

Penal charges on EMI default is taxable on receipt basis

Summary – The High Court of Madras in a recent case of Shriram Investments Ltd., (the Assessee) held that where in terms of agreements, which enabled assessee company to demand additional finance charges was only an enabling provision and recovery of same was not certain, same was taxable on cash receipts basis and not on accrual basis

Facts

- The assessee firm was engaged in the business of hire purchase financing, leasing and investments. The assessee was accounting Additional Financial Charges (AFC) on accrual basis in books of account maintained for purposes of the Companies Act, whereas, for purpose of the Income Tax, it was accounted on cash basis.
- The Assessing Officer was of the view that the assessee was following mercantile system of accounting and therefore, it was bound to show income arose out of AFC on accrual basis and therefore, additions on account of AFC was made in respect of each year. The Assessing Officer held that the AFC was an income accrued consequent on the failure on the part of the person concerned to pay the Equated Monthly Instalments (EMI). Since assessee had shown AFC in profit and loss account maintained for purpose of Companies Act, said amount should be reflected for the purpose of income tax as well.
- On appeal, the Commissioner(Appeals) deleted said addition on the ground that the assessee was entitled to show the income arising out of AFC as and when said income was received. On appeal, the Tribunal held that the amendment to section 145 did not have any effect on the issue under consideration, therefore, the Tribunal came to the holding that the AFC was an income arose only at the time of actual receipt.
- On appeal:

Held

- It is to be noted that in the instant case, the revenue is not in a position to show that due to the change of accounting method, the revenue suffered loss. Admittedly, there is no finding to that effect in the assessment order. The change in method of accounting has not caused any loss to the revenue, because AFC on receipt by the assessee-company has been offered to tax. Accordingly, the change of method of accounting of overdue charges from the mercantile basis to cash system insofar as AFC does not create any income, but the method of accounting only recognizes income.
- The terms of the agreements, which enable the assessee to demand overdue charges (AFC) is only an enabling provision and the recovery of overdue charges is not certain and is taxable on cash receipt basis and not accrual basis.
- Tribunal was right in upholding the order of the Commissioner (Appeals) deleting the additions made towards Additional Finance Charges, also known as Overdue charges.
- In the result, the issue is answered in favour of the assessee and against the revenue.