the event of the lessee being in arrears or any such rentals, such arrears of rental shall carry interest @ 2 per cent per month on compounding basis with monthly rests from the respective due date specified in the Schedule till date of actual payment.

2.3. Upon termination of this agreement by efflux of time, or otherwise, the lessee, shall at its own cost and expense, forthwith deliver or cause to be delivered to the lessor the said properties, at such time and place as may be directed by the lessor, in goods repair, order and condition (subject to normal wear and tear).

4. Lessee covenants :

During the subsistence of this lease and till the said properties are delivered back to the lessor in good order and condition, the lessee shall :

4.4. Maintain the said properties in good and working condition at all times and to effectuate and carry on at its own cost and expense all major and minor repairs thereto save and except that no structural or material changes alterations to the said properties or any of its technical specifications will be made or carried out except with the prior written consent of the lessor and in any event such alterations shall be carried out in the manner satisfactory to the lessor.

4.9. Insure the said properties in the joint names of the lessor and the lessee with the lessor's name as the sole loss payee for its full replacement value with such insurer as may be approved by the lessor against all reasonable risks, including fire, 'riot, explosion, tempest, flood, earthquake, strike, storm, malicious damage, theft, civil commotion, war and other such risks including third party risks as the lessor may require and pay all insurance premium and renew the policies from time to time and our original insurance policies and premium receipts to the lessor and maintain such insurance in full effect and not do or omit to be done in act deed or thing which might prejudicially vitiate or affect such insurance :

Provided that for the entire tenure of the lease period, the properties shall in any event be insured for value which shall not be less than the actual cost of acquisition of the said property to the lessor.

Schedule above mentioned (Being the brief discussion of the said movable) properties and the acquisition cost of the plant. Machinery and equipment at the plant leased by M/s Reliance Capital and Finance Trust Ltd. (Lessors) to CPPL Ltd. (lessees).

Description Amount I. Microprocessor based control system for monitoring energy flow intended to result in saving of Energy surveillance center and data Acquisition system (SCADA).

Rs. 803.388 lakhs.

II.

Equipment (said properties) to be used at at Patalganga and various CP stations on route to Patalganga from Chembur, Maharashtra.

III.

Commencement date for rentals 30th March, 1993.

IV.

Fixed period 60 months from the commencement date.

V. Rate Rs. 21.90/000 month.

VI.

Lease management fees 1/2% of the agreement amount-front ended.

The total lease rentals for the fixed period for the said properties is Rs. 10,55,65,200 (Rupees ten crores fifty-five lakhs sixty-five thousand and two hundred only), which has been worked out on the basis of the total acquisition cost. The rents would be payable by the lessees on the dates mentioned in the schedule herein below given. Such rentals should be payable by the lessees for the entire fixed period of the lease as follows :

Schedule ot lease rentals Amount S No. Rent payable on Rs.

1.

31-3-1993 17,59.420

2. 7-5-1993 17.59,420

60. 7-3-1998 17,59,420 Total 10,55,65,200 (Rupees ten crores fifty five lakhs sixty five thousand and two hundred only). It will be pertinent to mention the relevant clauses from the agreement dt. 5th April, 1993, which are mentioned as under :

"(ii) The parties hereto are desirous of amending Clause (iv) relating to period, schedule of lease rentals and Clause (ii) relating to variation in rentals, of the schedule to the said agreement as specifically agreed and appearing hereinafter.

Period Primary period 60 months from the commencement date Secondary period--120 months from the end of the primary period.

Under schedule of lease of rentals to add schedule of lease rentals for secondary period.

S. No. Rental paid on Amount Rs.

1. 1-4-1998 80.338

2. 1-4-1999 80.338

3. 1-4-2000 80,338

4. 1-4-2001 80.338

5. 1-4-2002 80,338

6. 1-4-2003 80.338

7. 1-4-2004 80,338

8. 1-42006 80,338

9. 1-4-2006 80,338

10. 1-4-2007 80.338 8,03,380 (Rupees eight lakhs threethousand three hundred and eighty only)."

(Rupees eight lakhs three thousand three hundred and eighty only)."

2. (ii) Variation in rental's on account of change in capital allowance.

(A) if for any reason whatsoever, the eligibility of the lessor to claim depreciation computed at the aforesaid rate is deceased or if for any reason the lessor is disallowed its claim for the same, whether wholly or partly in any year during the fixed period of the lease, instalments of rentals in that year or in any subsequent year/s would accordingly increased. Such change in the instalments would be computed having regard to the decrease in the eligibility to claim depreciation. If depreciation @ 100 per cent is not allowed, the lease rentals will be increased from 21.90 per month per thousand to Rs. 24.50 per month from the first rental.

(B) The decision and certificate of the lessor relating to the eligibility or otherwise of the above provision for variation shall be conclusive and binding on the lessees."

The case of assessee-company is that the company had accounted lease rentals in the books following the guidelines issued by the Institute of Chartered Accountants of India (hereinafter mentioned as ICAI), The assessee had claimed the entire expenditure of lease rent, which is a contractual liability as per agreement. This claim was based on the position that the assessee-company is following the mercantile system of accounting for the past several years and the same has been adopted for computing the income during the year under consideration.

3. The assessee-company had actually paid Rs. 2,11,13,040 to M/s Reliance Capital Ltd. However, the same has been accounted in the books as mentioned above. As per the guidelines of ICAI, lease rentals are written off in the P&L a/c on shorter of contractual period of lease or the useful life of the assets. In the instant case the contractual period was 15 years (the primary lease was for a period of five years and secondary period of 10 years). Lease rentals were proportionately written off over the period of lease (5 + 10 years). In view of the above, Rs. 70,83,671 was written off during the year in the P&L a/c and thus the same amount was debited to the P&L a/c under the head "Establishment and other expenses" (Schedule 13) and Rs. 1,40,29,364 was debited to prepaid expenses on the assets side of the balance sheet. In brief, the case of assessee-company was that as per the tease agreement, accrued liability was Rs. 2.11 crores and the entire amount was paid during the previous year. The book entry should be override the accrual and book entry is immaterial if it is an accrued

liability. And lastly the principles of accountancy do not override the statute. As per the lease agreement dt. 30th March, 1993, 12 instalments had accrued due and paid. The agreement required the assessee-company to pay Rs. 2.11 crores and under the mercantile system of accounting these amounts of lease rentals were accrued. Absence of book entry not defeat the accrual of liability.

4. However, the AO was of the view that the assessee was bound to compute its total income on the basis of books of account and it was not open to it to claim any deduction which was not debited in the books of account. In this connection, he has relied on the decision of the Calcutta High Court in the case of CIT v. Uco Bank, (1993) 200 ITR 68 (Cal). He thereafter referred to the decision of Court of Appeal of UK in GaUagher v. Jones and Threlflai Jhones (1993). He held that the accrual concept is made up of two principles, viz. recognition and matching and that the assessee could not make the claim in respect of the sum of Rs. 2,11,13,040 but only of Rs. 70,83,671 as that was the amount debited in the books of account on the basis of guidelines of ICAI. The AO restricted the claim to Rs. 79.28 lakhs and disallowed the balance lease rental amount of Rs. 140.29 lakhs on the ground that the assessee was not entitled to claim the larger amount, if the lesser amount had been debited in its books of account. According to the AO, a plain reading of the provisions of Section 145(1) makes it clear that once an assessee regularly follows a particular method of accounting from which income can properly be deduced, the method of accounting followed by the assessee is binding on the IT authorities and it is not open to the assessee to adopt a different basis for income-tax purposes, after having made entries in the books of account. The AO placed reliance on the decision of the Supreme Court in the case of Keshav Mills Ltd. v. CIT (1953) 23 ITR 230 (SC). After going through the guidelines of ICAI and agreements, the AO was of the view that the agreement was for a consolidated period of 15 years. Therefore lease rental will have to be spread over for a period of 15 years.

5. The finding given by the AO was challenged before the CIT(A). Besides making written submissions before the CIT(A), the assessee relied on the decision of the Supreme Court in Kedanath Jute Manufacturing Co. Ltd. v. CIT (1971) 82 ITR 363 (SC), Bombay High Court decision in the case of Addl. CIT v. Buckau Wolf New India Engineering Works Ltd. (1986) 157 ITR 751 (Bom) and the decisions in State Bank of India v. CIT (1986) 157 ITR 67 (SC), CIT v. Gujarat Mineral Development Corpn. (1981) 132 ITR 377 (Guj), CIT v. Shree Krishna Gyanoday Sugar Ltd. (1990) 186 ITR 541 (Cal), Buxa Dooars Tea Co. (India) v. CIT (1991) 188 ITR 218 (Cal), Industrial Machinery Mfg. (P) Ltd. v. CIT (1993) 203 ITR 442 (Guj), GIT v. O.E.N. India Ltd. (1995) 213 ITR 718 (Ker) and CIT v. Mogul Line Ltd. (1962) 46 ITR 590 (Bom). However the CIT(A) was not convinced with the argument of the assessee and concurred with the view taken by the AO. Besides discussing the cases cited before him, he has also discussed cases such as the decision of the Supreme Court in Challapalli Sugars Ltd. v. CIT (1975) 98 ITR 167 (SC). The assessee is aggrieved against disallowance of claim for lease rentals in all these years.

6. The learned counsel for the assessee submitted that the AO had mentioned that the assessee could not claim an amount different from the amount debited in the books of account. In this connection the AO has relied upon the decision of the Calcutta High Court in the case of CIT v. Uco Bank (supra) for the proposition that the assessee in that case claimed a notional loss on account of stock valuation only in the computation of income without following the same method in its regular books

while finalising the accounts. On the basis of this decision, the AO had concluded that :

> "It is clear that assessee after having made entries in the books on account consistent with the method of accounting followed by him cannot be permitted to adopt a different base for income-tax purpose, just because that base may be permissible under the method of accounting following by the assessee, i.e. mercantile system."

It is submitted that the reliance placed by the AO is misplaced. Firstly, that decision has been reversed by the Hon'ble Supreme Court in the case of Uco Bank v. CIT (1999) 240 ITR 355 (SC). In fact, the Supreme Court while reversing the decision had observed that for the purpose of income-tax what is to be taxed is the real income, which is deduced on the basis of accounting system regularly maintained by the assessee and that was not so done by the assessee in the case of Uco Bank. In coming to this conclusion the Supreme Court quoted its earlier decision in the case of Investment Ltd. v. CIT (1970) 77 ITR 533 (SC) at p. 537) (quoted by the Supreme Court in (1993) 200 ITR 68 (Cal) that valuation of stock is part of the method of accounting. It was also pointed out that the Court at p. 365 has further observed as follows :

> "Hence, for the purpose of income, whichever method is adopted by the assessee a true picture of the profit and gains, that is to say, the real income is to be disclosed. For determining the real income, the entries in a balance-sheet require to be maintained in a statutory form, may not be decisive or conclusive. In such cases, it is open to the ITO as well as the assessee to point out the true and proper income while submitting the income-tax return. In Kedarnath Jute Mfg. Ltd. v. CIT, (1971) 82 ITR 363 (SC), this Court has negatived the contention that (p. 367) :..... if an assessee under some misapprehension or mistake fails to make an entry into the books of account and although under the law, a deduction must be allowed by the ITO, the assessee will lose the right of claiming or will be debarred from being allowed that deduction'. The Court held that whether the assessee is entitled to the particular deduction or not will depend upon the provision of law relating thereto and not on the view which the assessee might take of his rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter. In the present case, the question is slightly different. For reasons, the Central Government, in exercise of the powers conferred by Section 53 of the Banking Regulation Act and on the recommendation of the Reserve Bank of India, permitted the assessee not to disclose the market value of its investment in the balance sheet required to be maintained as per the statutory form. But as the assessee was maintaining its accounts on the mercantile system, he was entitled to show his real income by taking into account the market value of such investments in arriving at the real taxable income."

Thus, it is clear that the decision lays down the principle that entries in a balance sheet, which is required to be maintained in a statutory form, may not be decisive or conclusive in determining real income of the assessee. It may sometime disentitle a deduction simply because under some misapprehension or mistake assessee fails to make an entry in the books of account, although under the law a deduction must be allowed by AO. The claim made by the assessee is in line with the method of accounting followed by the assessee, which is mercantile system of accounting. Coincidentally, the assessee had also paid the amount claimed as deductible during the year under consideration. The mercantile system of accounting brings into credit what is due immediately, it becomes legally due and before it is actually received and it brings into debit expenditure the amount for which a legal liability has been incurred before it is actually disbursed. The learned counsel further submitted that the word 'accrue' had been understood by the Supreme Court in E.D. Sassoon Co. Ltd. v. CIT (1954) 26 ITR 27 (SC) at p. 51 as under :

> "If the assessee acquires a right to receive the income, the income cannot 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 received the income. There must be a debt owed to him by somebody. There must be as is otherwise expressed debitum in praesenti, solvendum in futuro;
>
> see W.S. Try Ltd. v. Johnson (Inspector of Taxes (4), and Webb v. Stenton and Ors. Garnishees (5). Unless and unta there is created in favour of the assesses a debt due by somebody it cannot be said that he has acquired a right to receive the income or that income as accrued to him."

Thus, it is submitted that once a debt is owed, there is a corresponding liability which must be paid. Accordingly the assessee had claimed a deduction in respect of the amount due and further the amount accrued due and is liable to be paid to RCFTL. Therefore, it is submitted that notwithstanding the entries made in the books of account and amount which is actually owed and accrued due is deductible while computing the total income for the assessment year. The question whether a deduction can be claimed even though no entry was made in the books of account, had come up for consideration before Courts, including the Hon'ble Supreme Court and Bombay High Court in several cases. In the case of Kedarnath Jute Mfg. Co. Ltd. (supra), the Hon'ble Supreme Court held as under :

> "The main contention of the learned Solicitor-General is that the assessee failed to debit the liability in its books of account and, therefore, it was debarred from claiming the same as deduction either under Section 10(1) or under Section 10(2)(xv) of the Act. We are wholly unable to appreciate the suggestion that is an assessee under some misapprehension or mistake fails to make an entry in the books of account and although, under the law, a deduction must be allowed by the ITO, the assessee will lose the right of claiming or will be debarred from being allowed that deduction. Whether the assessee is entitled to a particular deduction or not will depend on the provision of law relating thereto and not on the view which the assessee might take of his rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter. The assessee who was maintaining accounts on the mercantile system was fully justified in claiming deduction of the sum of Rs. 1,49,776 being the amount of sales-tax which it was liable under the law to pay during the relevant accounting year. It may be added that the

> liability remained intact even after the assessee had taken appeals to higher authorities or Courts which failed. The appeal is consequently allowed and the judgment of the High Court is set aside. The question which was referred is answered in favour of the assessee and against the Revenue."

Our attention was also invited to the ratio laid down by the Gujarat High Court in the case of CIT v. Gujarat Mineral Development Corporation (supra) and Bombay High Court in the case of Addl. CIT v. Buckau Wolf New India Engineering Works Ltd. (supra) for the proposition that whether the assessee is entitled to a particular deduction or not will depend upon the provisions of law relating thereto and not on the view which the assessee might take of its rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter. The Court must have regard to the system of accounting followed by the assessee. It is pointed out that in the present case the facts are even stronger than in those cases inasmuch as the agreement provides for the liability of Rs. 219.57 lakhs and the entry in the books of account is of a far lesser figure. In Buckau Wolf's case the payment itself was deferred and yet the High Court held that the accrual occurred in the year under consideration. In assessee's case, on the other hand, the entire amount has been actually paid. In these circumstances it is submitted that the entry in the books of account is for a lesser amount is not conclusive of the matter.

7. The learned counsel further submitted that the assessment of income and the allowability of expenditure and dependent on the method of accounting followed by the assessee and not dependent on the entries made in the books of account. The method of accounting followed by the assessee is far greater and covers a larger area than mere entries made in the books of account. If entries are not made in the books of account or wrong entries are made in the books of account or inadequate amounts are provided in the books of account, it would not affect the taxability or deductibility. Actual income is to be determined from the method of accounting and not from the entries made or not made in the books of account. That is the reason why both the assessabiiity of the income and allowability of expenditure would be dependent on the method of accounting followed and not on the entries made in the books of. account. In this connection reliance was placed on the ratio laid down in the cases of CIT v. Shree Krishna Gyanoday Sugar Ltd. (supra), Buxa Dooars Tea Co. (India) v. CIT (supra), Industrial Machinery Mfg. (P) Ltd. v. CIT (supra), CIT v. O.E.N. India Ltd. (supra), State Bank of India v. CIT (supra) and CIT v. Mogul Line Ltd. (supra). It is pointed out that the AO has referred to the decision of Supreme Court in the case of Keshav Mills Ltd. v. CIT (supra) for the proposition that the method of accounting regularly adopted by the assessee is to be accepted by the IT authorities except in the case when the provisions of Section 145 come into operation. It is submitted that the proposition laid down is not in dispute. However, this proposition is the basis on which the claim is being made. The assessee is following mercantile system of accounting. The method of accounting required that any liability, which accrued during the year, ought to be claimed as a deduction in determining the income for the year under consideration. Therefore, this proposition does not militate against the view of Supreme Court in the case of Kedarnath Jute Mfg. Co. Ltd. (supra). In both these cases emphasis is laid on the principle that when one follows the mercantile system of accounting the liability which accrues must be allowed or upheld. The issue which arose in Kedainath Jute Mfg. Co. Ltd. and State Bank of India (supra) was whether the deductibility of an amount in the mercantile system of accounting is a

prisoner of entries being made or not being made in the books of account. It was held by the Hon'ble Supreme Court that taxability and deductibility is not however defeated by making entry or not making entry in the books of account. It is explained that in the case of Addl. CIT v. Buckau Wolf New India Engg. Works Ltd. (supra) the Hon'ble Bombay High Court considered whether the observations of the Hon'ble Supreme Court in the case of Kedarnath Jute were limited to the case of a statutory liability and could not be applied to a case of contractual liability. The Hon'ble Bombay High Court observed as under :

> "It was submitted further that the assessee had not made an entry in his books for the full amount in the year in question was irrelevant and for attention was drawn to the observations in the Supreme Court's decision in the matter of Kedarnath Jute Mfg. Co. Ltd. v. CIT (1971) 82 ITR 363 (SC). It is true that in the above decision, the Supreme Court was considering the statutory liability for payment of sales-tax, but the observations to be found at p. 367 would seem to apply to all types of liabilities and not only to tax liability."

[Emphasis, italicised in print, supplied by the assessee]

8. The AO as well as the CIT(A) have held that agreement dt. 30th March, 1993 and 5th April, 1993, are, in fact, one agreement and not two agreements and the C1T(A) has opined that the company has failed to offer any explanation as to why the supplemental agreement was signed within a week of signing of original agreement and further observed that the artificial device of primary and secondary period is clearly aimed to claim heavy deduction in the initial period of five years, which is not in consonance with the Guidance Notes issued by the ICAI. Therefore, the so called two agreements are in spirit only one agreement with the prime objective of taking assets on lease for 15 years. With regard to this observation of the CIT(A), it was submitted by the learned counsel for the assessee that the CIT(A) has concluded in para 4 of his speaking order for asst. yr. 1994-95 that the two agreements must be read together but at the same' time he has also concluded that the distinction between primary period and secondary period is artificial and only with a view to enlarging the period of lease to 15 years. In the absence of any explanation as to why a supplemental agreement was signed within one week of the signing of the first agreement, he held that the two agreements must be held to be artificial. This conclusion of the CIT(A) is self-contradictory. At one stage the CIT(A) mentions that no reason has been given as to why the supplemental agreement was signed within a week of signing the original agreement. But he does not set out the consequences of this finding. If no explanation has been given, one consequence can be that the supplemental agreement is to be ignored. If that is the only consequence, then clearly only the first agreement dt. 30th March, 1993, exists. Under this agreement, the amount of lease rent payable is Rs. 2,19,57,539 and that is the amount which is claimed deductible by the assessee. Thus, the consequence of finding is that the amount of lease rent is allowable. The other possibility is that even though no explanation is offered as to why the second agreement was signed, the two agreements must be read together. The conclusion which would follow from the proposition that the two agreements must be read together are that everything in the second agreement is valid and subsisting and must be given effect to. The second agreement modifies the first agreement in four different ways given below :

"(i) It extends the period of lease from 60 months to 120 months.

(ii) It provides for a further lease rent for the increased period.

(iii) It provides that the further lease rental is payable yearly instead of monthly.

(iv) It makes a provision for variation in rentals on account of change in capital allowances."

If the finding of the CIT(A) is interpreted, it will amount that the lease period is extended to 20 years. It is submitted that the learned CIT(A) has failed to read and comprehend the agreement in its totality. It is not open to the CIT(A) to pick at random one of the four different changes and give effect to that (albeit erroneously) and ignore the other three consequences or changes made in the agreement. It is not open to truncate the agreement and read it in part and ignore the other part. On a reading of both the agreements together, the first and primary fact to be noticed is that it does not affect, truncate, determine, touch upon, change or deviate from any of the contents of the original agreement. All that the second agreement does is to affect the period after the end of period of five years from the end of 30th March, 1993. The CIT(A) has wholly and grievously erred in failing to appreciate that if the two agreements are read together, it does not affect the claim of the assessee at all as regards the allowability of the lease rent. Therefore it is submitted that the order of the CIT(A) for asst. yr. 1994-95 does not take into account the consequence which flows from the finding that the two agreements must be read as one. The AO as well as the C1T(A) also observed that the assessee could not claim an amount which was not in accordance with the standards issued by the ICAI. According to them, the lease period is 15 years and, therefore, lease rentals have to be spread over 16 years in consonance with the Guidance Note issued by the ICAI. According to them, the method adopted by the assessee in respect of lease rentals has resulted in a distorted picture of true state of chargeable income to tax. With regard to this, it was submitted that the CIT(A) had laid great emphasis on the fact that the amount debited in the books is in accordance with the accounting standards adopted by the ICAI but the claim made is in excess of the amount debited. In other words, the submission is that the principles of accountancy must override the claim made under the income-tax law. The deduction claimed by the assessee is on the footing that according to the contract entered into on 30th March, 1993, liability used or accrued is Rs. 2.19.crores. It means that if the assessee has defaulted in the payment of the rent of Rs. 2.19 crores, the lessor would have a right to sue the assessee for the recovery of this amount. In this connection, the Department had laid emphasis on the decision of the Supreme Court in Keshav Mills' case (supra). The question, therefore, to be asked is, applying the principle of the Supreme Court decision, what is the legal liability of the assessee on 31st March, 1993. Is it open to the assessee to tell and submit before the Court in a suit filed by the lessor that although the contract provides for an obligation in the payment of disputed sum of Rs. 2.19 crores because of supplemental agreement and the entries in the books of account, it is legally liable only to the extent of Rs. 70 lakhs. The learned counsel submitted that it is preposterous to suggest that a legal liability can be changed unilaterally in the case of contractual obligation by a simple entry debiting in its books of account a sum far lesser than its contractual obligation. It is further submitted that a legal liability must be determined in accordance with the contract entered into between parties irrespective of the amount debited in the books of account. It cannot stand scrutiny for even a moment that the legal liability and a contractual obligation can be whisked away on the ground that a certain accounting standards have been followed to maintain the books of account. In this connection it must be borne in mind, as point out by the AO, that the accrual system of accounting has two limbs, viz., matching and recognition. On the other hand, it will be seen that IT Act does not recognize matching principle for accounting of income. In this connection attention is invited to the distinction between Accounting Standard 1 issued by the ICAI end Accounting Standard 1 issued by the GBDT. In exercise of the powers of the AO under Section 145 of the IT Act, it would be noticed that the matching principle embodied in prudence does not find in place in Accounting Standard issued by the CBDT. The learned counsel invited our attention to the following passages of AS 1 of ICAI and AS 1 issued by the CBDT :

> "Accounting Standard -1 as per ICAI 'Prudence' : In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash.
>
> Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.
>
> Accounting Standard - 1 as per CBDT 'Prudence' : Provisions should be made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information."

It will be seen that as per the CBDT profit can be anticipated even though dependent on uncertain future events and unrealised. This is a cornerstone of the matching principle but finds no place in Accounting Standard 1 issued by the CBDT. Clearly, therefore, the CBDT does not recognize the matching principle. Thus, it was submitted that the indiscriminate application of AS to determine income under the income-tax statute cannot be upheld. This is so because accrual of liability is the crux of the matter under the IT Act where the assesses is following mercantile system of accounting. On the other hand, Accounting Standards which are issued by the ICAI are governed by different disclosure norms and have different objectives.

9. The learned Departmental Representative very vehemently argued that the view of the assessee-company is clearly untenable in view of the following :

> "(A) The appellant has failed to offer any explanation as to why the second agreement (supplemental agreement) was signed within a week of signing of the original agreement. The supplemental agreement is silent in this respect.
>
> (B) No justification has been brought on record for introduction of the concept of 'primary period' and 'secondary period'. This is apparently an artificial device for enlarging the period of lease to 15 years.

(C) The original lease agreement and the supplementary lease agreement are in reality only one agreement with the prime objective of taking the asset on lease for the period of 15 years to that higher deduction could be claimed in the initial 5 years period.

(D) The so-called two agreements are in spirit only one agreement. Accordingly, lease rentals should be payable over lease terms of 15 years spread over equally as one in the original agreement. This is in accordance with the Guidance Note issued by the ICAI."

It was submitted that the Supreme Court in the case of Challapalli Sugars Ltd. v. CIT (supra) has laid down the proposition that where the law has not defined a concept known to accounting practice, that concept must draw on accounting practice to derive its meaning. ICAI taking into account of fact that leasing industry has made rapid strides in the recent years, considered it appropriate to develop an accounting system for leasing industry to provide sound economic measurements in accordance with well accepted principles. Accordingly, Guidance Notes on accounting for lease were issued in September 1988. As per the Guidance Notes of ICAI the lease rental accrues as an expenditure in the books of the assessee on the basis of the terms of the lease agreement and it is required to be distributed equally over the period of lease. It is pointed out that the first lease agreement was for a period of 60 months and the total lease rentals were Rs. 10,55,65,200 and this amount was worked out on the basis of the total acquisition cost. By supplemental agreement the period has been revised to 15 years, besides schedule to original lease agreement was also amended. As per the supplemental lease agreement, the lease rentals work out to Rs. 10,63,68,580. The learned Departmental Representative emphasised that supplemental agreement has been entered into within a week of signing of original agreement between two sister concerns and the assessee has not furnished any explanation which necessitated supplemental agreement. As per the first lease agreement, the total lease rent was spread over evenly over the lease period of five years. In the supplemental agreement, a further period of 10 years was added and thereby the total lease period became 15 years. The assessee-company introduced the concept of primary period and secondary period. The supplemental agreement is silent with regard to the basis of bifurcation of lease period into these two nomenclatures. For this bifurcation, no basis whatsoever has been given before the Revenue authorities. It is also not known as to what benefit both the parties to the agreement would derive from such bifurcation. In this connection, the learned Departmental Representative invited our attention to para 4 of the order (for asst. yr. 1994-95) of the CIT(A) where he gave four significant findings with respect to the two agreements. It is submitted that the two agreements, in spirit, constitute one integrated and indivisible agreement and they should not be read separately. Reliance was placed on the decision of the Supreme Court in the case of CIT v. Chamanlal Mangaldas & Co. (1960) 39 ITR 8 (SC) in which the Supreme Court held that clause in regard to commission in that case has to be read as one integrated whole. It is submitted that similarly in the present case the lease period has been increased by a supplemental agreement from five years to 15 years and, therefore, both the agreements should be treated as one.

10. It is further submitted that the assessee is following mercantile system of accounting, according to which the profits earned and credited to the accounts will be taken as the basis of computation of

total income. Our attention was invited to the mercantile system of accounting as explained by the Supreme Court in the case of Keshav Mills Ltd. (supra) and it was pointed out that the Supreme Court held that the mercantile system of accounting treats profit or gains as arising or accruing at the date of transaction notwithstanding the fact that they are not received or deemed to be received and under that system book profits are taxed. The Court further observed that profit earned and credited in the books of account became the basis of computation. In view of this decision, the AO adopted the book profit reflected in the P&L a/c for the year ending 31st March, 1996. It was further pointed out that the assessee debited Rs. 7.24 crores under the head Establishment and Other Expenses to the P&L a/c, the details of which have been furnished in Schedule 13 to P&L a/c in which the assessee had shown lease rent--machinery at Rs. 70.84 lakhs under the head Establishment and Other Expenses. The lease rent debited is in consonance with the Guidance Note issued by the ICAI. In this connection Notes on Accounts at Schedule 15 of assessee's annual report for the year ending 31st March, 1996 is significant. The significant accounting policies are reproduced as under :

> "(A) System of Accounting The company maintains its accounts on accrual basis. Income from construction contracts is accounted based on completed contract method and is net if the expenditure incurred in execution thereof.
>
> (G) Lease Rent Lease rentals are written off in the P&L a/c. On shorter of contractual period of lease or the useful life of the asset accept for rentals pertaining to the period upto the date of commissioning of the assets which are capitalised."

Thus, for recording the transaction in books of account relating to lease rents, the assessee followed Guidance Note issued by ICAI. The assessee has spread the lease rent over 15 years in the books of account and arrived at a profit of Rs. 19.46 crores and distributed dividend. The assessee debited the accrued liability of Rs. 70.84 lakhs (excluding lease tax) to the P&L a/c. These cannot be two accrued liabilities in respect of lease rent under the mercantile system of accounting, viz., one accrued liability of Rs. 70.84 lakhs in books of account and another accrued liability of Rs. 219.59 lakhs for the computation of total income. It is submitted that the profits of business or profession have to be computed as per the method of accounting regularly followed by the assessee and accrued liability as reflected in the books of account. Under the mercantile system of accounting, the transactions relating to "accounting period" are recorded in the books of account irrespective of payment. In the present case lease rent is a contractual obligation and the Bench has to decide the quantum of liability relating to this year. The learned Departmental Representative gave the following examples ;

> "(1) An assessee has taken machinery on lease for 4 years on 1st April, 1995 and the contract stimulates that the total rent for the entire lease period is Rs. 4,00,000 and the entire rent of Rs. 4 lakhs requires to be paid at the beginning of the contract. While preparing the P&L a/c for the year ending 31st March, 1996, how much is the accrued liability for the previous year 1995-96?

I humbly submit that in the mercantile system of accounting, the accrued liability of rent is Rs. 1,00,000 and this amount requires to be debited to the P&L a/c. For the year ending 31st March, 1996. In the balance-sheet for the year ended 31st March, 1996, lease rent advance of Rs. 3,00,000 will appear on the asset side of the balance sheet as "Rent in advance".

2(1) An assessee has taken machinery on lease for 15 years on 1st April, 1995 from a sister concern on a total rent of Rs. 15 lakhs payable as under :

Asst. yr.	Lease rent
1995-96	Rs. 10 Lakhs
1996-97	Rs. 3 Lakhs
1997-98	Rs. 1 Lakhs
1998-99	Rs. 8,335 per annum

And thereafter till end of the contract.

2(ii) An assessee has taken machinery'on lease for 15 years on 1st April, 1995, from a sister concern on a total lease rent of Rs. 15 lakhs payable as under :

Asst. yr.	Lease rent
1995-96	Rs. 8,335
1996-97	Rs. 8,335
1997-98	Rs. 8,335
1998-99	Rs. 10 Lakhs
1999-2000	Rs. 3 Lakhs
2000-2001	Rs. 17,500 per annum

And thereafter till end of the contract.

In the above examples, assuming that agreement was not between related parties, transactions were at arm's length and other conditions in the agreement being the same, what should be the quantum of lease rent that requires to be debited to the P&L a/c of the various years?"

> He submitted that in order to have uniformity in the method of accounting of lease rental, the Institute of Chartered Accountant of India has prescribed accounting standards and such standards have been placed in the paper-book submitted by the Department. It is submitted that Clauses 24 and 25 of the said accounting standards relate to finance leases and such lease is applicable to the assessee-company. Our attention was invited to Clause 25 of the Accounting Standards and it was submitted that as per the Guidance Note issued by the ICAI the accrued liability in the above examples is Rs. 1,00,000 and the remaining balance is required to be reflected in the balance sheet on the asset side. In the present case, the assessee followed the

Accounting Standard issued by the ICAI in its books of account and debited Rs. 79.28 lakhs to the P&L a/c, which includes proportionate lease rental for one year. In this connection, he has also invited our attention to p. 5 of the order of the CIT(A) wherein the lease rental calculation has been given. The learned Departmental Representative quoted the portion relating to lease tax paid from the order of the CIT(A) as under :

"Lease rent for one year 70,83,671.33 Add : Lease tax paid 8,44,524.00 79,28,195.33"

11. It is submitted that under the Lease Tax Act, assessee has to pay tax not exceeding 15 per cent on the turnover of sales in respect of the transfer of right to use goods specified in the Schedule. The tax paid by the assessee works out to 11.92 per cent or 12 per cent of the lease rent. The assessee added the lease tax to the lease rental recorded in the books of account. The basis on which lease tax has been paid has not been discussed by the CIT(A) in his order but a finding has been given that lease rental includes lease tax. Therefore, the assesses paid the lease tax on the accrued lease rent of Rs. 70.83 lakhs and not on the lease rent paid in advance of Rs. 1,40,29,364. Therefore, accrued lease rent requires to be restricted to Rs. 79.28 lakhs. If entire lease rent of Rs. 2.19 crores is allowed as deduction without corresponding payment of lease tax under Lease Tax Act, it would lead to violation of Lease Tax Act. In this connection, reliance was placed on the decision of the Supreme Court in the case of Muddi Venkataratnam & Co. Ltd. v. CIT (1998) 229 ITR 534 (SC). It is submitted that the assessee is not entitled to follow one method of accounting for preparation of P&L a/c and balance sheet and another method of accounting for tax purpose. In this connection, reliance was placed on the decision of the Tribunal in the case of Nagaijuna Finance Ltd. (ITA No. 2967/Hyd/l988) and Special Bench decision of the Tribunal in Dy. CIT v. Nagaijuna Investment Trust (1998) 62 TTJ (Hyd) (SB) 33 : (1998) 65 ITD 17 (Hyd) (SB). In view of this, it was submitted that the lease rental was to be spread over to the entire lease period of 15 years. Here the learned Departmental Representative invited our attention to the facts and ratio laid down in the case of Madras Industrial Investment Corporation Ltd. v. CIT (1977) 225 ITR 802 (SC). Thus it is submitted that the concept of spread over has been recognised by the Supreme Court. 12. Under Section 145 income under the head profits and gains of business or profession, where the assessee maintains books of account, has to be in accordance with the method of accounting regularly employed by the assessee, which could be cash or mercantile system of accounting. In the present case the assessee has been following the mercantile system of accounting. In the books of account, the accrued lease rentals were recorded at Rs. 79.28 lakhs and not Rs. 2.19 crores. There cannot be piecemeal method of accounting in respect of the same accrued expenditure. Reliance was placed on the decision of the Gujarat High Court in the case of CIT v. Super Scientific Clock Co. (1999) 238 ITR 731 (Guj). Thus it was submitted that the method of accounting recommended by ICAI requires to be accepted as an accounting principle and may be accepted in the absence of any statutory definition or other indication to the contrary. If the method adopted by the assessee in respect of lease rental is accepted, it will result in distorted picture of true state of chargeable income to tax. The assessee's method of accounting of lease rentals will result in reduction of profit in first five years. Consequently, it gives a completely misleading picture of financial result. In this connection, our attention was invited to the Supreme Court decision of the case of CIT v. British Paints India Ltd.

(1991) 188 ITR 44 (SC). Reliance was also placed on the decision of the Supreme Court in the case of State Bank of Travancore v. CIT (1986) 158 ITR 102 (SC) wherein it was held that income has to be computed on the basis of regularly employed method of accounting.

13. The learned Departmental Representative submitted that the arguments advanced by the learned counsel for the assessee have no substance and that the decisions cited by him are not applicable to the facts of the present case.

14. In reply, the learned counsel for the assessee submitted that the decision in the case of Madras Industrial Investment Corporation Ltd. (supra) was a decision rendered by two Judges of the Supreme Court for the proposition that the accounting standards must override the statute. That was the case where the discount relating to issue of debentures was claimed for the period for which the debentures were issued. The decision does not at all refer to any accounting standard but refers to an extract from two books which set out the principle that the discount on the issue of debentures is, in fact, deferred interest and should accordingly be written off over the period having the use of money. It is clear that it is in that context the Supreme Court has held that liability which has been incurred to generate funds which are used for his business activity must be allowed over the period of time for which the funds were used. This decision, therefore, was rendered on these peculiar facts and must be limited thereto. However, assuming for the sake of argument, without admitting, if the proposition is that the decision in Madras Industrial (supra) lays down that an accounting principle overrides income-tax law, then it is submitted that the proposition canvassed by learned Departmental Representative is contrary to the later decision of Supreme Court in Tuticorin Alkali Chemicals v. CIT (1997) 227 ITR 172 (SC). Here the issue which came up before the Supreme Court was directly whether a well recognized accounting principle must be given effect to in preference to income-tax law. This argument was summarily rejected by the Supreme Court at p. 188 in the following words :

> "Next it has been argued that according to well established accountancy practice the interest earned by the company even before the commencement of business from investing borrowed capital will have to be set off against interest payable by the company on that borrowed capital. The argument based on accountancy practice has little merit, if such practice cannot be justified by any provisions of the statute or is contrary to it.
>
> [Emphasis, italicised in print, supplied by the assessee] If these two decisions of Supreme Court lay down diametrically opposite views, it is submitted that the later decision must prevail over the earlier because it is well settled that where there is a conflict between two decisions, the later decision must prevail over the earlier one and secondly it is well settled that where there is a conflict between the two decisions the decision of larger Bench must prevail over that a smaller Bench. The decision in Tuticorin Alkali (supra) must prevail because it was rendered by three Judges, whereas the decision in Madras Industrial (supra) was rendered by two Judges.

15. The learned counsel for the assessee submitted that the reference to the decision of Hyderabad Bench of the Tribunal made by the learned Departmental Representative is of no consequence as inasmuch as the decision has not been accepted by the Special Bench in (1998) 62 TTJ (Hyd) (SB) 33 : (1998) 65 ITD 17 (Hyd) (SB) (supra) and it is contrary to several decisions of the Supreme Court.

16. As regards the argument of learned Departmental Representative with regard to tease tax paid is concerned, it is pointed out that the assessee has paid lease tax of Rs. 8,44,524. According to him, the tax paid is on the lease rent of Rs. 70,83,671 and in the circumstances the accrued lease rent is only Rs. 79.28 lakhs because if the entire lease rent of Rs. 2.19 crores is allowed as a deduction without corresponding payment of lease tax, it will violate the Lease Tax Act and, therefore, not deductible under Section 37 of the IT Act. It is pointed out that the learned Departmental Representative had submitted that because the lease rent tax has been paid on 70,83,671 instead of on Rs. 2.19 crores, the lease rental allowable is Rs. 70,83,671 and not Rs. 2.19 crores. In this connection, attention is invited to the Maharashtra Sales Tax on the Transfer of the Right to use any Goods for any Purpose Act, 1985. It is pointed out that levy of lease tax is under Section 4 of the above Act, which is given below :

> "There shall be levied a tax on the turnover of sales in respect of the transfer of the right to use goods specified in the Schedule at such rate not exceeding fifteen paise in the rupee as the State Government may by notification in the Official Gazette, specify from time to time and different rates may be specified for different goods specified in the Schedule :
>
> Provided that for computation of such turnover of sales, the turnover related to the goods in respect of which tax under the Bombay Sales-tax Act, 1959 has been paid on any earlier transaction, shall not be taken into consideration : Provided further that in computing the tax payable by a dealer under this section on the turnover of sales, the tax already paid into Government Treasury on the turnover of sales of the same goods at an immediate preceding stage shall be, set off against the tax so payable subject to rules."

The relevant Schedule to the Act at Sr. Nos. 3 and 8 (relevant to this case) reads as under :

> S. No. Description Rate of tax
>
> 3.

The transfer of the right to use plant, machinery, equipment, including office equipment, computers, instruments or appliances Four paise in the rupee

8. The transfer of the right to use all kinds of machinery

-Do-

The notification issued by the Maharashtra Government has specified the rate of tax mentioned above. The lease tax paid by the assessee was Rs. 8,44,524. The lease rent was Rs. 2,11,13,040. Four per cent of Rs. 2,11,13,040 is Rs. 8,44,524. Clearly, therefore, the assessee has, in fact, paid lease rent correctly on the amount which has accrued. The case of the learned Departmental Representative that lease tax has been paid on the sum of Rs. 70,83,671 is factually incorrect. On the other hand, the argument of learned Departmental Representative that the amount which is allowable is that amount on which lease tax is paid supports the assessee that the amount of lease rent which is allowable is Rs. 2,11,13,040 and not Rs. 70,83,671. It is pointed out at this stage that the assessment order under the abovementioned Act for the period 1st April, 1993, to 31st March, 1994 (Annexure-I to this order), indicates that the taxable turnover is Rs. 12,88,56,022, which includes Rs. 2,11,13,040 (Annexure-II) in respect of RCFTL.

17. Concluding his arguments, the learned counsel for the assessee submitted that the amount claimed by the assessee is allowable in all these years. Thus, the disallowance of balance lease rental of Rs. 140.29 lakhs is uncalled for.

18. We have considered the rival submissions and have gone through the material available on record- This is a case of sale and lease back of plant and machinery called SCADA. The assessee-company entered into lease agreement with RCFTL and leased back the said SCADA system. The lease rental originally was fixed for a period of 60 months vide agreement dt. 30th March, 1993, and each instalment was fixed for an amount of Rs. 17,59,420. However, by a supplemental agreement entered on 5th April, 1993, the original agreement was amended in Clause (iv) relating to the period and schedule of lease rental and in Clause (ii) relating to variation in rentals. The supplemental agreement extended the period of lease into primary period of 60 months from the commencement date and secondary period of 120 months from the end of the primary period. Consequently, the lease rentals, which were to end on 7th March, 1998, were extended by 10 further rentals as mentioned above. The first objection of the Department is that the two agreements dt. 30th March, 1993, and 5th April, 1993, could be treated as the agreement. The findings of the CIT(A) with regard to these agreements are that (1) the assessee-company failed to offer any explanation as to why the supplemental agreement was signed within a week of signing the original agreement, and (2) the artificial device of primary and secondary period is clearly aimed to claim heavy deduction in the initial period of five years, which is not in consonance with the Guidance Notes issued by the ICAI. Therefore, the so-called two agreements, in spirit, are only one agreement with the prime objective of taking the asset on lease for a period of 15 years. We have to see the consequence of treating both the agreements as one agreement and the second aspect is what is the consequence of ignoring the second agreement. We would like to mention here that the CIT(A) 'concluded his finding in para 4 of his speaking order for the asst. yr. 1994-95 opining that the two agreements must be read together. But at the same time he has also concluded that the distinction of primary period and secondary period is artificial and only with a view to enlarging the period of lease to 15 years. He has also questioned why the supplemental agreement was signed within a week of signing the first agreement. It is found that the assessee-company has offered no explanation as to why the supplemental agreement was executed. If no explanation has been given, one consequence

can be that the supplemental agreement is to be ignored. If that is the only consequence, then only the first agreement dt. 30th March, 1993, remains in existence. Under this agreement, the amount of lease rental payable is Rs. 2.19 crores, i.e. the amount which is claimed deductible by the assessee. The other possibility is that even though no explanation is offered as to why the second agreement was executed, the two agreements should be read together. The conclusion flows from the proposition that the two agreements must be read together or everything in the second agreement is valid and subsisting and must be given effect to. The second agreement modifies the first agreement in four ways :

(1) It extends the period of lease from 60 months to 120 months.

(2) It provides for a further lease rent for the increased period.

(3) It further provides that the lease rental is payable yearly instead of monthly.

(4) It makes a provision for variation in rental on account of change in capital allowances.

The CIT(A) while corning to the conclusion that these two agreements should in spirit be read as one agreement, had ignored the three other aspects mentioned above. It is not open to truncate the agreement and read it in part and ignore the other parts. If we go through the two agreements, the first and primary fact to be noticed is that it does not affect, truncate, determine, change or deviate from any contents of original agreement. All that the supplemental agreement does is to effect the period after the end of five years. Therefore, the CIT(A) has not taken .into account the consequence which flows from the finding that the. two agreements must be read together, i.e. that it does not affect the claim of the assessee at all as regards the allowability is concerned.

19. The other objection of the Department is that the assessee's claim is not in accordance with the standards issued by the ICAI. According to the Departmental Representative, the lease period has been increased by supplemental agreement from 5 to 15 years. Thus, the lease period is 15 years and lease rentals have to be spread over for 15 years in accordance with the Guidance Notes issued by the ICAI. To support this, he has given two hypothetical illustrations mentioned above. He further submitted that the method adopted by the assessee in respect of lease rental has resulted in a distorted picture of true state of chargeable income of tax because, according to him, the assessee's method of accounting would result in reduction of profit in first five years. It is also contended that there can be no two standards as regards accrual of liability, one for the books of account and another for tax liability. In other words, it is submitted that principles of accountancy must override the claim made under income-tax law. It is also canvassed that the Guidance Notes on accounting for lease issued by ICAI have been prescribed by the Institute, inter alia, considering that the accounting practices in many cases have led to distortions in income measurement, primarily due to mismatching of rental income with depreciation on leased assets. It was submitted that in the instant case the mismatch of rental income with the depreciation on leased assets is apparent inasmuch as the assessee-company through the artificial device of primary period and secondary period has endeavoured to avail practically entire lease rentals in the first five years. The learned

Departmental Representative has also referred to the decision of the Supreme Court in Keshav Mills' case (supra). The learned counsel for the assessee submitted that applying the principle of Supreme Court in the case of Keshav Mills (supra), the question has to be asked what is the liability of the assessee on 31st March? Is it open to the assessee to tell and submit before the Court in a suit filed by the lessor that although the contract provides for an obligation in the payment of Rs. 2.19 crores because of the supplemental agreement and the entries in the books of account, it is legally liable only to the extent of Rs. 70.83 lakhs. It was contended that it is preposterous to suggest that a legal liability can be changed unilaterally in the case of contractual obligation by a simple entry debiting in its books of account a sum far lesser than its contractual obligation. The legal liability must be determined in accordance with the contract entered into between the parties, irrespective of entries in the books of account. Otherwise it will not stand scrutiny for even a moment that a legal liability and contractual obligation can be whisked away on the ground that a certain accounting standard has been followed to maintain books of account. It is pointed that the IT Act does not recognize the matching principle of accounting of income. In this connection, distinction between Accounting Standard-1 issued by ICAI and Accounting Standard-1 issued by GBDT is clear from the said two standards reproduced at page of this order. It will be seen that as per AS-1 of CBDT, profits can be anticipated even though dependent on certain future events and unrealised. This is the crux of the matching principle but finds no place in AS-1 issued by the CBDT. Therefore the CBDT does not recognize matching principle. We find substance in the argument of assessee's learned counsel that indiscriminate application of principle of accounting standard to. determine income under the IT Act cannot be upheld. This is because accrual of liability is the crux of the matter under IT Act, where the assessee is following mercantile system of accounting. We further find substance in the argument of learned counsel for the assessee that in exercise of powers under s, 145 of the IT Act, the matching principle embodied in 'prudence' does not find place in AS-1 issued by CBDT. On the other hand, AS, which are issued by the ICAI, are governed by the disclosure norms and have different objectives. As such, we do not find any substance in the argument of the learned Departmental Representative with regard to the fact that the assessee could not claim an amount which was not in accordance with the accounting standard. The learned Departmental Representative has reiied on the decision of the Supreme Court in Madras Industrial Investment Corporation Ltd. (supra) for the proposition that accounting standards must overide the statute. But we would like to mention here that it was a case where the discount relating to the issue of debentures was claimed for the period for which the debentures were issued. The decision does not at all refer to any accounting standards but refers to an extract from two books, which set out the principle that the discount on issue of debentures is, in fact, deferred interest and should accordingly be written off over the period having the use of the money. It was under these circumstances the Supreme Court has rendered this decision. However we find that the decision of the Supreme Court in the case of Tuticorin Alkali Chemicals v. CIT (supra), was a decision rendered later than the decision cited by the learned Departmental Representative and was also rendered by a Full Bench of the Supreme Court, whereas the decision in Madras Industrial was rendered by two Judges. In the case of Tuticoiin (supra), the Hon'ble Supreme Court was directly concerned with an issue whether a well settled accounting principle must be given effect to in preference to Income-tax law and the Hon'ble Supreme Court has observed as under :

> "Next it has been argued that according to well-established accountancy practice the interest earned by the company even before the commencement of business from investing borrowed capital will have to be set off against interest payable by the company on that borrowed capital. The argument based on accountancy practice has little merit, if such practice cannot be justified by any provisions of the statute or is contrary to it."

In view of the above discussion, we are of the opinion that the two agreements are separate agreements and cannot be treated as one agreement because the supplemental agreement modifies the first agreement in four different ways cited above, and the accounting standard cannot be indiscriminately applied to determine the income under the Income-tax law because accrual of liability is the crux of the matter under the IT Act where the assessee is following mercantile system of accounting.

20. The assessee-company recorded annual lease rental by debiting Rs. 70.83 lakhs in its books of account. However, when return was filed, assessee wrote back the amount of Rs. 70,83,671 and claimed deduction of Rs. 2,11,13,040. The AO disallowed this difference of Rs. 1,40,29,369 on the ground that the assessee was not entitled to claim the larger amount if a lower amount has been debited in the books because provisions of Section 145(1) make it clear that once the assessee regularly followed a particular method of accounting, it is binding on IT authorities and on the assessee.

21. The claim of the assessee-company is that it had accounted lease rentals in books following the guidelines issued by ICAI. The assessee had claimed the entire expenditure of lease rent, which is a contractual liability as per agreement referred to above, because the company had paid Rs. 2,11,13,040 to RCFTL. According to the assessee, this claim is based on the method of accounting, i.e.. mercantile system, followed by the assessee for the last several years and it is as per the guidelines of ICAI that the lease rentals are written off in P&L a/c on shorter of contractual period of lease or useful life of the assets. The claim of the assessee is that in the instant case the contractual period was 15 years. Lease rentals were proportionately written off over the period of lease, i.e., 5 + 10 years. In view of this, a sum of Rs. 70,83,671 was written off during the year in P&L a/c under the head "establishment and other expenses" and a sum of Rs. 1,40,29,364 was debited to prepaid expenses on the assets side of the balance sheet. On the other hand, the AO was of the view, that the assessee could not claim an amount different from the amount debited in the books of account which was in accordance with the standards issued by the ICAI. In this connection, the learned Departmental Representative has pointed out the finding of CIT(A) given at page 17 in para 4 of his order (for asst. yr. 1994-95). It was also submitted that when the lease period has been extended by a supplemental agreement from 5 to 15 years, the lease rentals have to be spread over to 15 years in consonance with the Guidance Note issued by ICAI. Since the assessee had paid lease tax of Rs. 8,44,524 on lease rentals of Rs. 70,83,671, the accrued lease rental is only Rs. 79.28 lakhs. Therefore, there is no reason to allow deduction of Rs. 2.19 crores without corresponding payment of lease tax under the Lease Tax Act as it would be violative of Lease Tax Act as per the ratio laid down by Supreme Court in the case of Muddi Venkataratnam (supra). It was contended that if the assessee followed one method of accounting for preparation of P&L a/c and balance sheet, he cannot

be allowed to follow another method of accounting for tax purpose. For this proposition he has relied on the decision of Hyderabad Bench of the Tribunal in the case of Nagarjuna Finance Ltd. (supra) and decisions of the Supreme Court in the cases of Madras Industrial Investment Corporation Ltd. (supra) and Challapalli Sugars Ltd. (supra).

22. We find that the AO while disallowing the claim of the assessee has followed the decision of the Calcutta High Court in the case of CIT v. UCO Bank (supra) for the proposition that where the assessee had made entries in the books of account consistent with the method of accounting followed by him, he cannot be permitted to adopt different basis for income-tax purpose. So far as this contention of the AO is concerned, we would like to mention here that the decision of the Calcutta High Court had been reversed by the Supreme Court in the case of Uco Bank v. CIT (supra). While reversing the decision, it was observed that for the purpose of income-tax what is to be taxed is the real income which is deduced on the basis of accounting system regularly maintained by the assessee and that was not done by the assessee in the case of Uco Bank, it will be fruitful to mention here that the Hon'ble Supreme Court has quoted its earlier decision in the case of Investment Ltd. v. CTT (supra). In nutshell, it was held that "whether the assessee is entitled to a particular deduction or not will always depend upon the provisions of law relating thereto and not on the view which the assessee might take on its rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter". Therefore, it is clear that making or non-making of entries in the books of account is immaterial for submitting a claim- In the present case, the assessee is following mercantile system of accounting and it is also not in dispute that the assessee has also paid Rs. 2.11 crores, the amount claimed as deductible during the year under consideration. The mercantile system of accounting brings out into credit what is immediately legally due and before it is actually received. Similarly, it brings into debit expenditure the amount for which a legal liability has been incurred before it is actually disbursed.

23. In the case of E.D. Sassoon Co. Ltd. v. CTT (supra), the Hon'ble Supreme Court had interpreted the word 'accrue' and it was observed that, if the assessee acquires a right to receive the income, the income cannot 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 the right to receive the income. There must be debt owed to him by somebody. Once a debt is owed, there is a corresponding liability which must be paid. In the case before us, we find that the assessee had claimed deduction in respect of amount due and further the amount accrued has been paid to BCFTL. Therefore, notwithstanding the entries made in the books of account, the amount which is actually owed and accrued due is deductible while computing the total income of the assessment year.

24. Now the question arises whether deduction can be claimed even though no entry was made in the books of account. In the case of Kedamath Jute Mfg. Co. Ltd. (supra), the Hon'ble Supreme Court has observed that if an assessee under a misapprehension or mistake fails to make an entry in the books of account and although, under the law, a deduction must be allowed by the ITO, the assessee will lose the right of claiming or will be debarred from being allowed that deduction. Whether the assessee is entitled to a particular deduction or not will depend on the provisions of law relating thereto and not on the view which the assessee might take of its rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter. The learned

Departmental Representative has referred to the decision of -Gujarat High Court in the case of Gujarat Mineral Development Corporation (supra). In this case the facts were that the assessee has claimed entire expenditure in one year, whereas the expenditure was written off in the books of account over a period of seven years. Under these circumstances, the Hon'ble Gujarat High Court has held that the fact that certain entries were made or not made in a particular year of account, is totally immaterial and in any event such entries are not decisive or conclusive of the matter. The present case of the assessee is distinguishable from the abovementioned case before the Gujarat High Court. On the other hand, we find that in the case of Backau Wolf New India Engineering Works Ltd. (supra) the facts were that the assessee had entered into a technical know-how agreement for sale and transfer of technical information knowledge for a lump sura of Rs. 1,00,000 payable in five equal annual instalments of Rs. 20,000 each. The assessee made a claim of Rs. 1,00,000 on the ground that the assessee's liability to pay the said sum was crystallized in the year although the assessee had obtained the facility of paying the amount in five annual instalments. The Bombay High Court, referring to the decision of Supreme Court in Kedarnath Jute Mfg. Co. Ltd. (supra), has taken the view that a particular deduction should be allowed or not will depend on the provision of law relating thereto and not on the view which the assessee might take of its rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter. The Court, having regard to the system of accounting followed by the assessee, concluded that the entire sum of Rs. 1,00,000 was deductible in this year. Applying the principle laid down by the jurisdictional High Court we find that the assessee's case stands on much stronger footing inasmuch as the agreement provides for liability of Rs. 219.57 lakhs and the entry in the books of account is for a lesser figure. In Buckau Wolf's case (supra), the payment itself was deferred and yet the High Court has held that the accrual occurred in the year under consideration. In the case of assessee before us. the entire amount had been actually paid. In these circumstances, the case of the assessee for allowability of liability stands on a stronger footing. We would like to mention here that in the cases of CIT v. Shree Krishna Gyanoday Sugar Ltd. (supra) Industrial Machinery Manufacturers (P) Ltd. (supra), CIT v. O.E.N. India Ltd.(supra), State Bank of India v. CIT (supra) and CJT v. Mogul Line Ltd. (supra), the Hon'ble High Courts have laid down the principle that merely because the assessee has been following the mercantile system of accounting and merely because it did not provide for the expenditure in the accounts of that year, the claim of the assessee on the basis of bill could not have been denied. It was also mentioned that the way in which entries are made in the books of account is not determinative of the question whether assessee has earned any profit or suffered a loss. The assessee might be making entries which are not in conformity with the principles of accountancy. Therefore, the taxability could not be decided on the basis of entries which the assessee might choose to make in its account but had to be decided in accordance with the provision of law. What would determine the taxability is not whether the assessee has shown a particular item as profit or loss in the accounting year but whether the said item could be regarded either as profit or loss under the provisions of the Act. In view of the above decisions, it is clear that whether the deductibility of an amount in the mercantile system of accounting is dependent upon the entries being made or not being made in the books of account is not determinative. The Supreme Court in the case of Kedarnath Jute Mfg. Co. Ltd. (supra) has held that the method of accounting determines what income is brought to tax and what deductions are allowable in computing the income liable to tax. Such taxability and deductibility are not however defeated by making of entry or not making entry in the books of account. Thus, if the assessee omits to provide an income in the books of account and is following mercantile system of accounting, it is open to the AO to bring to tax such income despite the fact that no entry is made in the books of account. Similarly, this principle is applicable to the amount deductible irrespective of whether the entry is made in the books of account or not. Therefore, deductibility of an amount in the mercantile system of accounting is not a prisoner of entries being made or not being made. So the assessment of income and allowability of expenditure are dependent on the method of accounting followed by the assessee and not dependent on entries made in the books of account. In the present case, it is an admitted position that the method of accounting followed is mercantile system of accounting. The issue is whether the liability had accrued in pursuance of that method of accounting and whether the agreement dt. 30th March, 1993, gives rise to a liability of Rs. 2.11 crores or the liability of Rs. 70.83 lakhs. If we go through the agreement dt. 30th March, 1993, we will find that in the agreement the liability payable in the previous year ended on 31st March, 1996, is the sum of Rs. 2.11 crores and not Rs. 70.83 lakhs. It will be fruitful to mention here that the said sum is a contractual liability and not subject to variation by either the lessor or lessee and consequently it is not open to be varied either by the assessee or the AO. The learned Departmental Representative had argued that the ratio laid down by the Hon'ble Supreme Court in Kedarnath Jute Mfg. Co. Ltd. (supra) relates to a case of statutory liability but the present case relates to a contractual liability. Therefore, the ratio laid down in that case is not applicable to the facts of the present case. So far as this contention is concerned, the Hon'ble Bombay High Court while delivering the decision in Add). CIT v. Backau Wolf New India Engineering Works Ltd. (supra) has considered this aspect and has also referred to the decision oi the Hon'ble Supreme Court in the case of Kedarnath Jute Mfg. Co. Ltd. (supra) and it was observed by the Bombay High Court that it is true that in the decision in Kedatnath Jute Mfg. the Supreme Court was considering the statutory liability for payment of sales-tax but the observations to be found at page 367 would seem to apply to all types of liability and not only to tax liability. It has been observed by the Supreme Court that whether the assessee is entitled to a particular deduction or not will depend on provisions of law relating thereto and not on the view which the assessee might take of his rights nor can existence or absence of entries in books of account be decisive or conclusive in the matter. In view of this, we do not find any substance in the arguments of the learned Departmental Representative. 25. The learned Departmental Representative raised a valid point that the assessee had paid lease tax of Rs. 8,44,524. This tax is paid on the lease rent of . Rs. 70.83 lakhs and in the circumstances the accrued lease rent is only Rs. 79.28 lakhs and if the entire lease rent of Rs. 2.19 crores is allowed as a deduction without corresponding payment of lease tax under the Lease Tax Act, it would be violative of the Lease Tax Act and, therefore, it will not be allowable as deduction under Section 37 of the IT Act in view of the decision of the Supreme Court in the case of Muddi Venkataratnam (supra). In order to appreciate the above contention of the learned Departmental Representative, it will be useful to refer to s, 4 of the Maharashtra Sales-tax on the Transfer of the Right to use any Goods for any Purpose Act, 1985 (known as Lease Tax Act), which was quoted at para 16 (page 31) above. The relevant clauses of the Schedule to the said Act were also quoted above at para 16. On a perusal of the provision and the Schedule mentioned above of the Lease Tax Act, it will be clear that for our purpose entries at 3 and 8 of the Schedule are relevant. The notification issued by the Government of Maharashtra has specified the rate of tax as four paise in the rupee. Admittedly the lease tax paid by the assesses is Rs. 8,44,524. The lease rental claimed by the assessee was Rs. 2,11,13,040. If we calculate the percentage of lease rent, it will come to 4 per cent. Therefore, the assessee paid lease tax of Rs.

8.44,524 correctly on the amount of lease rental, which has accrued and paid, of Rs. 2,11,13,040. Therefore, the submission of the learned Departmental Representative that lease tax has been paid only on the sum of Rs. 70.83 lakhs is not correct. It seems that he has overlooked the fact that under Section 4 of the Lease Tax Act the maximum amount to be charged is mentioned as (not exceeding 15 paise) 15 per cent of the total turnover. It does not mean that 15 per cent should be charged. Secondly, the Schedule itself mentions the rate of tax on these two items at four paise per rupee, i.e. 4 per cent.

26. In view of the above discussion, we are of the opinion that the entire amount of Rs. 2,11,13,040 is allowable as a liability to the assessee. Therefore, the Revenue authorities were not justified in not allowing the balance of Rs. 1,40,29,364 in asst. yr. 1996-97. The same view shall apply to the other assessment years viz., 1994-95 and 1995-96. The AO is directed to allow the claim of the assessee accordingly.

27. Now we are left with the only remaining ground for asst. yr. 1996-97 where the CIT(A) has confirmed the disallowance of Rs. 50 lakhs treating the expenditure as capital in nature.

28. The assessee incurred an expenditure of Rs. 50 lakhs towards stamp duty and registration fee for increasing its authorised capital from Rs. 100 crores to Rs. 200 crores. As the expenditure was in connection with the increase in authorised share capital of the company, the assessee was requested to show cause why the claim should not be disallowed. The claim of the assessee was that the expenditure incurred is in the nature of revenue and in the alternative it was claimed that the amount is allowable under Section 35D of the IT Act. The assessee has made the foDowing submissions :

> "We have paid Rs. 50 lacs to Registrar of Companies.
>
> The above payment was made in connection with increasing the authorised capital from Rs. 100 Crores to Rs. 200 Crores of equity shares of Rs. 10 each. We further submit that above expenses of Rs. 50 lac ic fully allowable under Section 37(1) of the IT Act, 1961 as the expenditure is of revenue in nature and same has been laid out wholly and exclusively for the purpose of business or profession.
>
> The assesses-company further submits that Hon'ble Kerala High Court in the matter of Federal Bank Ltd. v. CIT (1989) 180 ITR 241 (Ker) has held that the expenses by way of filing fees on enhancement of authorised shares capital was only for the purpose of improving the existing business and cannot be said for the purpose of new business. The enhancement of the authorised capital was only to broaden the capital basis which would be conducive to the better conduct and efficiency and profitability of the business. Further, the expenses incurred by way of filing fees is of revenue expenditure under Section 37(1) of the IT Act, 1961.) In view of the above, our claim of Rs. 50 lacs being payment made towards filing fees to the Registrar of companies may please be allowed while computing the total income for the assessment year under reference. We enclose herewith a copy of Board of Resolution passed at Annual

> General meeting held in January, 1995 authorised the assessee company to increase its authorised capital from Rs. 100 to Rs. 200 Crores. We also enclose herewith a copy of receipt towards payment of Registrar of Companies. We further submit but without prejudice to our above contention and purely in the alternative, our claim of Rs. 50 lacs may be entertained under Section 35D of the IT Act, 1961. In this regard, we submit that the expenses have-been incurred after the commencement of business in connection with the extension of industrial undertaking.
>
> Hon'ble Rajasthan High Court in the matter of CIT v. Multimetals Ltd. (1991) 188 ITR 151 (Raj) has held that even if the provision of Sub-clause 2(c)(iii) of Section 35D of the IT Act, 1961 is not applicable, the language of Sub-section 2(c)(iv) of Section 35D is wide in nature and would include the deducibility of fees paid by the assessee company to the Registrar of Companies for enhancing the capital is allowable under s, 35D of the IT Act, 1961.
>
> Hence in view of the above and purely in the alternative to our contention your honour may please allow Rs. 5 lacs being l/10th of the amount while computing the total income of the assessee-company."

However, the AO and the CIT(A) disallowed the claim of the assessee on the ground that the expenditure in question is not allowable in view of the decisions of the Supreme Court in the case of Punjab State Industrial Development Corporation Ltd. v. CIT (1997) 225 ITR 792 (SC) and Brooke Bond (India) Ltd. v. CIT (1997) 225 ITR 798 (SC). The learned counsel for the assessee submitted that the expenditure does not result in the creation of any capital asset and, therefore, it is allowable as a revenue expenditure. It is further submitted that as regards the claim under Section 35 of the IT Act, the assessee has claimed in the alternative that if the amount is not allowable under Section 37, it should be allowed under Section 35D. Since the expenditure in question falls within the purview of Section 35D(2)(cj(iii) and (iv), the expenditure is allowable under Section 35D in 10 instalments as prescribed in Section 35D(1) provided it does not exceed an amount calculated at 2-1/2 per cent of the cost of the project or the capital employed at the option of the assessee.

29. The learned Departmental Representative relied on the orders of the Revenue authorities.

30. We have considered the rival submissions and have gone through the material available on record. The Hon'ble Supreme Court in the above noted two cases has clearly held that whether the fees is paid to the Registrar of Companies for expansion of the capital base of the company or in connection with the issue of shares with a view to increase its share capital, it is directly related to the expansion of the capital base of the company and is a capital expenditure even though it may incidentally help in the business of the company in the profits making. In the present case, the assessee is not entitled to deduction under Sub-section (1) of Section 35D as held above. If the assessee is not entitled to any deduction under Sub-section (1), there is no question of operation of Sub-section (2) of Section 35D. Sub-clause (iii) of Clause (c) of Sub-section (2) applies where the assessee-company has incurred an expenditure by way of fees for registering the company and Sub-clause (iv) applies in connection with public issue of shares and debentures. The emphasis is on

the public issue of shares and debentures. In the present case, there is no connection of the expenditure with the public issue. Therefore, this expenditure is not allowable. The CIT(A) has rightly rejected the contention of the assessee. The order of the CIT(A) on this issue is confirmed.

31. In the result, the appeals for asst. yrs. 1994-95 and 1995-96 are allowed, whereas the appeal for asst. yr. 1996-97 is partly allowed. S.C. TIWARI, A.M. :

32. During the course of hearing of these appeals, considerable arguments took place on fundamental issues such as mercantile principles of accounting and entries in the books of accounts vis-a-vis claims/deductions admissible in law. It, therefore, appears to be worthwhile to analyse the relevant provisions and the scheme of IT Act in this behalf. The basis of charge of income-tax is laid down by the provisions of Section 4 of IT Act, 1961, to be the total income of the previous year of every person. Section 5 of the Act enumerates scope of total income and Section 2(45) lays down that total income is income computed in the manner laid down in the IT Act. Section 2(31) defines "person" and Section 3 defines "Previous year". Section 4 makes it clear that income-tax is an annual levy and "previous year" is the period of assessment. It is the periodicity of the levy of income-tax with which we are mainly concerned in these appeals. In the case of an on-going business, the profit or loss made by the businessman from that business, as partly described in the case of Sunil Siddharthbhai v. CIT (1985) 156 ITR 509 (SC) remains in the "womb of future". The measurement of periodic income is, to that extent, a matter of estimation and it is for the accuracy and reasonableness of such an estimation that principles of accounting inevitably come into picture. There should have perhaps no difficulty if there was one and only one correct principle or method of accounting or, in the alternative, if by force of law any single method of accounting had been adopted for the purpose of computation of total income. We are concerned in these appeals with asst. yrs. 1994-95 to 1996-97. For these assessment years, provisions of Section 145(1) conferred a choice upon the taxpayers in the following words :

> "145. Method of accounting.--(1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with the method of accounting regularly employed by the assesses :
>
> Provided that in any case where the accounts are correct and complete to the satisfaction of the AO but the method employed is such that, in the opinion of the AO, the income cannot properly be deduced therefrom, then the computation shall be made upon such basis and in such matter as the AO may determine :"

The provisions of Section 145(1), as abovequoted, are practically the same as laid down in Section 13 of 1922 Act. There has been a significant departure to which we would adduce later on in this order to be effective from asst. yr. 1997-98 only. Section 145 until then mandates for computation of income chargeable under the heads "Profits and gains of business or profession" and "Income from other sources" to be in accordance with the method of accounting regularly employed by the assessee. The only exception of this general principle is the cases where the method employed is such that the income cannot properly be deduced therefrom or as laid down in Section 145(2) where the AO is not satisfied about correctness or completeness of the accounts of the assessee. There are any number of Court pronouncements where it has been held that provisions of Section 145 are mandatory and the proper method of accounting regularly followed by an assessee is binding on the assessee as well as assessing authorities. Further, the method referred to in Section 13/145 is one as followed by the assessee while maintaining his books of accounts and not a separate method which the assessee might choose for filing his return of income. As early as in the case of CIT v. Sarangpm Cotton Manufacturing Co. Ltd. (1938) 6 JTR 36 (PC), the Judicial Committee of the Privy Council observed as under :

> "Their Lordships are clearly of opinion that the section relates to a method of accounting regularly employed by the assessee for his own purposes--in this case for the purposes of the company's business and does not relate to a method of making up the statutory return for assessment of income-tax. Secondly, the section clearly makes such a method of accounting a compulsory basis of computation unless in the opinion of the ITO, the income, profits and gains cannot properly be deduced therefrom."

Thus, the Hon'ble Judicial Committee decided way back in 1932 that an assessee cannot ask for two different methods, one for writing books of accounts for the purposes of his business and another for having his tax liability determined under the IT Act. Along the same lines, decisions were given by Allahabad High Court in the case of CIT v. Smt. Singanbai (1945) 13 ITR 224 (All) and Madras High Court in the case of Bangalore Woollen and Silk Mills Co. Ltd. v. CIT (1950) 18 ITR 423 (Mad) that an assessee cannot ask for different system of accounting for the purpose of his income-tax assessment.

33. In Keshav Mills Ltd. v. CIT (1953) 23 ITR 230 (SC), the Hon'ble Supreme Court held that the provisions of Section 13 of 1922 Act (corresponding to Section 145 of 1961 Act) was compulsory on the IT authorities and imposed upon them an obligation to accept the method of accounting regularly adopted by the assessee except in cases when the proviso to that section come into operation. The profits earned and credited in the books of account were to be taken as the basis for computation of income (p. 240)- In CIT v. A. Krishnaswami Mudaliar (1964) 53 ITR 122 (SC), the Supreme Court reiterated that the ITO is bound to compute the profits by appropriate adjustments from the accounts maintained by an assessee where a system of account is regularly employed :

> "The only departure made by Section 13 of the Indian IT Act from the legislation in England is that whereas under the English legislation, the Commissioner is not obliged to determine the profits of a business venture, according to the method of accounting adopted by the assessee, under the Indian IT Act, prima facie, the ITO has for the purpose of Sections 10 and 12 to compute the income, profits and gains in accordance with the method of accounting regularly employed by the assessee. If, therefore, there is a system of accounting regularly employed and by appropriate adjustments from the accounts maintained taxable profit may properly be deduced, the ITO is bound to compute the profits in accordance with the method of accounting. But where in the opinion of the ITO, the profits cannot properly be deduced from the system of accounting adopted by the assessee it is open to him to

adopt a more suitable basis for computation of the true profits."

34. In the case of CIT v. Tata Iron & Steel Co. Ltd. (1977) 106 ITR 363 (Bom), the Hon'ble Bombay High Court pointed out that the method of accounting followed by the assessee has to be stressed and adopted for computation of total income if such method cannot be said to be unreasonable, even if a better method could be visualised. In the case of Md. Umer v. CPT (1975) 101 ITR 525 (Pat), the Hon'ble Patna High Court have categorically stated at page 530 (of 101 ITR), "once, therefore, the method of accounting employed by the assessee has been regularly employed and income, profits and gains can properly be deduced from such regularly employed method of accounting, that is the end of the matter for the purpose of proviso to Sub-section (1) of Section 145". In a recent case. CIT v. Smt. Vimla D. Sonwane (1995) 212 ITR 489 (Bom), the Hon'ble Bombay High Court have held that the option regarding adoption of the method of accounting is with the assessee and not with the Department and the assessee cannot be compelled to adopt any particular system of accounting.

35. From the various judgments enumerated in the foregoing paragraphs, which constitute only a fraction of the plethora of judgments to the similar effect from Hon'ble High Courts in India and the Hon'ble Supreme Court, it is well-settled legal position upto asst. yr. 1996-97 that the method of accounting followed by the assessee in writing his books of accounts has to be compulsorily taken as the basis of computation of income in the' assessment proceedings. Such method was equally binding on the assessee inasmuch as he could not follow one method or system of accounting for writing his books of accounts and yet another method or system of accounting for the return of income filed by him. The provisions of Section 13 of 1922 Act and Section 145 of 1961 Act and various judgments of the Courts in India give clear legal recognition to the fact that unlike laws of physics, there could be more than one correct answer in the fields of accounting. Even the accounting practices under the overall umbrella of the mercantile system to admit of considerable amount of diversity. In such a situation the question of choice arises and that choice is exercised by an assessee while writing his books of accounts. In other words, it is not the legal position that on identical facts, the same amount of income could be assessable in the cases of all the assessees. The provisions of Section 145(1) and the choice conferred upon the assesses would make no sense at all otherwise.

36. As pointed out earlier, income-tax is an annual levy. For the purpose of income-tax, each year is a separate self-contained period of time. As early as in the case of CIT v. PLSM Concern Minhla (1934) 2 ITR 417 (Rang), Hon'ble Rangoon High Court emphasised this fact and observed thus :

> "(d) what are chargeable to income-tax in respect of a business are the profits and gains of the year and in assessing the amount of the profits and gains of a year account must necessarily be taken of all losses incurred in that year. When setting out to ascertain the profits and gains of one year, loss which had in fact been incurred before the commencement of that year cannot be deduced, since by doing so one would not arrive at the true profits and gains of the year. For the purpose of computing yearly profits and gains each year is a separate self-contained period of time, in regard to which profits earned or losses sustained before its commencement

are irrelevant."

Hon'ble Supreme Court also held in the case of Kikabhai Premchand v. CIT (1953) 24 ITR 506 (SC) that the profits earned and the losses suffered that are taken into consideration are of the tax year only and that in an assessment Revenue is concerned with profits or gains in each previous year and not with any potential profits likely to be made in another year or with losses likely to occur in the future. Different considerations may, depending on the facts and circumstances of each case, weigh to determine profits or gains or losses of the year but the position remains that an expenditure which arose in an earlier year or which may arise in a subsequent year cannot be allowed as deduction where the system of accounting is the mercantile system. The relevant year in which deduction becomes allowable need not necessarily be the year in which payment is made, as held by Hon'ble Supreme Court in the case of CIT v. Associated Electucal Industries India (P) Ltd. (1986) 157 ITR 72 (SC). As the mercantile system of accounting is concerned with the year of "accrual" and not with the year of "payment", difficulties or disputes do arise from time to time as to when a right or liability has ripened and become enforceable. This issue is not always free from difficulty and for resolution of the same Courts have time and again relied upon the authority of time-honoured books of accountancy or Accounting Standards issued by Institute of Chartered Accountants of India. During the course of hearing before us, the learned counsel of the assessee pointed out to the difference between Accounting Standard-1 issued by ICAI and Accounting Standard-1 issued by CBDT and argued that CBDT does not recognise matching principle. In my humble opinion, any such difference between the Accounting Standards of ICAI and those of CBDT is not of much relevance upto asst. yr. 1996-97 because it is only with effect from asst. yr. 1997-98 that the new provisions of Section 145(2) substituted by the Finance Act, 1995, have come into operation which alone have empowered the Central Government to notify Accounting Standards to be followed by any class of assessees or in respect of any class of income. Until then, as pointed out, the method of accounting followed by the assessee in the books of accounts maintained by him has to be given effect to if the method of accounting is such that the income can properly be deduced therefrom.

37. During the course of hearing before us, it has been emphasised at considerable length that actual income is to be determined from the method of accounting and not from the entries made or not made in the books of account. It was pointed out that accrual of the legal liability cannot be thwarted or postponed merely by entries made in the books of account. It is the method of accounting that determines what income is brought to tax and what deductions are allowable in computing the income liable to tax. A number of Court pronouncements have been cited including the celebrated judgment of Hon'ble Supreme Court in the case of Kedarnath Jute Manufacturing Co. Ltd. (supra) that whether an assessee is entitled to a particular deduction or not will depend upon the provision of law relating thereto and not on the view which an assessee might take of his rights nor can the existence or absence of entries in the books of accounts be decisive or conclusive in the matter. There cannot be any dispute about correctness of this proposition. Any entries made in the books of account of an assessee which are erroneous or not in accordance with the method of accounting followed by the assessee have to be substituted or adjusted properly. However, as pointed out earlier, in the field of accounts, unlike in the field of physics, there can be more than one correct answer-Hence, in a case where the view taken by the assessee and entries made in the books of accounts are correct and acceptable in accordance with the method of accounting employed and well

established principles of accountancy, it would not be open to an assessee to seek a different basis of assessment in its returns of income in ensuing assessment proceedings on the ground that another view is also equally possible. To this extent, entries made in the books of accounts assume considerable significance and get priority. An illustration to this proposition may be found in the judgment of Hon'ble Bombay High Court in the case of CIT v. Citibank N.A. (1994) 208 ITR 930 (Bom). In that case, all loan accounts in respect of interest payments which were not forthcoming (in other words, sticky loans) were placed on a non-accrual basis in the books of account of the assessee and the interest thereon was not debited in the books to such accounts or credited to the P&L a/c. The assessee, however, maintained a memorandum record of interest due of such accounts. If any interest recorded in the memorandum record was subsequently received by the assessee, it was taken into account as interest received. In contrast, in the case of State Bank of Travancore v. CIT (1986) 158 ITR 102 (SC), the assessee charged interest even in the cases of sticky loans by debiting the concerned parties, yet it credited the said amounts to a separate account styled as the "Interest suspense account". Hon'ble Bombay High Court in the case of Citibank N.A. (supra) noted that the treatment given in the books of accounts made the difference and observed in the following words :

> "The above decision of the High Court was upheld by the Supreme Court in State Bank of Travancore v. CIT (1986) 158 ITR 102 (SC). It was observed by Sabyasachi Mukharji J. (at p. 136) : that the assessee indubitably maintained its accounts on the mercantile basis and had regularly adopted it. The assessee claimed that the three sums represented interest on what is called 'sticky' loans in its books of account but having regard to the deteriorating financial position of the concerned debtors and the history of these accounts, the assessee was of the view that in the relevant years, the advances had become so 'sticky' that even the recovery of the principal amounts had become highly improbable and extremely doubtful. Therefore, though the assessee charged such interest by debiting the concerned parties [Emphasis, italicised is print supplied by the Supreme Court], yet it credited the said amounts to a separate account styled as the "Interest suspense account". This the assessee claimed on the theory that it was to avoid showing unreal or inflated profits. The assessee claimed that it was not taxable as real income had not accrued to it. The Supreme Court, in the above case, was, therefore, required to examine whether an assessee, who had himself shown certain income in his accounts on the mercantile basis as income, can claim the same to be excluded from his income for the purpose of taxation by resorting to the real income theory. The Supreme Court was required to answer how far the concept of real income could defeat accrual of income in any particular case according to the well recognised theory of accounting principles which are accepted by the legal standards so far followed. It is evident from the above that before the Supreme Court, it was not the case of the assessee that the income had not accrued to it. The assessee itself had maintained its accounts in respect of the so-called 'sticky' loans on the mercantile basis and debited the accounts of the parties with the amount of interest which formed part of its income. The assessee, however, wanted to keep the said amount separately in an "Interest suspense account" to avoid taxation in the relevant assessment year by resorting to the real income theory, which was not

approved by the Supreme Court.

The position is just the reverse in the case before us. Here the undisputed position is that the accounts of the parties were not debited with the amount of interest nor was any interest credited to a separate account. What the assessee did was that it kept a memorandum record of the accounts of those parties in respect of which the mercantile system of accounting was not followed by it but a different system was followed. As stated earlier, it is the undisputed position that this system had been regularly followed by the assessee and had in fact been accepted by the Revenue as a proper method of accounting for deducting the profits of the year under consideration. Under these circumstances, in our opinion, the ratio of the abovereferred judgment of the Supreme Court does not apply to the facts of the present case." From these two judgments in the case of State Bank of Travancore (supra) and in the case of Citibank N.A. (supra), the position is reinforced that in most situations method of accounting and entries made in the books of account thereunder may be decisive of income chargeable to tax. On facts, there was not much difference--both cases related to interest chargeable on sticky loans--but the entries in the books of account were significantly different which made all the difference in assessment of income. It is also established from the judgment of the Hon'ble Supreme Court in the case of State Bank of Travancore (supra) that ordinarily, an assessee cannot be permitted to follow one yardstick for writing his books of accounts and yet another yardstick for the return of income or assessment. This position has remained unaffected even in the judgment of Hon'ble Supreme Court in the case of United Commercial Bank v. CIT (1999) 240 ITR 355 (SC). The Hon'ble apex Court reversed the decision of the High Court on the ground that valuing stock-in-trade investments "at cost" in the form of the balance sheet prescribed under the Banking Regulation Act did not disentitle the assesses in submitting income-tax return on the real taxable income when such practice was regularly followed by the assessee in past and that practice was accepted by the Department and there was no justifiable reason in not accepting the same subsequently.

38. To sum up, the general rule in law appears to be that an assessee must state in his return of income what he himself states in his books of accounts. It is not as if the assessee is altogether debarred from setting up a claim in the assessment proceedings at variance from entries made in the books of account but in order to make such an exception there must exist compelling reasons and justification, such as entries made in the books of account are erroneous or are not in accordance with the system of accounting followed or are otherwise not reflective of true nature of the transactions. On the facts of appeal before us being viewed against this legal backdrop, it appears that the decision in this appeal hinges on whether the two agreements dt. 30th March, 1993, and 5th April, 1993, between the assessee and RCFTL should be consolidated and read as only two parts of a single deal or these two agreements should be considered to be separate and independent from each other. If these agreements should be combined into one, the Revenue must succeed because in that event the case of Revenue is supported not only by the published accounts of the assessee himself

but also Accounting Standard issued by ICAI. However, if these two agreements are required to be treated as separate and distinct from each other, the assessee should succeed. As the learned counsel for the assessee has stressed, under the first agreement the assessee incurred the liability to pay a sum of Rs. 2,11,13,040 per annum for the period of five years and there was nothing to suggest that any part of these payments entitled the assessee to any benefit or advantage on expiry of the period of five years envisaged in the first agreement. Various arguments raised for and against these propositions during the course of hearing before us have been dealt with at considerable length in the order of the Hon'ble Vice President. The Revenue appears to have integrated these two agreements into one for the reason that parties to the agreement and the subject-matter of agreement remained the same and the time gap between these two agreements according to the authorities below was very small. In the assessment order the AO mainly stressed the treatment given by the assessee himself in his published accounts. The assessee raised before him the issue of the useful life of the assets but the learned AO held that if the useful life of the assets was only five years, the assessee could not have taken the assets on lease for a period of 15 years. In any event, the contractual period of lease amounted to 15 years and, therefore, total amount of lease rent had to be equally written off over the period of 15 years. The learned CIT(A) has emphasised that the assessee did not offer any explanation as to why the supplemental agreement was signed within a week of signing of the original agreement. The distinction between 'primary period' and 'secondary period' was only an artificial device for enlarging the period of 15 years and the original lease agreement and the supplemental lease agreement are, in spirit, only one agreement. The learned counsel for the assessee stressed during the course of hearing before us that the material changes brought about by the supplemental agreement were not restricted to extending the period of lease alone. There were several other changes. On consideration of the matter it appears that the authorities below have not been able to establish that these two lease agreements were merely an artificial device to bifurcate the lease period between primary period and secondary period with a view only to charge the major chunk of consideration payable by the assessee in the first five years itself. The Revenue has not even attempted to demonstrate that the lease rent payable by the assessee during the primary period was inflated or excessive or unreasonable having regard to the fair market value of the leased assets or the benefit derived by or accruing to the assessee therefrom. It appears that the only basis on which the lease rent for first five years has been found to be artificial is that the amount of lease rent agreed upon in the supplemental agreement is relatively much smaller amount. There is otherwise nothing to suggest that the lease rent payable from the assessee during the period of first five years was not fair and reasonable. In these circumstances there does not appear to be any justification to coalesce these two agreements into one. As the matter stands, the assessee has claimed deduction of the contractual liability which not only accrued during the relevant previous years but was actually paid by the assessee to the lessor. In these circumstances, merely because in the books of account the assessee wrote off on average basis over a period of 15 years the deduction of lease rent as claimed by the assessee on the strength of accrual of contractual liability as per the agreement cannot be defeated. In this view of the matter, I endorse the decision taken in this respect in the order of the Hon'ble Vice President.

39. In respect of the other ground of appeal for asst. yr. 1996-97. I fully endorse the order of the Hon'ble Vice-President.