Advance sum received by service provider deemed as income only when services are rendered by it

Summary – The Hyderabad ITAT in a recent case of R and A Corporate Consultants India (P.) Ltd., (the Assessee) held that where an assessee receives sum for some services but said services are not to be performed in current year but in subsequent year, till performance of service by assessee, assessee cannot be said to have received amount on accrual as assessee cannot exercise its dominion over receipt and, thus, said receipt should be taxed in year in which assessee would render service to payee.

Facts

- The assessee entered into a consultancy contract with Country Club, for raising of funds for the latter. The fee was payable for two different sets of services : one for raising of funds, and other as retainer fee for services to be rendered over a period of 3 years beginning from 1-4-2008. Since the retainer fee was payable in advance soon after the receipt of funds, the assessee raised an advance bill exclusive of service and the assessee prorated the retainer fee over the subsequent 3 relevant years respectively and, accordingly, credited its profit & loss account as well as offered the same as part of taxable income in its returns of income for each of the years.
- Country Club issued a TDS certificate on a gross fee towards fee for raising of funds and advance retainer fee.
- The Assessing Officer observed that the Country Club despite stating that the assessee had been appointed as a consultant for the next 3 financial years, nowhere mentioned that the income would be spread over a period of three financial years. Accordingly, the Assessing Officer treated the difference in gross receipts as income of the assessee for the relevant assessment year.
- The Commissioner (Appeals) held that in the absence of any specific stipulation regarding the nature of receipt, and in view of the fact that the receipt in the hands of the assessee had finally accrued, the only logical conclusion possible to arrive at would be that the entire amount was to be considered as the assessee's income in the year of receipt itself.
- On further appeal:

Held

- Section 4 deals with charge of income-tax. As per sub-section (2) of section 4, in respect of income chargeable under sub-section (1), income tax is to be deducted in advance. Income tax is to be charged at the rate or rates fixed for the year by the annual Finance Act. Under this section, the subject of charge is the income of the previous year. Thus, it is evident that mere receipt of amount is not taxable unless the same or the part embedded in that receipt partakes of the character of income. Section 5 determines the scope of total income depending upon residential status of the assessee. It prescribes the gamut of total income of an assessee. As per this section, profits are chargeable when it accrues, arise or are received.

- Merely because an amount has been entered into in assessee's book, it is not conclusive proof that income has accrued. Section 145 deals with method of accounting and is a procedural section. This section cannot be resorted to for taxing a particular receipt unless the receipts come within section 4 read with section 5 partakes of character of income. The assessee has to exercise his choice regarding method of accounting to be followed for recording the income. If the assessee has adopted the mercantile system of accounting, then the taxability event of income will arise the moment it accrues irrespective of receipt. However, when accounts are maintained on cash basis, income would be chargeable the moment it is received irrespective of the fact whether the source or from whom it was received exist or not. But it is ultimately the income which is taxable and not the whole amount irrespective of the method of accounting, whichever is followed. If an assessee may be required to refund the amount then it cannot be treated as assessee's income in that particular year. Unless the assessee can exercise his entire rights over a particular receipt, it cannot be said that income has accrued in his favour. No other person should have any charge over that receipt. The dominion over the amount should be of assessee.
- The Assessing Officer without appreciating that the amount is an advance receipt which would be assessable as income only in the subsequent years, when the services are rendered by the assessee, made the addition to the returned income on the short ground that the letter dated 23-10-2007 did not specify the deferral of income and, thus, he included the entire gross receipts in the current assessment year. The sole ground for the officer to take a divergent view was that the contract with Country Club did not specify the accounting treatment. According to the assessee, the Assessing Officer completely erred in this regard because the accounting treatment and the income-tax liability of a person depends on the nature of his business and objects. For instance, for a real estate company, the sale of flat is a trading transaction while for flat-buyer it could be a capital expenditure. Therefore, it is incorrect to assume that the contracts should also specify the accounting treatment by either party to the contract.
- No part of the retainer income can accrue in the present assessment year as the assessee is yet to render the services in this behalf. The amount is received with a view to incur expenditure in the future. Since the amount is in respect of a future liability in the form of incurring costs for rendering the professional services, the amount could not partake of character of income until it was earned and could be said to be earned only when the assessee would render professional service which is on a future date. The receipt came coupled with a liability for rendering services in the future. This fact, that the assessee is under an obligation to render services in the future has not been disputed by the Assessing Officer.
- Considering the fact that the amount of advance is received towards future services for which costs are required to be incurred in the future, and following the matching principle so well laid out under Accounting Convention, the assessee has postponed the recognition of the income into the three subsequent years, namely, 2008-09, 2009-10 and 2010-11.

- Thus, receipt in advance amount come within the provisions of section 4 or 5. Every receipt cannot be treated as income in the hands of the assessee, but, it is only when it bears the character of assessee's income at the time when it reaches the hands of the assessee that it becomes exigible to tax. In the present case, though the assessee received the fee in advance for which no service was rendered in the assessment under consideration and it cannot be held as taxable in the hands of the assessee in the year of receipt even though such income was reflected in the books of the assessee, as not only actual receipt to be seen but constructive receipt to be seen to tax the income in the assessment under consideration. Being, admittedly when services are not performed in relevant assessment year, till the performance of the service by the assessee, the assessee could not be said to have received the amount on accrual as the assessee could not exercise its dominion over the receipt and, thus, the impugned amounts should be taxed in the year in which the assessee would renders service to the payee. Being so, issue of tax of such impugned amount cannot be done in the assessment year under consideration.