

ACCRUAL OF INCOME

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INTRODUCTION

‘From the treasury, comes the power of the government and the earth whose ornament is the treasury, is acquired by means of the treasury and army’¹.

The above statement holds true for the most part even today and it is a reminder albeit an over simplified one of the importance of ensuring that the treasury of the State is replenished (for the lack of a better word) time and again. It is against the backdrop of the meaning of the aforementioned statement that one may understand the need for imposing tax on people. From the perspective of legislators perhaps the simplest mode of doing so is to tax the income of the people residing the country. The term income itself has engendered much debate however analysis and discussion of various theories in that regard is outside the scope of the present paper. However for the purposes of mere statement in this regard perhaps assuming income to mean a monetary return will suffice.

In the humble opinion of the researcher; taxation of income needs to take into account two important factors – firstly, the scope of tax must be wide enough to ensure the state does not overwhelmingly rely on a set of people and secondly, the quantum of taxation must be so much as to not to offset the incentive to earn more money. However, in today’s era of complex transactions it has become even more difficult to zero in onto a particular stage in transactions to identify the point in time

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¹ Kautilya in Arthshastra cited from <http://incometaxindia.gov.in/HISTORY/PRE-1922.ASP>.

when the income may be assumed to have reached a person and at which juncture it is advisable to tax the income in the hands of that particular individual.

The job of identifying such a point in time in the life of a particular transaction if it may be so said; has been made considerably easy by Income Tax Act, 1961. Income Tax Act, 1961, CH 2 provides that principle of ‘accrual of income’ may be applied to find when an income accrued to a particular individual and if an income has accrued to an individual it may be taxed in his hands. The explanation of this principle makes it imperative to refer to the basic concepts of accountancy. There are two types of accounting methods namely, cash system and mercantile system. ‘Under cash system, revenue and expenses are recorded only when received or paid’². Whereas under mercantile system of accounting ‘income is recorded when a sale occurs, whether it be the delivery of a product or the rendering of a service on part of an individual, regardless of when he gets paid. An expense is recorded when an individual receives goods or services, even though he may not pay for them until later’³. As per CH 2, accrual of income is sufficient to tax the income in the hands of the individual to whom the income has accrued⁴. In order to clarify the meaning of the term and to distinguish the same from other terms used in this regard the judiciary has time and again played an important role. Perhaps the most often cited passage regarding accrual of income is from the judgment delivered in the case of *E.D. Sassoon and Company Limited vs. Commissioner of Income Tax*⁵:

‘... income may accrue to an assessee without the actual receipt of the same. If the assessee acquires a right to receive the income, the income may be said to have accrued to him though it may be received later on its being

² See *infra* note 10.

³ http://taxguide.completetax.com/text/Q11_2208.asp.

⁴ Income Tax Act, 1961, s. 5 uses the phrase ‘accrues or arises’.

⁵ [1954 INDLAW SC 136](#), (1954) 26 ITR 27 (SC).

ascertained. The basic conception is that he must have acquired a right to receive the income. There must be a debt owed to him by somebody⁶.

However, overtime this apparently simple concept has gathered a lot of mire and in order to clear the same it is necessary to undertake a thorough analysis of the same and in the opinion of the researcher one may do no better a job in this regard than to analyse the case laws which have emerged in this area so as to state certain key elements of this concept in a precise manner. This research paper is a manifestation of the same attempt on part of the researcher. The researcher has also attempted to compare concepts such as right to receive, claim to income and actual receipt with the concept of accrual of income so as to present a clearer picture.

RIGHT TO RECEIVE

As illustrated in the introduction to this paper; crystallisation of right to receive is an important stage after a transaction inasmuch as it marks a reasonable assurance to the person entitled to the amount of money of receipt at some point of time in future. From the perspective of the taxman as also a researcher in the sphere of direct taxation it is important to explore the concept of 'right to receive' and to differentiate this concept from that of 'accrual of income' so as to achieve clarity in this regard.

The case of *Bhogil Laherchand vs. Commissioner of Income-tax, Bombay City*⁷ may in the opinion of the researcher serve as the best instrumentality towards the intended result as mentioned above. The facts are that one Bhogil had three sons, namely, Pratap, Arvind and Mahesh. Bhogil started a partnership with his three

⁶ *Ibid* at 51.

⁷ [1955 INDLAW MUM 25](#), (1955) 28 ITR 919 (Bom).

sons under a deed of partnership dated the 14 April 1943. At that date Pratap was a major and Arvind and Mahesh were minors and therefore Arvind and Mahesh were admitted to the benefits of the partnership. Arvind attained majority on 22 August 1950. He elected to continue to remain a partner of this firm and a fresh partnership deed was executed between Bhogilal, the father, and Pratap, Arvind and Mahesh on 28 August 1950. Arvind died on the 31 August 1950. The year of account of Bhogilal who was the assessee as an individual was *samvat* year 2006 and the profits which were ascertained on the 31 August 1950, as coming to the share of Arvind was Rs. 2,64,450 and the Income-tax department calculated the proportionate profits coming to the share of Arvind on this basis as of the 22 August 1950, when he attained majority at Rs. 2,49,459, and the contention of the department was that this sum of Rs. 2,49,459, constituted the income of Arvind as a minor and under the Income Tax Act, 1961, s. 16(3), this sum must be included in the assessment of Bhogilal, the father, and Bhogilal must pay tax on this amount. The tribunal held in favour of the department. The income which the department sought to tax in the hands of Bhogilal was not his own income; it was the income of his minor son; but by reason of s. 16(3) that income was deemed to be that of father. It is important to note that under both the partnership deeds, the partnership deed of the 14 April 1943, and the partnership deed of the 28 August 1950, it was specifically provided that on *Divali* in each year during the continuance of the partnership, accounts would be taken of all the assets and liabilities for the time being of the partnership and a balance-sheet and profit and loss account would be made up on a certain basis. Therefore, the profits or the losses of this partnership from the commercial point of view may only be ascertained on *Divali* of each year. In this case the high court observed that income may accrue to an assessee without the actual receipt of the same. If the assessee acquires a right to receive the income, the income may be said to have accrued to him though it may be received later on its being ascertained. The basic conception is that he must have acquired a right to receive the income. There must be a debt owed

to him by somebody⁸. The court further observed that the only debt that came into existence and with regard to which Arvind or rather his estate acquired a right to receive the payment was a debt which may only be ascertained on making up the accounts of the partnership as of the 31 August 1950. This case helps one to realise the concept of 'right to receive' in a proficient manner. This case states to differentiate right to receive as understood in a pedestrian sense from that in the sense in which it is normally understood for the purposes of direct taxation. Thus; it may be culled from this case that though a person (more specifically a partner with a firm) may be said to have a right in the profit of a particular entity with which it is associated this right crystallises only on a particular date, that is, on the date of preparation of accounts and this principle enforces the explanation of the concept of 'accrual of income' in the introduction to this paper i.e. an income may be said to have accrued to someone only when right to receive that income crystallises and is no more a possibility or a statement of that possibility.

Another case which deals with the point in time in which income accrues is that of *Khan Bahadur Ahmed Alladin and Sons vs. Commissioner of Income-tax*⁹. Facts are that a portion of a plot of land purchased by the appellants was acquired by Government of Hyderabad under Land Acquisition Act, 1894 and the government took possession of the land. The quantum of compensation engendered a lot of dispute resolution and much after the Government took possession of the land, that is, on 22 of March 1956 compensation was paid to the appellant. The income-tax officer accordingly made assessment including the compensation in that year, that is, assessment year 1957-58. The appellant contended that this compensation must have been included in assessment year 1954-55 as possession was taken in 1953-54. On

⁸ This was a mere recitation of the opinion of Bhagwati, J. in the case of *E.D. Sassoon and Company Limited vs. Commissioner of Income Tax*, [1954 INDLAW SC 136](#), (1954) 26 ITR 27 (SC).

⁹ [1968 INDLAW AP 48](#), (1969) 74 ITR 651 (AP).

this point of difference of opinion this case reached the high court. The court observed that though on acquisition and subsequent coming into possession a right to receive compensation had vested in the assessee but it was still an inchoate right and only when compensation was settled, it may be said that the income due to compensation had accrued to the assessee.

Cases discussed above deals with explanation of the concept of ‘accrual of income’ so as to clarify the temporal nuances involved in accrual of income as a result of right to receive crystallising much before it is actually received.

A case which will clarify the geographical nuances involved in the concept of accrual of income is that of *Seth Pusabahal Mansinghka Private Limited vs. Commissioner of Income-Tax, Delhi, Rajasthan and Madhya Pradesh*¹⁰, the facts were that the appellant owned few mica mines, factory and office at Bhilwara in Rajasthan. After necessary processing, mica was despatched by rail to Koderma and Giridih. The appellant consigned the goods to ‘self’. The railway receipts along with the bills of exchange were presented by the appellant to the Rajasthan Bank at Bhilwara for collection after endorsing the railway receipts in the favour of the bank. The bank in turn endorsed the receipts in favour of its branches in Koderma and Giridih and the goods were delivered to buyers only when they paid the price to the bank and obtained the railway receipts. The court observed that in such a case the profit from sales of mica accrued to the appellant at the place where sales were effected, that is, where the property in goods passed on to the buyers. Thus the appellant became entitled to the price of the goods in Koderma and Giridih though he received the sum of money at Bhilwara itself. This judgment reflects the opinion of Mukherjee, J¹¹. that income accrues at a place where it is paid or where the right to demand

¹⁰ [1967 INDLAW SC 323](#), (1967) 66 ITR 159 (SC).

¹¹ See *infra* note 15.

arises. In this case; as per the arrangement of the appellant with the buyers and the bank, the appellant had a right to receive a sum of money at Bhilwara but the income may be said to have accrued at Koderma and Giridih and not Bhilwara.

ACTUAL RECEIPT

In the previous section it was emphasised that in order to claim accrual of income it is necessary that the right to receive the income must have crystallised. It is the interpretation of this phrase – ‘crystallisation of right to receive income’ which has been a subject of great debate and interpretation in view of different events to be referred to and used for identifying a point in time when the right had crystallised. One important issue arises in cases related to Land Acquisition – when should interest on compensation be deemed to have accrued. It is to be noted here that as per relevant provisions of Land Acquisition Act, 1894, interest is to be paid from the date of possession of the property to the date of payment of compensation, that is, in cases where full compensation has not been paid to the person whose property has been acquired. In the case of *Commissioner of Income-tax vs. A.B.V. Gowda*¹² this issue was decided by the Karnataka High Court which observed that in such cases interest must be deemed to have accrued yearly and even when the total quantum of compensation is yet to be resolved, the interest on the quantum of compensation decided initially must be deemed to have accrued on year to year basis from the date of possession until the date on which the quantum of compensation was settled.

CLAIM TO INCOME

¹² [1984 INDLAW KAR 84](#), (1986) 157 ITR 697 (Kar).

In cases discussed and analysed above it has been repeated by the honourable courts that a mere claim on income without an enforceable right does not lead to even an inchoate right to income leave alone accrual of income. It is pertinent to illustrate this observation with analysis of a case. Facts of the case of *Commissioner of Income-tax vs. Govind Prasad Prabhu Nath*¹³ were that the assessee-firm (appellant) sold fertilisers. The selling price of fertiliser was revised upwards by the Government of India with effect from 01 June 1974. Later on the Uttar Pradesh Government issued an Ordinance stating that the stock of fertiliser which the dealers held as on 31 May 1974, will have to be sold at the old rates. The fertiliser dealers challenged this ordinance unsuccessfully before the Allahabad High Court. Aggrieved against the said judgement of the high court, the dealers preferred an appeal in the Supreme Court. In the appeals, the Supreme Court passed an interim order permitting them to deposit the excess price with the district magistrate concerned in a separate account. In pursuance of this interim order, the assessee sold its old stocks in the accounting period relevant to the assessment year 1975-76 and deposited it. The claim of the assessee was that this amount did not represent its income but the income-tax officer did not agree with this claim. But the tribunal held that this amount was not assessable. On a reference, it was held by the court that till the claim of the assessee was decided by the Supreme Court, it may not be said that there was in existence a right in favour of the assessee to receive the amount in question. The court held that the amount had not accrued or arisen to the assessee nor was it received by it and so it was not assessable in the hands of the assessee.

Another case in which though the assessee had a claim on income but the claim did not fructify into an inchoate right is that of *Commissioner of Income-tax vs. Eastern Investments Limited*¹⁴ in which; in view of placing of the companies from which

¹³ [1987 INDIA LAW ALL 136](#), (1988) 171 ITR 417 (All).

¹⁴ [1993 INDIA LAW CAL 108](#), (1995) 213 ITR 334 (Cal).

the assessee claimed interest on debentures issued by them it was highly doubtful if the assessee would be able to get any income in nature of interest on debentures.

DEEMED ACCRUAL

After having dealt with various concepts to illustrate when income may be said to have accrued to a person it is necessary to focus on the concept of 'deemed accrual' which as the term suggests is used to describe a principle whereby in certain situations wherein income accrued outside India is deemed to have accrued in India. Needless to say, the operation of this principle pre supposes accrual of income in some country other than India and by virtue of operation of this principle it is deemed i.e. considered to have accrued in India. In some cases by virtue of operation of the Income Tax Act, 1961, s. 9; income is deemed to accrue or arise in India even though it may actually accrue or arise outside India¹⁵. There are several categories of income which are deemed to accrue or arise in India however as per s. 9 (1)(i), the following conditions must be satisfied before this¹⁶:

- (1) the taxpayer has a 'business connection' in India - The term 'business connection' has been illustrated in the aforementioned section to include a person acting on behalf of a non-resident and who concludes contracts, maintains stock or secures orders for the non-resident; and
- (2) by virtue of 'business connection' in India, income annually arises outside India. In such cases, only so much of income which may be attributed to operations carried out in India may be deemed to accrue in India.

¹⁵ V.K. SINGHANIA and M. SINGHANIA, STUDENTS' GUIDE TO INCOME TAX, (35 edn., New Delhi: Taaxmann Publications, 2006) (43).

¹⁶ See *supra* note 1.

The abovementioned provision assumes special importance and relevance in view of the practise of business process outsourcing whereby foreign companies delegate work to BPOs ranging from mere procurement of orders for sale to the provision of services. In such cases; the BPO unit is to be treated as an agent and the principle is to be applied accordingly.

There are other important points to be culled from the aforementioned provision:

- (1) income from any property, asset or source of income in India is deemed to accrue in India – the term ‘property’ includes movable as well as any tangible or immovable property. The term ‘asset includes all intangible rights and consequently, interests, patent and copyright, royalties, rent etc¹⁷;
- (2) any capital gain earned by a non- resident by transfer of any capital asset situated in India is deemed to accrue in India¹⁸;
- (3) income of a non-resident which falls under the head ‘salaries’ is deemed to accrue or arise in India if the service is rendered in India¹⁹. Salary paid by the government to a citizen of India from the government out of India is deemed to accrue or arise in India²⁰;
- (4) any dividend paid by an Indian company outside India is deemed to accrue or arise in India²¹;
- (5) income received by way of interest from the Central Government or state government or a resident in certain circumstances and also from

¹⁷ Income Tax Act, 1961, s. 9(1)(i).

¹⁸ Income Tax Act, 1961, s. 9(1)(i).

¹⁹ Income Tax Act, 1961, s. 9(1)(ii).

²⁰ Income Tax Act, 1961, s. 9(1)(iii).

²¹ Income Tax Act, 1961, s. 9(1)(iv).

a non- resident if the debt is incurred for purposes of a business or profession in India²²;

- (6) royalty income received from the Central Government or state government, resident (in certain circumstances) and non- resident if payment is related to business or profession in India is deemed to accrue in India²³; and
- (7) income by way of fees for technical services received from the Central Government or state government, resident (in certain circumstances) and non-resident if the services are related to a business or profession in India²⁴.

The best case to illustrate this concept would be that of *Sir T. Vijaya Raghavacharya vs. Commissioner of Income –tax, Lahore*²⁵. This case is important because it offers the reader an insight into the change in the law regarding payment of salary by the government to an individual outside India. As of now such a salary accruing to a person thought accruing outside India may be deemed to have accrued in India however, earlier such a salary was deemed to have accrued in India only if received in India or brought into India. As per the facts of the case, the appellant was paid pension in London for duties he performed as a civil servant in British India (as it was then called). The appellant had a right to receive the same in India or in London. He chose to receive the same in London. The court observed that pension is a right to receive a certain sum of money annually at a particular place unlike pay – indicating that pension is to be credited to the account of the pensioner wherever he or she resides. The court referred to the observation of Mukherjee, J. in the case of

²² Income Tax Act, 1961, s. 9(1)(v).

²³ Income Tax Act, 1961, s. 9(1)(vi).

²⁴ Income Tax Act, 1961, s. 9(1)(vii).

²⁵ AIR 1936 Lah 713.

*Rogers Pyatt Shellac and Company vs. Secretary of State*²⁶ as per which income arises in a country where there is a right to demand payment of it or where it is actually paid. In this case the pension was paid in London and thus it accrued in London.

CONCLUSION

The object of the research was to cull out certain rules which may be referred so as to ascertain whether in a particular fact situation, income had accrued to a taxable entity²⁷ or not. This is no small task in view of the various circumstances in which the proposed rules (inferred from case laws) might need to be used and also complexities of transactions largely increased by a growing number of intermediaries between consumers and suppliers such as banks and also pro active role played by state such as by acting as purchaser of land and thus assuming the form of a consumer²⁸. However, a statement in nature of a caution that the following principles will serve the purpose better in cases with similar facts as those discussed in this paper will, the researcher hopes indicate the near impossibility of laying down comprehensive principles. These principles (rather rules of thumb) gathered by the researcher which may be used to ascertain accrual of income; are as follows:

- (1) a mere claim to income without an enforceable right thereto may not be regarded as an accrued income for the purpose of the Income-tax Act, 1961;
- (2) in certain cases where the quantum of an individual's share (for lack of a better word) is to be determined on a specific date such as in the case of a partnership firm, ascertainment of accrual of income

²⁶ 1925 Cal 34 as cited in AIR 1936 Lah 713 at 715.

²⁷ This term is important as it indicates that apart from individuals, incomes of companies,

²⁸ As evident by the facts of various cases discussed in this paper which involved the government acquiring land from citizens.

requires referring to that date and though in a pedestrian sense of the term, the individual has a right to a particular quantum unless the quantum is decided upon, income may not be said to have accrued to the individual. This principle applies to cases where the quantum of claim (compensation) is pending before the court;

- (3) however, in certain cases due to the statutory provisions the accrual of income arising out of a claim to compensation may be on two different dates. To illustrate, facts and judgement in cases of *Khan Bahadur*²⁹ and *A.B.V. Gowda*³⁰ need to be contrasted. It will be clear that in case where compensation is not paid on the date on which government takes possession of a plot of land and the person whose property is acquired contests the quantum of compensation, then the interest payable by the government³¹ from the date on which the acquired plot of land passed into possession of the government till the date on which compensation is paid to the person whose land was acquired will accrue to the latter yearly however the compensation amount as such will accrue on him on the date on which the quantum of compensation is settled and paid; and
- (4) for the purposes of widening the tax base, the government may rely on certain provisions like 'deemed accrual' of income and in cases of deemed accrual the enabling (deeming provision) needs to be followed strictly so as to ensure all conditions contained in such a provision are met before the income is deemed to accrue in India.

In the opinion of the researcher the principle of accrual of income (from utilitarian perspective) reflects the truism generally used in literature related to

²⁹ See *supra* note 9.

³⁰ See *supra* note 12.

³¹ Which is mandatory as per the provisions of the statute.

investment as per which a rupee received today is worth more than a rupee received few days later and perhaps it is in the interests of a healthy flow of tax into the coffers of the state to tax an income in the hands of an individual as and when right of an individual to such an income crystallises.