* **THE HIGH COURT OF DELHI AT NEW DELHI**

% Judgment reserved on : 25.01.2011
Judgment delivered on: 07.02.2011

\+ **ITA No.67/1999**

CYBER MEDIA (INDIA) LTD. ..... APPELLANT

Vs

COMMISSIONER OF INCOME TAX-1& ANR. ..... RESPONDENTS

**Advocates who appeared in this case:**

For the Appellant : Mr. Rajan Bhatia, Advocate
For the Respondents : Mr. Sanjeev Sabharwal, Advocate

**CORAM :-**
**HON'BLE MR. JUSTICE SANJAY KISHAN KAUL**
**HON'BLE MR JUSTICE RAJIV SHAKDHER**

1. Whether the Reporters of local papers may be allowed to see the judgment ? yes
2. To be referred to Reporters or not ? yes
3. Whether the judgment should be reported in the Digest ? yes

**RAJIV SHAKDHER, J**

1. This is an appeal preferred under Section 260A of the Income Tax Act, 1961 (hereinafter, referred to as the 'I.T. Act') against the judgment of the Income Tax Appellate Tribunal, Delhi Bench, New Delhi (hereinafter referred to as the 'Tribunal') dated 11.05.1999 passed in I.T.A. No.207/D/92, pertaining to the assessment year 1989-1990.

2. The assessee, who is appellant before us, is aggrieved by the impugned judgment in as much as the authorities below have disallowed the deduction claimed by the assessee in a sum of Rs.5,85,428/- towards advertisement income accrued but not received in cash. The assessee sought deduction of the aforementioned income predicated on the fact that the method of accounting regularly followed by it, for income tax purposes, was "cash" basis.

3. In the instant appeal, by order dated 06.12.2000, this court while admitting the same, framed the following question of law for adjudication :-

> "Whether the Tribunal was justified in disallowing the claim of assessee of Rs.5,85,428/- being advertisement income accrued but not received, on the background of absence of corresponding amendment in the Income Tax Act vis-à-vis Section 209 of the Companies Act, 1956?"

4. In order to appreciate the issue at hand, it may be relevant to detail out the relevant facts in that regard :-

4.1 The assessee is mainly in the business of publishing. The assessee is, evidently involved in the printing of two magazines pertaining to the field of computers namely, Data Quest and PC World. The business of the assessee enables it to earn income broadly from following sources : (i) subscription received in respect of the magazines published by it; (ii) sale of magazines through agents; (iii) advertisement space sold in the aforementioned magazines; (iv) income earned from carrying out research and preparation of survey reports; and (v) lastly, income earned from software development.

4.2 It appears that the assessee was showing income received from subscription of magazines and advertisements on receipt basis i.e. cash basis while, income from sale of magazines, research, survey & software development was shown on mercantile basis. In other words, it was the stand of the assessee before the authorities below that it had been following hybrid system of accounting; which had been regularly employed and accepted by the revenue till the preceding assessment year i.e., Assessment Year 1988-1989.

4.3 It is not disputed that an amendment was effected in Section 209 of the Companies Act, 1996. The amendment was made by virtue of the Companies Amendment Act, 1988 which, required the assessee to maintain its accounts on accrual basis, and according to double entry system of accounting. Consequently, the financial year relevant to the assessment year in issue spanned a period of nineteen (19) months i.e., from 01.09.1987 to 31.03.1989. Resultantly, the assessee prepared its accounts stretching over two (2) period, i.e., from 01.09.1987 to 31.08.1988 and thereafter, from 01.09.1988 to 31.03.1989. The accounts for the period from 01.09.1987 to 31.08.1988

were prepared on the basis of hybrid system of accounting while, that for the latter period i.e., 01.09.1988 to 31.03.1989 were prepared on accrual basis i.e., mercantile system of accounting. The necessary consequences of which was that: income from advertisement carried in the assessee's magazines were accounted for on accrual basis as against cash basis.

4.4 It may be pertinent to note at this stage that the assessee had also received during the relevant assessment year, a portion of the income in advance which was accounted for on cash basis. The said income amounted to Rs.2,33,690/-, which comprised of the sources of income tabulated hereinbelow. We have referred to this aspect, in particular, because the assessing officer has taken exception to this sum, which was received in advance, being shown on cash basis. According to the assessing officer this demonstrated inconsistent accounting method being followed by the assessee even with respect to income from advertisement.

| **S.No.** | **Particular** | **Amount (Rs.)** |
|---|---|---|
| 1. | Advance against advertisement, which was to be published at a latter date | 24,440.00 |
| 2. | Market research and survey to be carried out in subsequent year | 1,71,750.00 |
| 3. | Car advances | 30,000.00 |
| 4. | Funds towards rent of machinery | 7,500.00 |
| | Total | 2,33,690.00 |

4.5 In the background of these circumstances, the assessee filed its return on 31.12.1989 declaring an income of Rs.64,610/- under the provisions of Section 115 J of the I.T. Act; though the assessee otherwise had returned a loss of Rs.3,94,421/-. In the return, in respect of the said deduction, the assessee had appended the following note :-

> "To comply with the amendments in the Companies Act, 1956 which made it mandatory for the company to maintain the books of accounts on accrual

basis Rs.5,85,428/- was shown as advertisements income accrued and due. And since, the method accepted by the Company is Hybrid system of accounting, i.e., where income has been accounted for on cash basis, the same being yet to receive is hereby deducted."

4.6 A notice was issued by the Assessing Officer under Section 143(2) of the I.T. Act. After carrying out a scrutiny and giving an opportunity to the assessee by order dated 28.02.1991, an order of assessment was passed whereby, the deduction in issue was disallowed.

4.7 Aggrieved by the order of the Assessing Officer, an appeal was preferred before the Commissioner of Income Tax (A) [hereinafter, referred to as 'CIT(A)], *inter alia*, in respect of the said deduction. The CIT (A) by order dated 29.10.1991 sustained the order of the Assessing Officer in respect of the deduction in issue.

4.8 The assessee carried the matter further, in appeal, to the Tribunal. The appeal before the Tribunal came to the same pass. By the impugned judgment, the order of the CIT(A) was sustained.

5. Based on the aforesaid circumstances, Mr. Bhatia, who appeared for the assessee contended that the impugned judgment deserved to be set aside for the following reasons:

5.1 The assessee had been consistently following a hybrid system of accounting. The said system of accounting, which had been regularly followed by the assessee, had been accepted by the revenue till the preceding assessment year i.e., Assessment Year 1987-1988. The learned counsel submitted that the change in the accounting system had to be brought about in view of the amendment made in the Companies Act. The learned counsel submitted that there was no such amendment in the I.T. Act, which mandated the assessee to follow a mercantile system of accounting as against hybrid system of accounting being followed by it for the purposes of ascertainment of taxable income.

5.2 Mr. Bhatia further contended that the observation of the Assessing Officer to the effect that, it was not possible to properly deduce the income of the assessee based on the method employed by it; was erroneous. The learned counsel submitted that the

Assessing Officer's view was based on the fact that expenditure on printing, publishing, block designing, etc., connected with insertion of advertisements in the magazines had been accounted for on accrual basis, while the income received from advertisements and publicity had been accounted for on cash basis – had created an imbalance; violating evidently, the principle of matching expenses to income adhered to while, preparing accounts. The learned counsel submitted that in respect of this finding, the Assessing officer has also observed that the system of accounting i.e., cash basis for advertisements was also not followed consistently since, advances received in cash in the relevant assessment year had not been accounted for. Our attention was drawn to the fact that even though the Tribunal in the impugned judgment disagreed on these aspects of the matter with authorities below, it erroneously went on to sustain the disallowance of deduction. Mr. Bhatia contended that it was open to the assessee to follow any of the three methods of accounting available to it in the relevant assessment year; the only caveat being that it had to be followed regularly. Therefore, according to the learned counsel, the revenue could not have first proceeded to reject the system of accounting followed by it i.e., hybrid system of accounting and followed it up disallowing the deduction claimed.

7. On the other hand, Mr. Sabharwal, who appeared for the revenue relied upon the line of reasoning adopted by the Assessing Officer. He submitted that since the mis-match in the expenditure and income was created by the hybrid method of accounting followed by the assessee, the Assessing Officer had rightly disallowed the deduction in issue. This apart, Mr Sabharwal largely relied upon the view taken in the impugned judgment.

8. We have heard the learned counsels for the parties and also perused the record of the case including the orders and the judgment passed by the authorities below.

9. On consideration of the material on record, what emerges is that: (i) the assessee had been following hybrid system of accounting till the preceding assessment year i.e., Assessment Year 1988-1989; (ii). the assessee had been accounting for income received

from advertisement on cash basis, which admittedly had been accepted by the revenue in the preceding years ending with Assessment Year 1988-1989; and (iii). the Tribunal has returned a finding of fact, in favour of the assessee, that the assessing officer's observation that because expenses against advertisement and publicity had been recorded on accrual basis while, income from the said sources had been recorded on cash basis had created an "imbalance" was without merit.

9.1 With regard to the aforesaid, it would be important to extract the observations of the Tribunal:-

> "Further, the appellant company since inception showing income from Research and Survey, Job Income of Development of Software on Mercantile basis. In other words, the income from all sources except advertisement and subscription is shown on mercantile basis. The accounts were prepared on the same basis and accepted by the department till assessment year 1988-1989. **As per the uncontroverted submissions, the aforesaid method has been regularly employed and accepted by the department till assessment year 1988-1989. The method so deployed was never questioned on the ground that the same did not result in proper determination of income. The objections against the aforesaid method as mentioned by the AO and reiterated by the ld. DR in his argument is that not accounting for advances and income from advertisements and publicity after having been accrued resulted in imbalance leading to improper determination of income. While no basis for arriving at the aforesaid conclusions was given we agree with the explanation offered by the assessee in this regard.** As mentioned earlier major part of advances flowed from market research and survey work, which was carried out in the subsequent assessment year. **As mentioned earlier while no expenditure was incurred against the aforesaid advances, the income was accounted for when the research work was carried out. Similar was the case in respect of advertisement to be published subsequently.** Car advances did not constitute income and as such could not have been accounted for. Similar was the case in respect of advance rent of machinery. The assertions of the assessee in this regard were not refuted by the ld. DR. While the decisions relied upon by the ld. AR support the assessee's contention, the decision of Hon'ble Madras High

Court in 182 ITR Page 1 in the case of G. Padmanabha Chettiar & Sons Vs. CIT is distinguishable on facts. In the aforesaid case, the assessee has adopted different methods in respect of income from the same head i.e. interest. It is not so in the case of the assessee." (emphasis is ours)

10. Similarly, with regard to the issue as to whether the change in the method of accounting from 'hybrid' to 'mercantile' system was "***bonafide***", the Tribunal observed as follows :-

> "As per Section 145(1) of the Act, as it was there on the Statute at the relevant period of time, the income chargeable under the head 'Profits and gains of business or profession" **is to be computed as per method of accounting regularly followed. As stated earlier, the assessee has changed its method of accounting from hybrid to mercantile system. This is stated to be on account of amendment brought to Companies Act. There could be no two opinions that change has been affected for a bonafide reason. This apart, the system of accounting to which the assessee has shifted is a well-recognized method which cannot be faulted with. Therefore, the option exercised by the assessee in view of statutory amendment to Companies Act is to be upheld.**"

11. Therefore, upon reading the observations extracted above by us, which are contained in paragraph nos.6 and 7 of the impugned judgment, it is clear that the Tribunal on facts, it appears, was persuaded to hold that the assessee had been following a hybrid system of accounting consistently till the preceding assessment year. Furthermore, the Tribunal was also persuaded to hold that this system of accounting had been accepted by the revenue, as also the fact that, the change in the system of accounting from a 'hybrid' to a 'mercantile' system was carried out by the assessee for bonafide reasons on account of the amendment carried out in the Companies Act. Where the Tribunal disagreed with the assessee was that having effected a change in the method of accounting, and having recorded its income on the basis of mercantile system, it could not go back to the cash system and hence, proceeded to sustain the order of the Assessing Officer disallowing the deduction.

12. In our view, this last limb of the conclusion does not follow from what was observed and found by the Tribunal in the earlier part of its judgment. Once, the Tribunal accepts that the assessee had regularly employed a hybrid system of accounting for income tax purposes and it was only to adhere to procedure under the Companies Act that it switched bonafidely to a mercantile system – it erred in concluding that the assessee's income for the purposes of income tax proceedings could not hark back to the hybrid system. It is not unknown to income tax that the assesses' income determined in the normal course in the books of accounts is adjusted to fall in line with the provisions of the I.T. Act; some of which are even non-cash expenses. The example which easily comes to our minds is depreciation. Under the Income Tax Act, depreciation is calculated on the 'Written Down Value' (WDV) of the asset, while in books of accounts, under the regime set out in the Companies Act, an assessee can calculate depreciation on the basis of 'Straight Line Method' or 'Written Down Value' (see Section 32 of the I.T. Act and Schedule XIV of the Companies Act). Therefore, while calculating profits of an assessee for the purposes of the I.T. Act, adjustments are routinely made in respect to depreciation. By adding depreciation in the books of accounts to the net profit and thereafter, deducting depreciation as calculated under the I.T. Act.

12.1 On a perusal of the impugned judgment we find that Tribunal has not placed its imprimatur to the finding of the Assessing Officer that it was not possible to deduce the income of the assessee. In our opinion, if that was so, what logically ought to have followed was that the deduction claimed ought to have been allowed. The Tribunal seems to have latched on to a ground which did not strict-to-sensu emerge from the order of the authorities below.

13. At this stage, we may note that the Tribunal has noted the contention of learned counsel or the assessee that in the subsequent assessment year the said income from advertisement was offered for tax. We propose to hold the assessee to this representation. If this position as claimed obtains, the issue at hand would perhaps have no impact on the revenue.

14. In these circumstances, we are of the opinion that the order passed by the Tribunal is perverse and hence, has to be set aside. Accordingly, the question of law framed has to be answered in favour of the assessee and against the revenue. Consequently, the appeal is allowed. The cost shall follow the result in the appeal.

**RAJIV SHAKDHER, J**

**SANJAY KISHAN KAUL,J**

**FEBRUARY 07, 2011**
yg