IN THE INCOME TAX APPELLATE TRIBUNAL
CHENNAI BENCH 'B'

(SPECIAL BENCH CASE)

BEFORE SHRI PRADEEP PARIKH, VICE-PRESIDENT,
SHRI N.BARATHVAJA SANKAR, VICE PRESIDENT
AND SHRI HARI OM MARATHA, JUDICIAL MEMBER

I.T.A. Nos.2412 to 2416/Mds/2005
Assessment Years: 1998-99 to 2002-03

The Asst. Commissioner of IT/The Dy. Commissioner of IT, Company Circle-IV(1), Chennai – 34.	Vs.	M/s. Mahindra Holidays & Resorts (India) Ltd., 2, Lalithapuram, Gaudia Mutt Road, Royapettah, Chennai – 600 014. PAN – AAACM 6468 L
(Appellant)		(Respondent)

C.O.Nos. 7 to 11/Mds/2006
(in I.T.A. Nos.2412 to 2416/Mds/2005)
Assessment Years: 1998-99 to 2002-03

M/s. Mahindra Holidays & Resorts (India) Ltd., Chennai-14.	Vs.	The Asst. Commissioner Of IT/ The Dy. Commissioner of IT, Chennai – 34.
(Cross objector)		(Appellant in appeal)

Department by: S/Shri P.B.Sekaran, CIT-DR &
Shaji P. Jacob
Cross objector by: S/Shri B.K.Khare & H.P.Mahajani

Intervener by: Shri T. Banusekar

O R D E R

PER PRADEEP PARIKH, V.P.

A Special Bench was constituted under sec.255 (3) of the Income-tax Act, 1961 (the Act) by the Hon'ble President at the instance of the assessee by his order dated 5.3.2008 in the above matters to consider the following question:

> *"Whether the entire amount of the time-share membership fee receivable by the assessee upfront at the time of enrolment of a member is the income chargeable to tax in the initial year when there is a contractual obligation fastened to the receipt to provide the services in future over the term of the contract?"*

Subsequently, again at the instance of the assessee, the Hon'ble President referred the following question also to the Special Bench by his order dated 16.1.2009:

> *"Whether on the facts and in the circumstances of the case the initiation of proceedings under sec.147/148 in the above cases is legal or valid?"*

It has also been directed by the Hon'ble President to dispose of the entire appeals while considering the above two questions. As a matter of fact, the first question mentioned above constitutes the only ground raised by the department in its appeals. Similarly, the second question referred to above constitutes the only ground raised by the assessee in its cross objections. All the appeals of the department and the cross objections of the assessee arise from a combined order of the ld. CIT (A) dated 15.7.2005 for assessment years 1998-99 to 2002-03. Since the ground raised by the assessee in its cross objections goes to the root of the matter and has a bearing on the validity of the assessments, we deem it proper to deal with that question first in this order.

2. At the outset, it may be pointed out that the assessment for assessment year 2002-03 is a normal assessment under sec.143 (3) of the Act and is not an assessment reopened under sec.147 of the Act. Therefore, so far as the cross objection of the assessee for assessment year 2002-03 is concerned, it is misconceived and hence dismissed.

3. Out of the remaining four years, the assessment for assessment year 1998-99 is reopened four years after the end of the relevant assessment year whereas for assessment years 1999-2000 to 2001-02, they are reopened within four years. Accordingly, we first deal with the issue of reopening of assessments with regard to assessment years 1999-2000 to 2001-02.

4. At the outset, it was pointed out by the ld. D.R. that in ground No.2 taken by the assessee in its cross objections for these years, it has been mentioned that the assessments are reopened after four years. This is factually incorrect and the same is confirmed by the learned counsel for the assessee also. On merits, the ld. D.R. relied on the judgment of the Madras High Court in the case of ITO vs. K.M.Pachiappan (311 ITR 31) and also on the judgment of the Supreme Court in the case of ACIT vs. Rajesh Jhaveri Stock Brokers Pvt. Ltd. (291 ITR 500).

5. The contention of Mr. Khare was that even where assessments were made under sec.143(1) of the Act, the basic condition of sec.147, that is, that the Assessing Officer should have reason to believe that income has escaped assessment, has to be fulfilled. The reopening cannot be

based merely on change of opinion. It was submitted that in assessment year 1997-98, the entire facts relating to the issue including the agreements entered into with the customers were considered by the Assessing Officer. Therefore, it cannot be said that the real causa causans, viz., "reason to believe" existed. Thus, it was contended that the reopening of assessments for assessment years 1999-2000 to 2001-02 was bad in law.

6. We have duly considered the rival contentions and the material on record. It is undisputed that the assessments for these years were completed under sec.143 (1). The contention of the learned counsel is that since the issue was duly considered in assessment year 1997-98, this amounts to a change of opinion. In our view, the view taken in a particular assessment year cannot bind the Assessing Officer for subsequent assessment years. It is true that a completed assessment cannot be reopened on a mere change of opinion. However, that opinion must have been expressed in the same year itself. It is well established that each assessment year is a separate unit of assessment and the law relating to reopening of assessment has to be applied keeping the facts and circumstances of that year only in mind. Of course, the basic requirement that there has to be a reason to believe that income has escaped assessment has to be fulfilled. There is no allegation by the assessee that the Assessing Officer has not recorded due reasons to reopen the assessments. At the same time, since the assessments are completed under sec.143 (1) of the Act, it cannot be said that a definite opinion has been expressed by the Assessing Officer. As a matter of fact, considering the wide scope given in Explanation 2 to sec.147, the Assessing Officer can

be said to be of the view that income chargeable to tax has been under-assessed. It has been held by the Supreme Court in the case of CIT vs. Kelvinator of India Ltd. (320 ITR 561) that the Assessing Officer has power to reopen provided there is tangible material to come to the conclusion that there is escapement of income from assessment. The tangible material available with the Assessing Officer is that the assessee has received certain subscription from customers only a portion of which has been declared as income. Therefore, it can be said that the Assessing Officer had reason to believe about the escapement of income. The fact that the material was available in earlier assessment year on the basis of which a view was taken, cannot be relevant for the years under consideration. Therefore, in our view, the reopening of the assessments for assessment years 1999-2000 to 2001-02 is valid.

7. Now we take up the issue of reopening for assessment year 1998-99. Admittedly, the assessment has been reopened after the expiry of four years from the end of relevant assessment year and the assessment has been completed under sec.143 (3) of the Act. Therefore, the first proviso to sec.147 would come into play. In this connection, the ld. D.R. drew our attention to page 3 of the assessee's paper book I which is the profit and loss account of the assessee for the accounting year 1997-98. It was pointed out that the assessee has shown timeshare income to the extent of Rs.9.45 crores against the actual collection of Rs.23.56 crores. There is no schedule to this item of the profit and loss account nor has any note been inserted to explain as to what the basis of bifurcation is and why the remaining collection has not been shown as income. The ld.

D.R. then referred to the accounting policies declared by the assessee in its annual accounts. The note mentioned that relevant portion of membership fee which is reasonably attributable towards direct cost required to sell timeshare unit is recognised as timeshare income. In this connection, the contention of the ld. D.R. was that there are no details as to what are the direct costs and no other relevant details are available. In the assessment order also there is no discussion and hence it cannot be said that the assessee had fully and truly disclosed all the material facts necessary for the assessment. He relied on several judgments including the judgment of the jurisdictional High Court in the case of M/s.WCI Madras Pvt. Ltd. vs. ACIT in Tax Case (Appeals) Nos.26 to 32 of 2008 dated 10.8.2009.

8. Mr. Mahajani, ld. counsel for the assessee, contended that the annual accounts of the assessee as well as the previous file which is on the record of the department clearly shows that the assessee is in timesharing business. Unlike last year, this year the assessee did disclose the ratio of 40:60 in which the income was shown. According to him, the Assessing Officer should have exercised due diligence by referring to the earlier records. It was contended that Explanation 2 will not hit the assessee because it had filed everything that was mandatorily required. It was submitted that all the relevant material including the agreements were on the record of the Department and were examined in the proceedings for assessment year 1997-98. The method of accounting was spelt out in the earlier assessment year and the Assessing Officer was required to make a mention about the same in the subsequent years only if there was a change. Similarly, in the tax audit report also only the change was to

be indicated if there was any. There being no such change in the year under consideration, the Assessing Officer was not required to re-examine it and record his finding once again. Our attention was drawn to section 143(2) to point out that the notice under the said sub-section was to be issued, inter-alia, to ensure that the assessee has not understated the income. Therefore, having passed the order under section 143(3), it cannot be said that there was escapement of income and more so, four years after the end of the assessment year. Therefore, the contention was that the first proviso to section 147 was clearly applicable as the assessee had disclosed fully and truly all the material facts necessary for the assessment. Reliance was placed on the judgment of the Supreme Court in the case of ITO vs Lakhmani Mewal Das (103 ITR 437). The judgment of the Punjab & Haryana High Court in the case of Winsome Textiles Industries Ltd vs Union of India (278 ITR 470) was also relied upon. Another contention of the learned counsel was that under sec.151 of the Act, the Assessing Officer was required to obtain necessary approval of the competent authority before issuing notice under sec.148 of the Act. In this connection, attention was drawn to the notice of reopening dated 27.10.2003 in which the relevant portion signifying the approval was scored off. Further, in the assessment order also there is no mention of the fact that there was any failure on the part of the assessee to disclose relevant material. Therefore, it was pleaded that the re-assessment should be held to be invalid.

9. On the issue of notice being without proper approval, the reply of the ld. D.R. was that this issue had not been raised earlier before any authority and hence it cannot be

raised now. It is also not known whether the copy of the notice now produced before the Tribunal is a true copy of the original or not. If at all it has to be admitted as evidence, then records should be called for verification.

10. We have duly considered the rival contentions and the material on record. As regards the approval of the competent authority, we called for the original records from the department and found that the approval of the competent authority was duly obtained before issuing notice under sec. 147 of the Act. How the relevant portion in the copy of the notice produced by the ld. Counsel got to be scored off could not be ascertained. However, since the records clearly indicated the approval having been obtained, we reject this contention of the ld. Counsel. On the merits of the re-opening of the assessment, here also as in other assessment years, the main contention is that all the relevant material was on the record of the department furnished at the time of the assessment of the previous year. We are unable to accept the contention of the ld. Counsel. As mentioned in paragraph 6 above, each assessment year is to be considered a separate unit of assessment and the view taken in an earlier assessment year cannot bind the Assessing Officer for the subsequent assessment years. By stating this, we are not in any way suggesting that consistency should not be maintained. Consistency is undoubtedly necessary but it may not be relevant for all the issues. Each issue has to be weighed on its own merits and legal principles cannot be sacrificed on the altar of consistency. We are in agreement with the contention of the ld. DR that there is no explanation about the basis for offering part of the receipts as income for taxation. It is also

true that the assessee has given three contradictory arguments to justify the offer of part receipts as income. One argument is that the assessee is required to incur maintenance expenses during the entire period of timeshare. Second argument is that the assessee has to incur reasonable direct expenses to sell the timeshare and thirdly, before the Service Tax Authorities, an affidavit has been filed to the effect that once the timeshare is sold, the transaction is over. These inherently contradictory arguments go to prove that the assessee has not fully and truly disclosed all the material facts during the year for the purpose of assessment. If the argument of the ld. Counsel with regard to the issue of notice under sec.143 (2) is to be accepted, then the entire section 147 will be rendered otiose. Similar would be the fate of sec. 147 if it is held that an assessment cannot be re-opened as there is no change in the accounting method over the previous year. Therefore, considering all the facts and circumstances of the case, we are of the view that the assessment for 1998-99, though re-opened after four years, is validly re-opened.

11. In the result, the cross objections of the assessee for all the years are dismissed.

12. We now go to the merits of the addition made. The main grievance of the department is against the deletion of the addition made by the Assessing Officer towards subscription received from customers. In support of this ground, the department has relied on the judgment of the Madras High Court in the case of CIT v. A.R. Santhanakrishnan (256 ITR 187). In the grounds, it has also assailed the order of the CIT(A) for relying on the judgment

of the Supreme Court in the case of Calcutta Company Ltd. v. CIT (37 ITR 1) which according to the revenue is distinguishable on facts. The department has also assailed the argument of the assessee that it has to set apart a sizeable portion of subscription charges received for providing facilities throughout the period of timeshare in the light of the fact that the assessee receives from its customers Annual Maintenance Charges (AMC) as well as other utility charges.

13. Except for the figures, the facts in all the years are the same and hence for the sake of convenience, we shall narrate the facts pertaining to assessment year 1998-99 only. The assessee company is in the business of selling timeshare units in its various resorts. For the said year the assessee declared a total loss of Rs.3,90,42,370/- which loss was determined at Rs.1,87,58,252/- by an order under sec.143(3) of the Act. Subsequently, the assessment was reopened under sec.147 of the Act and the present appeal arises from the re-assessment proceedings. It was noticed by the Assessing Officer that the relevant balance sheet showed an amount of Rs.14,98,30,966/- under the heading "Deferred income – advance towards members facilities – see note 1(vi)(a)". This figure represented the amount collected from timeshare members but not recognised as revenue for the current year. The explanation of the assessee was that it had considered only 40% of the membership fees collected as income and the balance 60% was treated as deferred income. It was stated that the balance amount was to be spread over the next 33 years during which the assessee is expected to provide timeshare facilities to the members. It was also stated that in order to

provide various facilities during the next 33 years, it has to incur many costs. Further explanation of the assessee was that the AMC was exclusively meant to cover the maintenance of various facilities which are an integral part of the timeshare property. These charges were for the maintenance of various electronic gadgets made available in the accommodation, furniture, kitchen equipments, central air-conditioning etc. On the other hand, the consideration for future obligations received in the initial stages is towards transfer facility from one resort to another, split, accumulation and advancing facility, domestic and international exchange, transmission, up-gradation etc. The assessee mainly relied on the judgment of the Supreme Court in the case of Calcutta Co. Ltd. (supra). The Assessing Officer observed that the assessee is following mercantile system of accounting and hence, income has to be accounted for on accrual basis. He was of the view that the receipt was undisputedly income as the assessee itself had shown it as deferred income. However, the Act does not recognise the concept of deferred income and hence the assessee's explanation cannot be accepted. The Assessing Officer referred to the various clauses of the agreement and also a confirmation obtained from each customer. The confirmation stated that the customer agrees to pay the AMC as the company needs to maintain the resort. Thus, the Assessing Officer was not convinced about the future costs to be incurred by the assessee. He also pointed out from the agreement that the assessee was not under any contractual or other obligation to provide the facilities as all the requests for holiday were subject to availability. Considering all these aspects, the Assessing Officer added a sum of

Rs.14,10,85,366/- being 60% of the receipts shown by the assessee as advance subscription.

14. The CIT (A) observed that the assessee has to construct holiday resorts and provide timeshare facilities over a period of time. Further, the annual subscription fee collected meets only the maintenance of the resorts. The utility charges collected are as per actual consumption of things like electricity, water etc. It does not cover major renovation and repairs. The CIT (A) also took note of the fact that over a period of 24 years, the assessee has to incur about 171% of the original investment for major renovation and replacement of assets. He also relied on the judgment in the case of Calcutta Co. Ltd. (supra) and also on the decision of the Hyderabad Bench of the Tribunal in the case of Treasure Island Resorts Pvt. Ltd. reported in 90 ITD 814. Decision of the Cuttack Bench of the Tribunal in the case of T.K. International Ltd. (91 ITD 481) was also relied upon. Accordingly, he upheld the contentions of the assessee and deleted the addition in all the years.

15. Opening his arguments, the ld. D.R. firstly pointed out from the assessment order for assessment year 1997-98 that the method of accounting followed by the assessee is mercantile system of accounting. The assessee is in the business of selling timeshare units. Taking us through the membership rules, it was pointed out that a person can become a member either by paying the full amount at a time or by paying instalments. The members are entitled to enjoy the holidays only after 12 or 18 months from the date of membership depending on the number of instalments that have been opted for by the member. Our attention was then

drawn to the rules relating to the consequences following default in payment of instalments and the rules relating to cancellation of membership. Barring these few circumstances, the money collected by the assessee becomes its exclusive asset. From the rules it was also pointed out as to what constitutes the cost of membership. The cost of accommodation constitutes 40% of the total cost of membership and advance payment towards facilities (APF) constitutes 60% of the total cost of membership. The member was also liable to pay annual maintenance charges (AMC) for the maintenance and upkeep of the various resorts. AMC was payable irrespective of the fact whether the facilities were used or not. In essence, it was submitted, a person becoming member was actually purchasing occupancy right for a specific floor area for specified days. It was further submitted that the member had a right to transfer, bequeath or gift his membership/timeshare unit to any person. One of the arguments of the assessee before the CIT(A) was that it had to incur substantial expenses either to construct new properties, or for renovation and replacement of various assets and hence the income was spread over 33/25 years depending on the scheme. To counteract this argument, the ld. D.R. drew our attention to the affidavit filed by the Managing Director of the assessee company before the Madras High Court in a litigation relating to service tax matter. In this affidavit it was averred that the company had no further service to be rendered once the contract and enrolment making a person member were executed. Therefore, the argument was that the claim of the assessee that it had to incur expenses in future was not correct. The ld. D.R. supported the contention of the Assessing Officer

that there was no concept of deferred income in the Income-tax Act and that all the expenses incurred during the year were allowed. He also assailed the order of the CIT (A) on the point that the assessee had to incur marketing expenses. However, the argument was that when once sale to a particular person has taken place there is no further need for advertisement qua that person. It is not like a hotel which would always expect repeat customers. Further, there was no obligation on the part of the assessee to refund the amount and there was no provision made for any liabilities which the assessee claimed it would incur in future. Referring to the assessee's contention before the lower authorities that it had followed AS 9, even according to the said Standard, it was contended that once the sale has taken place, revenue had to be recognised. For all his contentions, the ld. D.R. relied on the following decisions:

1. Maharajkumar Gopal Saran Narain Singh v. CIT - 3 ITR 237 (PC)
2. Keshav Mills Ltd. v. CIT – 23 ITR 230 (SC)
3. E.D.Sassoon & Co. Ltd. v. CIT – 26 ITR 27 (SC)
4. Parimisetti Seetharamamma v. CIT – 57 ITR 532 (SC)
5. Sutlej Cotton Mills Ltd. v. CIT – 116 ITR 1 (SC)
6. CIT v. Bazpur Co-op. Sugar Factory Ltd. – 172 ITR 321 (SC)
7. Shree Nirmal Commercial Ltd. v. CIT – 193 ITR 695 (Bom)
8. Tuticorin Alkali Chemicals & Fertlizers Ltd. v. CIT – 227 ITR 172 (SC)
9. CIT v. Varghese Mani – 252 ITR 735 (Ker)

10. E.I.D. Parry (I) Ltd. vs. CIT – 258 ITR 404 (Mad.)

11. CIT v. G.S.R.Krishnamurthy – 262 ITR 392 (Mad.)

12. P.L.Ganapathi Rao vs. CIT – 285 ITR 501 (AP)

13. CIT v. Mangal Tirth Estates Ltd. – 303 ITR 366 (Mad.)

14. CIT v. K.Thangamani – 309 ITR 15 (Mad.)

15. Sterling Holiday Resorts (India) Ltd. vs. ACIT – 111 ITD 116 (Chenn.)

Thus, the ld. D.R. strongly supported the order of the Assessing Officer.

16. Shri B.K. Khare, learned counsel for the assessee, first took us through the Directors' Report for the financial year 1997-98. This financial period comprised of 15 months and pointed out that the assessee has taken resorts under leave and licence arrangements at Goa, Mussourie and Shimla. The Members have already started availing the holidays at these resorts. From the auditor's report it was pointed out that the company has maintained proper records relating to fixed assets, stores, supplies, etc. and had adequate internal control procedures commensurate with the size and the nature of its business. Coming to the accounts proper and the notes thereon, it was pointed out that Members who paid the entire amount in lump sum, 60% of that sum was treated as deferred income and 40% was offered for taxation. The reason for not offering the entire amount as income was stated to be that the assessee had to incur huge marketing expenses and that it was under an obligation to provide service to the Members for 33 years during which the membership subsisted. Later, this period was reduced to 25 years. Further, the immediate reason to bifurcate the sum

received in the ratio of 40:60 was stated to be to follow what Sterling Holiday Resorts, a company engaged in similar business, had done. Three years later, when the industry gained more maturity and when the assessee almost reached the break-even point, 60% of the amount received was offered as income and balance 40% was treated as deferred income. The prime argument of the learned counsel was that though the assessee received the amount in full, in reality it had not become richer as there was a corresponding liability to service the Members for 33/25 years. It was submitted that the assessee can be said to be the owner of the entire sum only when service is fully discharged for the entire period of membership. Till then, it was only an advance in the hands of the assessee. It was argued that though income may accrue but when the benefit is spread over a period, income also should be spread or else, the accounts will show distorted profits. The importance of the accounts showing a true and fair view of the profits / losses and the state of affairs was emphasised. Shri Khare then drew our attention to the Membership Rules. Our particular attention was drawn to clause 10.17 which stated that nothing in the Membership Rules will affect the Members' statutory rights which prevail over anything inconsistent with them in the Rules. Elaborating on this issue, the learned counsel emphasised the contractual obligation which the assessee had undertaken and it was argued that such a contract almost assumed the character of a statute. It was contended that the assessee was selling only the right to the use of occupancy and, therefore, it was to be treated as a licence. The space could not be given or used for office purposes. Therefore, the contention was that quite an opportunity cost was involved.

17. The learned counsel then turned to the provisions of section 145 of the Act. It was pointed out that after the said provision was amended w.e.f. 1.4.1997, the Assessing Officer had no right to tinker with the accounts of the assessee if the method of accounting was systematically followed and also had been accepted by the Department. The method followed was not irrational but was sanctified by usage. Our attention was drawn to the commentary by Kanga, Palkiwala and Vyas in the Ninth Edition of the Law and Practice of Income Tax. He referred to pages 321 to 323 in Vol. I of the said treatise. Distinction was sought to be drawn between the words “accrue” and “arise”. It is stated that income, profits and gains accrue when they first come into existence or the right to receive them comes into existence; but they may be said to arise when the method of accounting shows them in the shape of profits or gains. It was submitted that depending on the system of accounting, a case may very well arise where income accrues in one year, arises (according to the method of accounting) in a different year and is received at some third point of time. When the statute requires that income, profits or gains should accrue, arise or be received in the previous year, it contemplates three different points of time at which they can possibly be brought to charge, the actual charge being at such one of the three points of time as the assessee’s method of accounting warrants. Emphasis was placed on this part of the commentary by the learned counsel. The learned counsel referred to the definition of “previous year” and referring to section 4, it was contended that the only occasion for the Assessing Officer to change the year of taxability was as provided in the proviso to section 4.

Otherwise, he could not do it. At this juncture, the learned counsel relied on the judgment of the Supreme Court in the case of Sir Kikabhai Premchand Vs. CIT (24 ITR 506).

18. From the synopsis of facts placed on record, the ld. counsel pointed out that its Resorts at Munnar, Goa and Coorg have been consistently rated as Five Star category and the services provided at all the Resorts have been consistently rated by RCI (Resort Condominium International Inc.) as "Gold Crown" (highest rating) for excellence of service. It was further pointed out as to how the company has been increasing the number of resorts from time to time, how the number of membership has been growing from year to year and how the revenues have been rising every year. The point he was trying to drive home is that the assessee had to incur heavy costs to induce customers to become Members and it had to incur huge costs for the upkeep of the Resorts. He then turned his attention to the order of the Tribunal in the case of Sterling Holidays & Resorts (111 ITD 116) which is against the assessee. Our particular attention was drawn to the observation in the order that the concept of deferred income is alien to Income Tax Act. The contention was that it is not deferred income but it is the amount waiting in the wings to assume the form of income. It assumes the form of income only when the obligation spread over the 33/25 year period is discharged. He took particular exception to the observation in the order that not offering the entire receipt as income was a subterfuge devised to hoodwink the Revenue. The contention was that it was purely a commercial transaction and there is nothing like subterfuge. He distinguished the cases relied upon by the Tribunal in the case of Sterling Holidays supra.

19. Shri Khare then took us on a long journey of various case laws on which he relied and also to distinguish those on which the Department relied. His main reliance was on the judgment of the Supreme Court in the case of Calcutta Co. Ltd. in 37 ITR 1. In that case, the assessee had claimed expenses on development of land though no money was actually spent. The court held that the undertaking of the assessee to carry out the development was unconditional and it imported a liability on the assessee which accrued on the date of sale of the plots. It was thus an accrued liability and the expenditure which would be incurred was held to be deductible. Drawing analogy from this it was contended by the ld. counsel that the judgment was applicable not only to expenditure but also to income and it was also contended that in the present case, the assessee was bound to incur expenses on the upkeep of the resorts. Thus, the undertaking to spend the money was expenditure. His next reliance was on the judgment of the Supreme Court in the case of Madras Industrial Investment Corporation Ltd.(225 ITR 802). On the basis of this judgment it was contended that 'expenditure' includes a liability which has accrued or which has been incurred although to be discharged at a future date. It was also argued that where the liability is a continuing one, the amount of expenditure if allowed in one year would give a distorted picture of the profits of a particular year and that where there is a continuing benefit to the business over a period of time, the liability should be spread over the period of such benefit. Similarly, many other decisions were relied upon mainly to press in service the principles of matching concept, distortion of profits, true accounting principles in the light of the method of accounting

followed, ascertainment of profits as per normal book keeping practice, emphasis on business aspect rather than a theoretical or doctrinaire aspect and so on. Shri Khare referred to the affidavit filed in the Service Tax matter to contend that the reliance of the department on the same is out of context.

20. Shri Mahajani also referred to the affidavit and submitted that collection of instalments from those who opted to become members by paying in instalments, was merely realisation of debts and therefore, in that context it was stated in the affidavit that no service is rendered once the person acquired the membership. Our attention was then drawn to AS9 issued by ICAI with regard to revenue recognition. Our particular attention was drawn to paragraph 7. Paragraph 7 pertains to recognition of revenue from service transactions. It states that revenue from such transactions is usually recognised as the service is performed, either by the proportionate completion method or by the completed service contract method. The emphasis was on proportionate completion method. It states, inter alia, that for practical purposes, when services are provided by an indeterminate number of acts over a specific period of time, revenue is recognised on a straight line basis over the specific period unless there is evidence that some other method better represents the pattern of performance. Shri Mahajani went on to argue that membership is an independent marketable commodity and therefore the fees are not refundable. There is a continuing obligation to provide occupancy to the members. The resorts are highly rated and therefore, the assessee is obliged to maintain them immaculately. Marketing expenses have to be incurred

not only to attract new members but also to motivate the existing members to use the resorts. It is a continuous and a seamless activity related to the new and old members alike. There is no provision for refund because it is not anticipated by the assessee. Despite these facts, 60% of the collection (earlier 40%) is already taxed. If taxing the entire receipt in a single year would have given a distorted picture, taxing 1/33rd of the receipts in each year would have made the picture more distorting. It was submitted that there was no continuing obligation in most of the cases relied upon by the ld. D.R.

21. Shri T.Banusekar appeared as intervener on behalf of T.K.International. He explained the relevancy of incurring marketing expenses which was stated to be to make timesharing saleable. By and large, he supported the arguments advanced on behalf of the assessee before us with the only difference that in the case of the intervener, it did not collect any maintenance charge. Only management fee was collected which was sufficient to recover certain administrative expenses like taking care of bookings etc. He also ventured to state that what was meant by mentioning in the affidavit before the service tax authorities that no services were rendered after selling the membership was that there was no taxable event once the membership was sold. Shri Banusekar referred to the observation of the Tribunal at paragraph 15 in the case of Sterling Holiday Resorts (supra). It is observed that the computation of income is to be made in accordance with the method of accounting regularly employed by the assessee. It was argued that the assessee adopted the proportionate completion method as mentioned in AS9. It is also stated in

the said Standard that if the membership fee permits only membership and all other services or products are paid for separately, or if there is a separate annual subscription, the fee should be recognised when received. If the membership fee entitles the member to services or publications to be provided during the year, it should be recognised on systematic and rational basis having regard to the timing and nature of all services provided. Thus, the contention was that the assessee is following a consistent method to recognise the revenue which is in accordance with AS9 and hence the same should not be disturbed by the Assessing Officer. Reference was then made to the Guidance Note on Accrual Basis of Accounting issued by ICAI. As per the said Guidance Note, the goal of accrual basis of accounting is to relate the accomplishments (measured in the form of revenue) and the efforts (measured in terms of cost) so that reported net income measures an enterprise's performance during a period instead of merely listing its cash receipts and payments. Reference was then made to International Accounting Standard (IAS) 18 pertaining to Revenue. The crux of this Standard is that when the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction should be recognised by reference to the stage of completion of the transaction at the balance sheet date. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied: (a) the amount of revenue can be measured reliably; (b) it is probable that the economic benefits associated with the transaction will flow to the enterprise; (c) the stage of completion of the transaction at the balance sheet date can be measured reliably; and (d) the costs incurred for the transaction and the costs to complete

the transaction can be measured reliably. He also advocated the real income theory by referring to the judgment of the Supreme Court in the case of Godhra Electricity Co. Ltd. v. CIT (225 ITR 746).

22. In his counter-reply, the ld. D.R. stated that the basic fact remained that what the assessee sold was the occupancy right of a specified area for specified days for specified years. The AMC was collected compulsorily. Depreciation and marketing expenses were allowed and when a person became a member, he got a television as gift which was allowed as revenue expenditure. Therefore, there is no logic to incur any marketing expenditure in future and how can it be matched with the revenue which is collected today. As an illustration, he referred to the AMC/ASF chart showing the amount charged to members per room night for each category of apartment. It was submitted that the charges collected on annual basis was sufficient to carry out the normal maintenance. Referring to paragraph 5 of the Membership Rules, it was submitted that the mere statement by the assessee to treat certain portion as Advance Payment towards Facilities (APF) does not make the receipt non-taxable. Referring to paragraph 5.1 in the revised Membership Rules, it was submitted that unlike the previous Rules, there was no bifurcation about the cost of membership. It was submitted that in fact, the commentary of the ld. authors Kanga & Palkhivala supported the case of the revenue and further as per the judgment of the Supreme Court in the case of CIT v. British Paints India Ltd. (188 ITR 44), the Assessing Officer was justified in bringing to tax the entire membership fee collected by the assessee, particularly

when no provision in the Act has been pointed out to show as to how 60%/40% of the fee collected is left out.

23. We have duly considered the rival contentions and the material on record. Thousands of litres of ink have been consumed lavishly over the past more than hundred years in discussing the concept of accrual and yet there is no end to it, and rightly so as it indicates the ever changing dynamics of business and commerce. Hospitality business, though in existence since more than hundred years, it has come into limelight recently with several variants and sale of timeshare unit is one such variant with which are concerned in the present group of appeals.

24. The dynamics of how timeshare industry works is not difficult to grasp. The company will set up several resorts at tourist places, either on its own or take such resorts on lease or may enter into arrangements with other resort owners. The company will grant membership on payment of certain amount. On payment of the amount, the member acquires membership for a specified number of years. During the currency of the membership, the member gets a right to have a holiday for one week in a year at the place of his choice from amongst the places offered by the company. The types of membership may differ depending on the type of accommodation opted by the person. The company receives the membership fee either in lumpsum or it may grant instalments to the prospective member. In addition to the membership fee, the company also charges annual maintenance charges (AMC) or annual subscription fees (ASF) or administrative charges. These charges generally are collected irrespective of the fact whether the member makes use of the resort or not. Further, if the member

utilises the resort, he makes an additional payment towards utilities like electricity, water, air-conditioning, heater etc. There are other incidental facilities also like exchange facilities, one-up exchange, RCI exchange etc. There are certain rules pertaining to cancellation of membership also along with the rules pertaining to quantification of refund. The assessee before us initially granted membership for 33 years which was later reduced to 25 years. The entire membership fee received by the assessee is treated as revenue receipt, but the entire amount collected is not recognised as revenue and offered for taxation in the year of its receipt. During the first three years of its operation, the assessee recognised 40% of the revenue as income in the year of receipt and from 4th year onwards, it started recognising 60% of the receipt as income in the year of receipt. The balance amount was equally spread over the period of membership i.e. 25 or 33 years, as the case may be. The case of the assessee is that though it has received the entire amount in one year only, its obligation to the members remain spread over the period of membership and therefore, part of the fees are recognised as income in the subsequent years. There is no basis for recognising the income in the ratio of 40:60 and it is stated to be as per industry norms. The basis for the ratio of 60:40 is stated to be that with experience, the assessee has become wiser. The case of the revenue is that having received the income in the first year itself, the same should be recognised as income in that year only. So far as maintenance of resorts and other utilities are concerned, they, according to the ld. D.R., are being taken care of by the AMC/ASF etc. We proceed to resolve this dispute.

25. It is not in dispute that the assessee follows mercantile system of accounting. Sec.5 (1) of the Act defines the scope of total income in case of a resident and includes all income which –

(a) Is received or is deemed to be receive in India in such year by or on behalf of such person; or
(b) Accrues or arises or is deemed to accrue or arise to him in India during such year; or
(c) Accrues or arises to him outside India during such year.

As per sec.29 of the Act, the profits and gains of business or profession have to be computed in accordance with the provisions contained in sections 30 to 43D of the Act which in nutshell means that it is the net income which is taxable and not the gross income. Net income has to be arrived at after allowing all deductions permissible under the Act. In the backdrop of these facts and statutory provisions, we have to examine whether the income received by the assessee has really accrued to it or not. The most enlightening judgment in this regard and which has also been the bedrock of subsequent decisions, is that of the Supreme Court in the case of E.D. Sassoon & Co. Ltd. v. CIT in 26 ITR 27.

26. The assessee in that case (the Sassoons for short) were the managing agents for three companies. They were entitled to receive as their remuneration, a commission of certain per cent. per annum on the annual net profits of the three companies. The Sassoons decided to transfer the managing agencies to three other companies along with all their rights and benefits under the managing agency agreement. The transfer took place on different dates during the accounting year. The accounts of the managed

companies were made up at the end of the year and the commission payable was computed. The commission was paid over to the three new managing agents. The Sassoons did not include any part of the commission in their income but the commission was assessed in the hands of the three transferees. The transferees objected to the said assessment stating that the agency commission received by them should be apportioned on a proportionate basis and the transferees should be made liable to pay tax only on the commission earned by them during the period that they had worked as managing agents of the respective companies. It was argued on behalf of the Sassoons that it was a condition precedent to the earning of the remuneration that they fulfilled the terms of their employment and completed the period for which the remuneration was payable to them and the service for the particular period was a condition precedent to their earning the remuneration for that period. Since the stated period of one year was not over, no remuneration was payable to the Sassoons till the end of the year and it did not become a debt due by the companies to the Sassoons. Therefore, according to the Sassoons, no income accrued to them. On the other hand, it was urged on behalf of the transferees that though under the deed of assignment, they were paid the whole of the commission, they had merely earned the commission for the period of actual services rendered by them to the company. Even though the ascertainment and the payment came later it made no difference to the accrual of income which could be referred back to the period during which the income was earned and accordingly whatever amount was earned by the Sassoons during the respective periods that they had acted as agents, had accrued to them during those periods. The

court by majority decision held that no income accrued to the Sassoons.

27. Now let us examine the principles laid down in the case of Sassoons and try to apply them to the facts of the present case. One of the important observations the court made is at page 52 of ITR 26. It observed that the Sassoons had no doubt rendered services as managing agents of the companies for the broken periods. But unless and until they completed their performance, viz., the completion of the definite period of service of a year which was a condition precedent to their being entitled to receive the remuneration or commission stipulated there under no debt payable by the companies was created in their favour and they had no right to receive any payment from the companies. No remuneration or commission could therefore be said to have accrued to them at the dates of the respective transfers. In the present case, of course, the fees are payable on the execution of the contract between the company and the prospective member. Once a person agrees to become member the fees are immediately payable to the company. It becomes a debt payable by the person to the company. In that sense income has arisen to the company. However, the question is whether it has accrued to the company or not. In this connection, the Supreme Court has explained the meaning of the word 'earned' and we reproduce the relevant observation below (pages 51 & 52 of 26 ITR):

> "The word "earned" even though it does not appear in Section 4 of the Act has been very often used in the course of the judgments by learned Judges both in the High Courts as well as

> the Supreme Court, (Vide Commissioner of Income-tax, Bombay v. Ahmedbhai Umarbhai & Co., Bombay, 18 ITR 472, and Commissioner of Income-tax, Madras v. K.R.M.T.T.Thiagaraja Chetty & Co.,24 ITR 525 at533). It has also been used by the Judicial Committee of the Privy Council in Commissioners of Taxation v. Kirk (1900) A.C. 588 at 592. The concept however cannot be divorced from that of income accruing to the assessee. If income has accrued to the assessee it is certainly earned by him in the sense that he has contributed to its production or the parenthood of the income can be traced to him. But in order that the income can be said to have accrued to or earned by the assessee it is not only necessary that the assessee must have contributed to its accruing or arising by rendering services or otherwise but he must have created a debt in his favour. A debt must have come into existence and he must have acquired a right to receive the payment. Unless and until his contribution or parenthood is effective in bringing into existence a debt or a right to receive the payment or in other words a *debitum in praesenti, solvendum in futuro* it cannot be said that any income has accrued to him. The mere expression "earned" in the sense of rendering the services etc. by itself is of no avail."

From the above observations, it is evident that two conditions are necessary to say that income has accrued to or earned by the assessee. They are, (i) it is necessary that

the assessee must have contributed to its accruing or arising by rendering services or otherwise, and (ii) a debt must have come into existence and he must have acquired a right to receive the payment. In the present case, a debt is created in favour of the assessee immediately on execution of the agreement. However, it cannot be said that the assessee has fully contributed to its accruing by rendering services. The assessee is bound to provide accommodation to the members for one week every year till the currency of the membership. Till the assessee fulfils its promise, the parenthood cannot be traced to it. In this connection, certain clauses in the membership rules need to be examined. The reservation for holiday can be done 90 days to 1 day before the commencement of holiday but the same is subject to availability. In other words, if the resort requested for is not available, the member would be deprived of the holiday. If the assessee confirms the reservation but is not able to provide the allotted or the alternate accommodation, assessee is liable to pay liquidated damages to the member. It is worth noting that the assessee is liable to pay liquidated damages only if it is not in a position to provide accommodation as per confirmed reservation. But it is not liable to pay any damages if it is not able to provide an accommodation on account of non-availability. Under such circumstances, the only recourse for the member is to approach the Consumer Forum which will term it as deficiency in services and direct the assessee to pay damages. The point we are trying to drive home is that the matter does not end on signing of the agreement and on a person becoming a member. There is a continuing liability on the part of the assessee not only to provide accommodation but also to provide other incidental services

attached with the accommodation. This is an important aspect of the matter.

28. It has been argued on behalf of the assessee that the main reason to spread the balance amount of membership fees over the tenure of membership is that it has to incur heavy expenditure for the upkeep and maintenance of its various resorts. However, we are not impressed with this argument. Separate charges are collected for maintenance and for use of utilities and therefore, the matching concept cannot be pressed into service so far as membership fee is concerned. No doubt, it will be the constant endeavour of the assessee to go on adding new resources which will be available to the existing members also. To that extent one can say that some portion of the membership fees will go to finance new properties. But membership fee is essentially a consideration for the right to occupy a resort for one week in a year for 33/25 years. But the contingency of non-availability of accommodation will always be there. Sometimes, if the assessee is not able to provide accommodation in any of its notified resorts, it will try to procure alternate accommodation. This also will entail additional expenditure on the part of the assessee over and above paying liquidated damages to the assessee. Unlike the case in Calcutta Co. Ltd. v. CIT (37 ITR 1), the liability in this case is difficult not only to quantify but also to reasonably estimate it. The liability is undoubtedly there. However, no scientific basis has been brought to our notice to quantify the same even reasonably. Just as life insurance premium or provision for encashment of leave can be quantified reasonably on actuarial basis, there is no such method brought to our notice to quantify the liability of the

assessee in the present case. In the case of life insurance, the premium is computed on actuarial basis only for the life assured whose longevity can be reasonably estimated. In the case of encashment of leave, despite the change in the number of employees, reasonable number of retirements every year can be estimated and hence the provision thereof is not rendered that difficult. However, in the case before us, the membership is ever increasing and in which year how many contingencies of non-availability of accommodation can arise, can be anybody's guess. At this juncture we may clarify the use of the word "contingencies". It is not used in the sense that the event of non-availability of accommodation is wholly uncertain. The event is certain, only how many such events can occur is uncertain. As a matter of fact, the Supreme Court has also used the words "contingent liability" for warranty expense and allowed deduction in the case of Rotork Controls India P. Ltd. v. CIT(314 ITR 62 at 75). Therefore, coming back to the point of making provision, even if the assessee had chosen to provide for the liability in every year to comply with the matching concept, it would have been wholly unscientific and arbitrary. At this juncture, when we are making the observation that the assessee has incurred a liability to provide accommodation, it would be appropriate to deal with the argument of the department in connection with the affidavit filed by the assessee before the service tax authorities. The department is banking on the averment in the affidavit to the effect that once the agreement is signed, there is no service left to be rendered by the assessee. This argument has to be rejected. The department itself admits that the assessee is bound to provide accommodation for one week in a year during the tenure of the membership.

Secondly, by saying that no service is left to be rendered, what the assessee means to say is that there is no taxable event under the Service Tax laws once a person becomes member. Therefore, the reliance of the department on the affidavit has no substance at all.

29. We again revert to the aspect of liability. In this connection, the judgment of the Supreme Court in the case of Rotork Controls India Pvt. Ltd. v. CIT (supra) is quite useful. Of course, we are conscious of the fact that that case pertained to provision for warranties, nonetheless, certain principles enunciated therein are quite apt for the case on hand as well. In the said case, the assessee had made provision for warranties. The Madras High Court in their judgment reported in 293 ITR 311 denied deduction of the provision for warranties on the ground that the liability was not certain. In fact at page 315 the High Court expressed this view by stating that considering the nature of the liability, which is yet to crystallise but loaded with uncertainty of the event to cause a liability, there is no justification to accept the plea of the assessee. On the other hand, the Supreme Court observed that liability is defined as a present obligation arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits. It was further observed that a past event that leads to a present obligation is called as an obligating event. The obligating event is an event that creates an obligation which results in an outflow of resources. It also observed that for a liability to qualify for recognition there must be not only present obligation but also the probability of an outflow of resources to settle that obligation (underline by us). If we consider the

facts in the present case, the past event is admitting a person as a member with a promise to fulfil the obligation of providing him accommodation for one week every year for the next 33/25 years. It is not an ordinary obligation. In fact, in our view, the obligation is heavier than that in the case of sale of goods. In the case of sale of goods, the goods are already in possession of the buyer and are being used by the buyer. On the other hand, the sale of timeshare unit is not as tangible as sale of goods but becomes tangible when the assessee fulfils its promise. Let us consider certain factors which may prevent the assessee from keeping its promise. Most of the members would opt for a holiday during the peak season i.e. during vacation in schools and this can put a lot of pressure on the assessee to satisfy each and every member. It will have to disappoint certain members for non-availability of accommodation and this may invite outflow of resources. There may be a demand for a particular resort but the assessee may not be able to provide it if the same is under some major repairs or renovation. These types of contingencies will always entail outflow of resources for the assessee in future. Therefore, we are of the view that there is every possibility of an obligating event arising which will result in an outflow of resources.

30. A question may be raised that if the obligating event is sure to arise, the assessee could have made reasonable provision every year which would meet the matching concept also. Let us see how it is not possible. In the case of Rotork Controls (supra), the Supreme Court has observed that a provision is recognised when: (a) an enterprise has a present obligation as a result of a past event; (b) it is probable that an outflow of resources will be required to settle the

obligation; and (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision can be recognised. In the present case, we have already observed in the preceding paragraphs that the assessee has a present obligation as a result of a past event. Thus, the first condition is satisfied. We have also observed that outflow of resources is probable to settle the obligation. The second condition is also satisfied. However, considering the nature of activity, it is the third condition which is difficult to satisfy. The demand for accommodation by the members is essentially tourism oriented. Tourism, in turn, depends on several factors. They may be social, political, climatic and so on. If wedding season is in full swing, tourism can get affected. If there is some commotion around a particular resort or if the law and order situation is not conducive, tourism can be affected. Sudden change in weather can also affect tourism. Further, availability of rail or air reservation can also affect tourism. The possibility of leave travel concession (LTC) getting lapsed can see sudden spurt in tourism. These are only a few illustrations which can affect the demand for accommodation either way. There may be many possibilities which may not come to mind but may put the assessee into tremendous pressure. All these factors are such which are twined with the normal human life and hence are not only certain to occur but also makes it difficult to reasonably estimate the probable outflow of resources. Moreover, as mentioned earlier, most of the grievances are settled by Consumer Forum and it can be anybody's guess as to what damages the Forum will award. Some orders of the Consumer Forum awarding damages to the complainants have been placed on record. Considering the difficulty in

estimating reasonably the obligation in monetary terms, no provision can be made.

31. We have held that there is a definite liability cast on the assessee to fulfil its promise and therefore, it cannot be said that the entire fee received by it has accrued as income. We have also considered the peculiar nature of the activity along with the complexity attached to it as a result of which no reasonable provision for the liability can be made. Therefore, recognising the entire receipt as income in the year of receipt can lead to distortion. Somewhat similar, though not exactly identical, situation was faced by the Supreme Court in the case of Madras Industrial Investment Corporation Ltd. v. CIT (225 ITR 802). In that case, the assessee had issued debentures of Rs.1.5 crores at a discount of 2% redeemable after 12 years. At page 813 of the report, the court observed that ordinarily, revenue expenditure which is incurred wholly and exclusively for the purpose of business must be allowed in its entirety in the year in which it incurred. It cannot be spread over a number of years even if the assessee has written it off in his books over a period of years. However, the facts may justify an assessee who has incurred expenditure in a particular year to spread and claim it over a period of ensuing years. In fact, allowing the entire expenditure in one year might give a very distorted picture of the profits of a particular year. It is this distortion we have talked about in the earlier part of this paragraph. The only difference is that in the case of Madras Industrial Investment Corporation (supra), the distortion was supposed to be on account of expenditure, in the present case the distortion is on account of the entire income being accounted in the year of receipt. Earlier, we have also

discussed as to how difficult it is to estimate the liability which is likely to be incurred in future, more so in the absence of any scientific basis or historical data. Therefore, the only way to minimise the distortion is to spread over a part of the income over the ensuing years. At this juncture, we may deal with one of the arguments made on behalf of the assessee and the intervener. It was argued that accounting for the whole of the income in one year would give a distorted view of the profits of the company which will be against the true and fair principle required for the annual accounts. Well, the distortion the ld. counsel talked about was vis a vis the presentation of published accounts whereas the distortion the Supreme Court talked about and which we are inclined to follow, is vis a vis the real taxable income for a particular year. Therefore, in view of the foregoing discussion, we accept the proposition of the assessee that it is not justifiable to tax the entire income in a single year as is the case of the department.

32. Accordingly, to answer the question posed to the Special Bench, the entire amount of timeshare membership fee receivable by the assessee up front at the time of enrolment of a member is not the income chargeable to tax in the initial year on account of contractual obligation that is fastened to the receipt to provide services in future over the term of contract.

33. In the result, all the appeals of the department are dismissed and the cross objections of the assessee are also dismissed.

The order was pronounced in the court on 26-5-2010.

Sd/-	Sd/-	Sd/-
(Hari Om Maratha)	(N.Barathvaja Sankar)	(Pradeep Parikh)
Judicial Member	Vice-President	Vice-President

Chennai,
Dated the 26th May, 2010

mpo*

Copy to : Appellant/Respondent/CIT/CIT(A)/DR