

EMI method can be used for taxability of hire purchase transaction even if sum of digit method used for accounting

Summary – The High Court of Madras in a recent case of Sundaram Finance Ltd., (the Assessee) held that In case of hire purchase transactions, assessee was justified in adopting EMI method for taxability of interest income in its return even though assessee had adopted SOD method in its books of account on basis of guidelines issued by ICAI

Facts

- In the course of appellate proceedings, the Tribunal held that the interest income on hire purchase transactions accrued only under the Internal Rate Return (IRR) method and formed part of the mercantile system of accounting.
- It was further contended that the Internal Rate Return (IRR) method was the appropriate method of income recognition in hire purchase transaction as against the Equated Sum Method (ESM) regularly followed by the assessee.
- On appeal:

Held

- It is well settled that where there is no indication in the Hire Purchase Agreements reflecting the bifurcation of the EMIs into principal and interest components, the common and accepted usage of the Indexing system of accounting in the Hire Purchase trade must be held to be valid as otherwise the rate of interest under the mercantile system insofar as the later EMIs are concerned would be far higher and contrary to the rate prescribed in the assessee's agreements.
- Admittedly, the assessee has been following the same method of E.M.I for bifurcation of its income into Principal and interest component for all these years in question. The S.O.D method gives higher finance charges (interest) for the initial years and lower finance charges (interest) for the later years, *i.e.*, the Sum of Digits is sum total of the number of years *e.g.* If the Hire Purchase Agreement is for 10 years, the SOD is 55 (1+2+3+4+5+6+7+8+9+10 = 55). Therefore, total financial charges for the first year would be 10/55, for the second year 9/55, for third year 8/55 and so forth which would clearly give higher financial charges for interest taxable in the first year. This SOD method even though adopted by the assessee in its Book of Account on the basis of Guidelines issued by the Institute of Chartered Accountants of India was not adopted in the Returns of Income filed by it which consistently adopted EMI method for taxability of interest income all these years. Since, for the previous assessment years, the Court has already approved such bifurcation of income and has held that interest income (Finance charges) on consistently adopted basis of E.M.I. would be taxable in

the hands of the assessee, the mere change of Accounting method in its Book of Account on the basis of S.O.D. does not alter the position in the tax in the hands of the assessee.

- On the other hand, since in the case of *CIT v. Ashok Leyland Ltd.* [\[2012\] 23 taxmann.com 50/\[2013\] 213 Taxman 204 \(Mad.\)](#) the Co-ordinate Bench of this Court has upheld the taxability with regard to interest income on EMI method, which has been consistently followed, there is no reason to take a different view in the matter for the present assessment years, in instant case.
- Accordingly, the instant appeal of assessee is allowed.