

Advance received by lawyers on legal matters can't be treated as income till completion of case

Summary – The High Court of Delhi in a recent case of Om Prakash Khaitan., (the Assessee) held that In case of legal fees, only when legal matter is over and assessee advocate decides on quantum of fees, it becomes income in hands of advocate and entire advance amount that includes pocket payments would not bear any particular characterization for purpose of treating it as income

Facts

- The petitioner-assessee was proprietor of firm of Solicitors and Advocates. The assessee followed the cash system of accounting since inception and that had been consistently accepted by the department. The assessee received advances from its clients for various legal matters for meeting out of pocket payment towards expenses in travelling, preparation cases, engaging lawyers etc. Such advances/receipts were kept in a separate ledger account in the name of client where all the expenses are debited from time to time. At the end of the year, credit balances in the account, where the matters were complicated or settled, were transferred to the profit & loss account. Where the cases were pending, the credit balances were carried forward to the next year as sundry creditors.
- The Assessing Officer made an addition of Rs. 10.78 crores representing balances outstanding out of the total credit balances of Rs. 20.79 crores. Hence, the Assessing Officer held that since the assessee adopted the cash system of accounting, the taxing of the income could not be deferred to the subsequent year. Income had to be taxed in the year in which it was received. Since the above amount had not been returned or shown as professional fees, it had to be taxed during the current assessment year.
- On appeal, the Commissioner (Appeals) as regard to disallowance under section 14A, read with rule 8D, the Commissioner (Appeals) restricted it to Rs. 94,721 on the ground that no direct or indirect expenses were incurred for earning the exempt income.
- On second appeal, the Tribunal noticed that the addition for the assessment year under consideration was similar to the ones made by the Assessing Officer for assessment years 2001-02 and 2003-04 and which had been deleted by the Commissioner (Appeals) and concurred with by the Tribunal. Nothing had been brought on record to persuade the Tribunal to differ from the view taken by the Tribunal in the assessee's case for that year. The view taken earlier under similar circumstances must be followed.
- On appeal before the High Court:

Held

- The only ground urged before the Court is that the monies were kept invested by the assessee in the mutual funds in the name of the assessee and, therefore, had to be treated as income in his hands. However, as noted by the Tribunal these facts were not new to the assessment year in question. The

issue was whether the assessee consistently following a certain system of accounting which had been accepted by the department. There is no change of system of accounting followed by the assessee. Allowing the department to adopt a different stance in the assessment year in question would create an anomalous situation as far as the assessee is concerned. The issue of lawyers accepting monies from clients on account to defray the expenses and appropriating fees as income only upon completion of a case has been examined in the past and a consistent view has been taken by the Tribunal. This has been adverted to in the impugned order of the Tribunal. The principles on the basis of which those decisions were taken are unexceptionable. Given the manner and functioning of the lawyers and law firms, it is correct that the categorisation of a receipt can take place only at the time of appropriation, *i.e.*, in case of fees only when the matter is over or as when the assessee decided on the quantum of fees. This will not be the entire advance received as at the time it is received it does not bear any particular characterisation for the purposes of treating it as income.