

आयकर अपीलीय अधिकरण “बी” न्यायपीठ मुंबई में।
IN THE INCOME TAX APPELLATE TRIBUNAL “B” BENCH, MUMBAI
श्री जोगिन्दर सिंह, न्यायिक सदस्य एवं श्री संजय अरोड़ा, लेखा सदस्य के समक्ष ।
BEFORE SHRI JOGINDER SINGH, JM AND SHRI SANJAY ARORA, AM

आयकर अपील सं./I.T.A. No. 2832/Mum/2012

(निर्धारण वर्ष / Assessment Year: 2008-09)

Mahindra Telecommunications Investment Private Limited Gateway Building, Apollo Bunder, Mumbai-400 001	बनाम/ Vs.	Income Tax officer, 2(2)(3), Aaykar Bhavan, Mumbai-400 020
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. AAACM 3774 E		
(अपीलार्थी /Appellant)	:	(प्रत्यर्थी / Respondent)
अपीलार्थी की ओर से / Appellant by	:	Shri H. P. Mahajani
प्रत्यर्थी की ओर से/Respondent by	:	Shri Randhir Gupta
सुनवाई की तारीख / Date of Hearing	:	24.02.2016
घोषणा की तारीख / Date of Pronouncement	:	24.05.2016

आदेश / ORDER

Per Sanjay Arora, A. M.:

This is an Appeal by the Assessee directed against the Order by the Commissioner of Income Tax (Appeals)-5, Mumbai ('CIT(A)' for short) dated 18.1.2012, dismissing the assessee's appeal contesting its assessment u/s.143(3) of the Income Tax Act, 1961 ('the Act' hereinafter) for the assessment year (A.Y.) 2008-09 vide order dated 30.12.2010.

2. *The background facts*

The facts of the case are simple and undisputed. The assessee-company, incorporated under the Companies Act, 1956, pursuant to a shareholders' agreement dated March

7, 2006 with AT & T Global Network Holdings LLC, Texas, USA ('AT & T Global' for short), a leading telecommunication company, agreed to subscribe to and invest in shares of AT & T Global Network Services India P. Ltd. (AT & T India), a company under the Companies Act, 1956 promoted by AT & T Global, upto 26% of the equity capital of the former, i.e., AT & T India. The balance 74% was to be held by AT & T Global, i.e., to the extent of the cap on the foreign direct investment (FDI) under the extant policy regime of the Government of India (GOI) for the telecommunication sector. The date/s of investment is termed as a capitalization date/s. AT & T Global had under the agreement an irrevocable call option to increase its' holding in AT & T India to the extent permissible by laws in India by requiring appellant company to sell shares to it or to its' affiliates at the option price. Similarly, the appellant company also has an irrevocable option to sell these shares at the option price to AT & T Global (or its affiliates), which had the right to first refusal. The option by either could be exercised on or after three years of investment or the elimination of the Indian Government regulation on foreign equity holding levels, whichever is earlier. The option price for the purpose of the afore-said purchase and sale is defined as the equity contribution plus return at 11% p.a. compounded annually on the said contribution over the period of holding. The assessee-company is also entitled to, besides option price, so determined, what is termed as 'call option fee', on each anniversary of the capitalization date @ 5.5% of its equity contribution. For the period of holding beyond the anniversary date, proportionate fees calculated at the said rate is to be allowed. That is, for the broken period since the last anniversary, the assessee is entitled to a fee on a proportionate basis, calculated at the said rate, from the last anniversary to the date of divesture.

3. *The respective cases*

The issue arising for determination is whether the income by way of return on 'equity' accrues to the assessee from day to day, i.e., on the basis of the holding period, for each previous year comprising the holding period, or shall accrue only on the sale of

shares, i.e., on the exercise of the put option or, equivalently, call option by AT & T Global. As per the assessee, the income had not accrued in-as-much as the option had not been exercised, i.e., accrued and shall only be so on the (sale) transfer of shares. Reliance stands placed by it on *E. D. Sassoon and Co. Ltd. vs. CIT* [1954] 26 ITR 27 (SC) and *CIT vs. Canara Bank* [1992] 195 ITR 66 (Kar). In view of the Revenue, the income being defined to arise on the basis of time, i.e., as a linear function of and by elapse of time, accrues to the assessee on time basis and, accordingly, *working out that accrued for the current year*, reflected by an increase in the option price during the year, brought it to tax. Reliance is placed by it on *Madras Industrial Investment Corporation Ltd. vs. CIT* [1997] 225 ITR 802 (SC); *State Bank of Travancore vs. CIT* [1986] 158 ITR 102 (SC); and *CIT vs. A. Gajapathy Naidu* [1964] 53 ITR 114 (SC).

4. We have heard the parties, and perused the material on record.

4.1 *The issue*

The issue arising for determination in the present case is whether income has in the given facts and circumstances of the case accrued to the assessee or not? Admittedly, there has been no exercise of put option by the assessee or, equivalently, call option by AT & T Global (AT & T). In fact, it could not possibly be, with this being the second year of the acquisition of the shares and, rather, the first year in respect of some shares (refer para 3.4 of the assessment order), with there being understandably no relaxation in the policy guidelines by the GOI prescribing a cap on the Foreign Direct Investment (FDI) in the telecommunication ('telecom') sector at 74%. *Ex-consequenti*, there is no transfer of shares, in the increased value of which, realizable on their transfer, the impugned income is embedded. To the extent of call option fees, defined again in terms of a rate per unit of time – on the investment (i.e., at 5.5% p.a.), which stands allowed and, further, prescribed to fall due (for payment) on each anniversary date (of capitalization), income stands accounted for and disclosed as business income.

4.2 It is, to begin with, important to understand the meaning and connotation of the term 'accrual', the scope of which is the bone of contention between the parties. Section 5 of the Act, which defines the scope of 'total income' of a resident, provides for it to include income that accrues or arises to the assessee during the year. As a legal concept, the same stands defined per a series of decisions by the Apex Court, as a right to receive. The Hon'ble Court in *Gajapathy Naidu* (supra) succinctly stated the following propositions that are to be considered for the purpose:

'When an Income-tax Officer proceeds to include a particular income in the assessment, he should ask himself, inter alia, two questions, namely : (i) what is the system of accountancy adopted by the assessee? and (ii) if it is the mercantile system, subject to the deemed provisions, *when has the right to receive that amount accrued?* If he comes to the conclusion that *such a right accrued or arose to the assessee in a particular accounting year, he shall include the said income in the assessment of the succeeding assessment year.* No power is conferred on the Income-tax Officer under the Act to relate back an income that accrued or arose in a subsequent year to another earlier year, on the ground that that income arose out of an earlier transaction. Nor is the question of reopening of accounts relevant in the matter of ascertaining when a particular income accrued or arose.

The meaning of the word "accrue" or "arise" in s. 4(1)(b)(i) of the Income-tax Act, 1922, *cannot* be extended so as to take in amounts received by the assessee in a later year, though the receipt was *not on the basis of the right accrued in the earlier year.* Such amounts are in law received by the assessee only in the year when they are paid.'

Again, explaining the concept of accrual, it was held by the said Court in *CIT vs. Ashokbhai Chamanbhai* [1965] 56 ITR 42 (SC), as under:

'The two "accrue" and "arise" are used to contra-distinguish the word "receive". Income is said to be received when it reaches the assessee; *when the right to receive the income becomes vested in the assessee, it is said to accrue or arise.*

Income becomes taxable on the footing of accrual only after the right of the taxpayer to the income accrues or arises, and in the case of an agreement which makes profits receivable at or on the happening of a contingency, the fact that the profits are the result of transactions spread over a period which covers a period preceding the happening of that contingency would not make the receipt liable to be paid to persons

other than those who are entitled to receive it on the date on which it is actually received *or became receivable.*'

[emphasis, ours]

Section 5 is further subject to the other provisions of the Act. Section 145(1), which would thus override, i.e., where and to the extent inconsistent or even in variation therewith, provides that the income chargeable under the heads of income 'Profits and gains of business or profession' (PGBP) or 'Income from other sources' (IFOS) shall, subject to the provision of sub section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee. Sub-section (2) thereof further provides that the Central Government may notify from time to time income computation and disclosure standards to be followed by any class of assesseees or in respect of any class of income. The assessee is admittedly following accrual method of accounting which, it being a company, incorporated under the Companies Act, 1956, is even otherwise statutorily obliged to in terms of the provisions of the said governing Act. The Central Government has notified two Accounting Standards (AS-I and AS-II) on 25.1.1996 u/s. 145(2) of the Act. The said Accounting Standards have a legal mandate, so that the word 'accrual', to which a clear meaning has been assigned, acquires the force of law. The relevant part of AS-I reads as under:

'ACCOUNTING STANDARDS NOTIFIED UNDER SECTION 145(2)

A. Accounting Standard I relating to disclosure of accounting policies:

1. All significant accounting policies adopted in the preparation and presentation of financial statements shall be disclosed.

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4. Accounting policies adopted by an assessee should be such so as to represent a true and fair view of the state of affairs of the business, profession or vocation in the financial statements prepared and presented on the basis of such accounting policies. For this purpose, the major considerations governing the selection and application of accounting policies are following, namely:—

(ii) *Substance over form* - The accounting treatment and presentation in financial statements of transactions and events should be *governed by their substance and not merely by the legal form*;

5. If the *fundamental accounting assumptions* relating to Going Concern, Consistency and *Accrual* are followed in financial statements, specific disclosure in respect of such assumptions is not required. If a fundamental accounting assumption is not followed, such fact shall be disclosed.

6. For the purposes of paragraphs (1) to (5), the expressions,—

(b) "Accrual" refers to the assumption that revenues and costs are accrued, that is, *recognised as they are earned or incurred (and not as money is received or paid)* and recorded in the financial statements of the period to which they relate;

(e) "Going concern" refers to the assumption that the assessee has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the business, profession or vocation and intends to continue his business, profession or vocation for the foreseeable future.'

[emphasis, ours]

Accrual, which thus constitutes a fundamental accounting assumption, is defined to denote and signify the concept of 'earning' or 'incurring', i.e., in relation to 'income' and 'expenditure' respectively. What stands 'earned' or, as the case may be, 'incurred', can be said to be accrued. This, as shall be seen, is consistent with words 'accrues' or 'arises' as judicially explained and understood. As we see it, it explains the concept further in-as-much as earning or, equivalently, incurring itself is regarded as the basis of accrual. Surely, the parenthood or the ownership of the income is to be of the assessee, and exclusively at that, else how could it be regarded as its' income. Equally, there has to be a clear nexus with the time of accrual, so that the income has to be for a particular period.

Continuing further, the Hon'ble Apex Court has time and again clarified that in the absence of any specific provision, it is the principles of commercial accounting that would hold (viz. *Challapalli Sugars Ltd. vs. CIT* [1975] 98 ITR 167 (SC)). Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI), which is the regulatory body for the profession of accountancy in India, are

also relevant. These Accounting Standards are binding on companies in view of the Companies Act, 1956, so that they again have the force of law (s.209). Rather, as explained by the Apex Court, they represent the crystallized accounting principles as recognized by the accounting policies and, further, those issued by ICAI are required to be followed [*J.K. Industries Ltd. vs. Union of India* [2008] 297 ITR 176 (SC)]. They provide discipline and harmonization of concepts and accounting principles; the objective being true and fair accounting. Accounting Standard (AS)-1 issued by ICAI, titled ‘Disclosure of accounting policies’, again, enlists accrual, along with ‘Going Concern’ and ‘Consistency’, as fundamental accounting assumptions that underlie the preparation and presentation of financial statements. ‘*Substance over form*’ is stated, along with the ‘Prudence’ and ‘Materiality’, as the major considerations for the selection of the accounting policies. AS-9 issued by ICAI is on Revenue Recognition. The same, in its relevant part, reads as under:

‘Definitions

4. The following terms are used in this Standard with the meanings specified:

4.1 Revenue is the gross *inflow* of cash, *receivables* or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.

Main Principles

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13. Revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following bases:

i)	Interest	on a <i>time proportion basis</i> taking into account the <i>amount outstanding</i> and the <i>rate applicable</i> .
ii)	Royalties	on an accrual basis in accordance with the terms of the relevant agreement.
iii)	Dividends from investments in shares	when the owner's right to receive payment is established

[emphasis, ours]

The two set of Accounting Standards, i.e., as notified by the Board and as issued by ICAI, both legally binding, are in complete agreement and harmony, both as regards the primacy of 'accrual' in preparation and presentation of financial statements, as well as to what it signifies, i.e., as a method of accounting to be followed for disclosing and presenting the true state of affairs of the reporting enterprise as on the value date, as well as, concomitantly, the operating results for the account period. And further, that substance over form should govern the accounting policies to be followed for the same. The third aspect we observe is that both sets of Accounting Standards (i.e., as notified by the Board and as issued by ICAI) also indicate the manner in which the relevant income is to be recognized, i.e., as it is earned (AS-I), and on time basis, i.e., as it accrues (per AS-9). Equally importantly, accrual as an accounting concept is in agreement with that as judicially explained, i.e., as a legal concept. That is, the word 'accrual' as occurring in section 5 signifies the same meaning as in section 145, per the Accounting Standard notified there-under.

The entries that stand to be passed in the books of account, it may be further noted, are akin to that which shall stand to be passed where the funds are invested in interest bearing loan/advance, as (say) a deposit with the bank, with a fixed tenure. We may, for better understanding, illustrate these accounting entries (on (say) a FDR of Rs.1000/- at 10% p.a., compounded annually), as: (Amt in Rs.)

1) Interest accrued but not due A/c Dr. 100/110/121

To Interest accrued A/c	Cr.	100/110/121
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(being the amount of interest accrued on FDR No. dated maturing on at % p.a. compounded annually).

- 2) Now considering that the FDR is for 42 months (say), the entire interest accrued for the first three years (Rs.331/-) shall, along with principal amount (Rs.1000/-), form part of the principal for earning interest for the balance six months, as:

Interest accrued but not due A/c	Dr.	133
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To Interest accrued A/c	Cr.	133
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(being the amount of interest for the six month period ending on FDR No..... dated, i.e., upto the date of maturity)

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|---------------------------------|-----|-----|-----|
| 3) Interest accrued and due | Dr. | 464 | |
| To interest accrued and not due | Cr. | | 464 |

(being the interest accrued on FDR No..... transferred to due account on the maturity of the FDR, i.e., on completion of its tenure of 42 months).

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|-----------------------------|-----|------|------|
| 4) Bank | Dr. | 1464 | |
| To FDR | Cr. | | 1000 |
| To interest accrued and due | Cr. | | 464 |

(on realization of the maturity proceeds on FDR No. dated)

There is in fact a specific stipulation to depict 'interest accrued but not due' as a 'current asset' in the final accounts (balance-sheet), while the 'interest accrued and due' is to be included as a part of the 'investment'. The difference in either case, surely of presentation, signifies a distinction between what has accrued but has not fallen due for payment, and that which is since due, so that the former is a debt *in futuro* while the latter is a debt *in praesenti*. Interest does not cease to accrue only because it is receivable at a later date, which is in essence a timing difference, giving rise to the discounting aspect, which we shall presently discuss, and, in fact, the fundamental difference between 'receipt' and 'right to receive', the former representing the maturity of the right, i.e., indicating its culmination into a receipt,

discharging the obligation to the depositor-payee. Another common example could be, where sales (or, equivalently, purchases) are made on credit. Goods are sold on credit for (say) 60 days, which (credit) period could well be higher, as (say) 90/120/180/360, etc. days, though by itself of little consequence. Income is recognized the moment goods are sold and the property therein passes by delivery to the purchaser (or, equivalently, by services rendered – refer AS-9), with accounts reflecting the following entries:

(Amt. in Rs.)

1) Trade/Bills Receivable A/c	Dr.	1000 (say)	
To Sale A/c	Cr.		1000

(the value of the goods sold to ... vide bill no..... dated, due for payment on

2) Customer (by name) A/c	Dr.	1000	
To trade/bills receivable A/c	Cr.		1000

(to bill no..... dated on becoming due for payment)

3) Bank A/c	Dr.	1000	
To Customer A/c	Cr.		1000

(on receipt of payment vide cheque no..... dated..... against bill no..... dated.....).

In fact, if this basic difference (between debt in praesenti and debt in futuro) is ignored, there would be no difference between ‘cash’ and ‘accrual’ method of accounting, or determination of income, i.e., speaking in the context of tax laws, or section 145 of the Act. In particular, which in fact only endorses and subscribes the accounting principles of income recognition as prescribed by AS-9 (of ICAI), which again has statutory force u/s. 209 of the Companies Act, 1956. These entries, are not only in accord and harmony with the principles of commercial accounting, well established, the prime objective of which is to reflect the true state of affairs of the reporting enterprise and, thus, in the absence of anything to the contrary in law,

applicable, but also, as shall be seen, consistent with the accounting standards, legally mandated, so that the same have the force of law.

4.3 As the right to the assessee arises on the basis of the Agreement, we next examine the nature of this right, i.e., on facts. The right to call or put, in exercise of the option, is a right separate and distinct from the right to an increase in the value of the shares – the subject matter of call and put option, over time. In fact, it is the two rights, the right to an enhancement in the value of the shares, in which the assessee company is invested, and the right to, at its option, subject to the satisfaction of the condition as to time, i.e., holding period, sell the shares to AT & T at the agreed price, predetermined as a function of time, that results in the earning of the income or the accrual of the right to receive, i.e., leads to a ‘receivable’. The amount may itself stand to be received, or even the exact amount to be ascertained, i.e., quantified, later – which though is not in any manner of doubt in the instant case. That is not of any consequence. The amount stands to be received as per the agreement on a future date, yet the right to receive the same has inured. There is no mistake or uncertainty about it. In fact, as we see it, there is no difference between the call option fee, which falls due for payment on each anniversary (of the capitalization date), with an interim divesture entitling the assessee to a pro-rata return (fee) at the prescribed rate for the holding period, i.e., in proportion to the holding period, beginning from the anniversary immediately prior to and up to the date of divesture, and the option price, i.e., at which the shares stand to be sold under the agreement. We say so as the two only represent the different modes in which the assessee stands to earn the return on its investment, accruing on time basis. Surely, the option price is to be paid only on divesture, but that is the only difference and by itself of no moment. Further, the annual return (of 11%) gets, instead of being paid, compounded, i.e., liable to fetch return at the prescribed rate (11% p.a.), for each subsequent period. That is, the two – the call option fee and the option price are, in terms of the agreement, *pari materia*, with one getting paid, and the other taken into account for computing the price

calculated to yield a return at the prescribed rate for each future period/s, with the holding period in either case being determined likewise, i.e., the date of investment (capitalization date) to the date of divesture. Why, the sponsors, implying the assessee (ML) and the parent company (AT & T) collectively, themselves regard the 'option price' and the 'call option fee' as constituting a reasonable return on investment, for which reference be made to clause 2.6 of the Agreement, which reads as under:

'2.6 The Sponsors acknowledge that pursuant to the terms of this Agreement and based on the nature of global telecommunications services and the financial prospects of AT&T India, ML will realize in almost all cases an equity return equal to the Option Price and Call Option Fee and further acknowledge that the cost structure of AT&T India is dependent upon allocations of expenses across AT&T's global operations, which allocations shall be made by AT&T in a commercially reasonable manner without specific regard to the profitability or un-profitability of AT&T India. *The Sponsors acknowledge that the Option Price plus the Call Option Fee represents a reasonable return on equity investment in the company.*'

The difference of the return (to the extent of 11%) getting paid only on the transfer of shares, i.e., on divesture, along with the return of capital, is on account of the very nature of the agreement. The same only represents the form in which the return gets received by the assessee (ML), without in any manner impacting the substance of the agreement, i.e., to secure investment for a certain period of time at a prescribed rate of return. How could then, we wonder, the assessee object to the Revenue regarding the two together as constituting its' revenue model, considering them as two streams, as it were, in which the return, forming part of revenue of the business, gets manifested.

Compound rate of return

4.4 Implicit in the concept of a compound rate of return is the notion of the income (return) for the prior period getting received and reinvested (or ploughed back); we having rather termed the two returns as *pari materia*. We may discuss this aspect of this matter, i.e., the prescription of the compound rate of return in the Agreement, in some detail. Firstly, it ensures that the return at a definite rate (16.50% p.a.) is

received for each year (representing the unit of time for which the return is defined to accrue at a specified rate), or part thereof, comprising the holding period, i.e., beginning with the date of investment up to the date of divesture. Conceptually, income at a compound rate implies that the interest/return for period 1 (say) is reinvested along with the principal (price) at the same rate. *Since the return on investment in shares (capital) is to be received only as a part of the sale price, so that it cannot be received independent of it, i.e., cannot even be notionally received, providing for it in the share holders' agreement is conceptually untenable if it were to be viewed only in the terms of investment in shares which stand to be transferred, i.e., solely as an instrument for investment in shares to be redeemed at its fair price in future.* The two terminus point (for investment) in time would be the date of investment and divesture. It is only the compounding provision that ensures a return of income for each annum (period), reckoned from the date of investment up to the date of divesture, at the same (defined) rate. Couple this with the fact that the fair price is independent of the actual value of the shares or the performance of the company during the holding period, or on the date of divesture (refer clauses 2.6, 8.13 of the Agreement), and the picture is complete. The future price would depend not on the performance of the company, and predetermining the same, which is of essence (to the agreement) lends it with a character of a financial instrument toward earning income at a defined (agreed) rate, rather than a promoter investing in an enterprise in a defined business, i.e., acquiring a stake in a particular business. *Shares, thus, represent only a medium and manner in which the investment takes place, which is regarded as parking of funds by the investor, calculated to yield a definite and stipulated rate of return.* The terms of the agreement, when read as a whole, make this abundantly clear, with the agreement in fact making no bones about it. Reference in this context be made to, *inter alia*, clauses 2.5, 2.6, 4.9, 6.11, 6.13, 6.15, 6.16, 7.3, 7.4, 8.4, 8.5, 8.8, 8.13 – 8.15, 9, 17.2 (c), 17.3 (c), 17.4-17.5 of the Agreement, some of which we reproduce as under:

‘6.13 Subject to the provisions of the Act, the Board of Directors shall determine all matters by simple majority vote, which majority shall include at least two (2) directors nominated by AT&T.

7.3 Subject to the provisions as contained in the Articles and the Act any resolution at a duly constituted General Meeting shall be adopted by a simple majority vote of the total votes validly cast at such General Meeting which majority shall include affirmative vote of AT&T.

7.4 At a General Meeting the Parties shall cause their votes in respect of their respective Shares to be cast on the matters before the meeting in a manner so to ensure that matters that have been specifically agreed to herein between the Parties get approved. ML agrees to vote all its shares in conformity with AT&T's vote on all matters presented to the shareholders by the board, except as required by applicable law and except if reasonably seen to be detrimental to ML's economic interests or reputation, provided however, that ML shall vote all its shares in conformity with AT&T's vote in regard to actions relating to matters set forth in Sections 2, 4.3, 8 and 9 of this Agreement. Without limiting the generality of the forgoing, the actions specified in Subsections 7.4(a) and (b) hereof may be undertaken by, or on behalf of, the Company only following a shareholder resolution thereon in which votes in respect of paid up equity capital of more than 75% are cast in favour of such resolution:

- a) Winding up of the Company; and
- b) if a matter is reasonably seen to be detrimental to ML's economic interests or reputation, provided however, that ML shall vote all its shares in conformity with AT&T's vote in regard to actions relating to matters set forth in Sections 2, 4.3, 8 and 9 of this Agreement.

It is hereby clarified that the failure of ML to support AT&T in the manner envisaged herein shall constitute a breach under this Agreement.

9 Buy Back of Shares

The company may, subject only to a majority vote of its Board of Directors, undertake a buy back of its shares to buy back ML's shares or adopt such other measures to repurchase, withdraw, terminate or otherwise cancel such shares in accordance with the Laws of India (the

"Buy Back") and ML agrees to (and agrees to cause any representative it may have on the Board of Directors to) support the same. The price per share for the Buy Back shall be equal to the Option Price. If another price is required to be paid by the Laws of India then the Company may elect to cancel such Buy Back. Above purchases of shares shall be made in Indian Rupees.

17.2 In the following cases, AT&T shall have the right and option to terminate this

Agreement by a written notice of thirty (30) days to ML:

(c) if AT&T is prohibited from holding some or all of the shares in the Company, as provided in this Agreement, due to any reason whatsoever, not directly attributable to the actions of AT&T.

17.3 In the following case, ML shall have the right and option to terminate this Agreement by a written notice of thirty (30) days to AT&T:

(c) if ML, subject to Section 9.1 of the Agreement, is prohibited from holding some or all of the shares in the Company due to any reason whatsoever, not directly attributable to the actions of ML.

17.4 On termination of this Agreement, as aforesaid, shall not relieve any Party of any obligations or liabilities accrued to it prior to the date of termination and the provisions of Sections 13, 16.1, 17.4 and 24 shall survive termination of this Agreement. Further notwithstanding anything contained in this Agreement:

17.4.1 On termination of this Agreement by AT&T

(i) pursuant to Section 17.2(a) or (b) AT&T may elect to require ML to sell its entire shares at their par value, to a person resident in India or other eligible person identified by AT&T and in the event of such election the sale and purchase of shares shall be completed within a period of 120 (one hundred twenty) days from the date of the written notice for termination; or

(ii) pursuant to Section 17.2(c) AT&T shall offer to sell to ML such number of shares in the Company that it can not hold at the Option Price and if ML does not exercise the said offer within 10 business days then AT&T may sell the offered shares to a person resident in India or other eligible person identified by AT&T.

17.4.2 On termination of this Agreement by ML

(i) pursuant to Section 17.3(a) or (b) ML may elect to offer its shares in the Company to AT&T at the Option Price (subject to Subsection 8.13) and the Call Option Fee pro rated for the period between the prior anniversary of the Capitalization Date and the date of termination; or

(ii) pursuant to Section 17.3(c) ML may sell the excess holding to an eligible person identified by AT&T at the Option Price (subject to Subsection 8.13) and the Call Option Fee pro rated for the period between the prior anniversary of the Capitalization Date and the date of termination.’

Discount

4.5 The compounding aspect of the rate of return has another dimension to it. It is open to be contended that in-as-much as the amount is to be admittedly received only in future, only its discounted value could be, even where so, brought to tax as the income for the year. That is, though the amount stands accrued during the year, the very fact that the right to receive is itself only for a future date, the present value of the right is not equal to the amount that stands to be received (in future). Discounting, seeks as it does to scale down future sums to their present values, is a valid and well recognized concept, both in accountancy and law (refer: *Rotork Controls India (P) Ltd. vs. CIT* [2009] 314 ITR 62 (SC); *Bharat Earth Movers vs. CIT* [2000] 245 ITR 428 (SC)). The contention, however, is misplaced in the facts of the case. This is as, as afore-stated, compounding envisages a notional receipt, which is then reinvested at the stipulated rate, as we may seek to demonstrate per a table, giving rise to secondary, tertiary, etc. income streams, i.e., the income for the intervening period, as:

[Givens - Principal Amount: Rs.1000/-, Rate: 10% p.a.]

Investment/Yr.	1	2	3	TR(@)	GA(@)
Rs.1000	(100)	(100)	100	100	1100
Rs.100	-	(10)	10	10	110
Rs.110	-	-	11	11	121
Total	100	110	121	-	1331

[@: at the end of third year; TR =} total return (exclusive of the amount considered as reinvested and, therefore, not forming part of the principal); GA = Gross Amount;

figures in brackets denote negative sums, being notionally received back for reinvestment]

The return for the first year (Rs.100/-) yields Rs.10/- each for the second and the third year, with Rs. 10/- for the first year yields Re.1/- for the third year. Similarly, the return of Rs.100 for the second year yields a return of Rs.10/- for the third year, taking the total return for that year to Rs. 21/-. Compounding, as afore explained, involves the concept of merger of principal and return thereon, i.e., capital and income, at defined intervals of time. Clearly, the return for the first and the second year gets included in the principal amount (notionally) for the second and the third year respectively, obliterating the conceptual difference between the principal (capital) and return (of income). The income for each of the three years comprising the gross amount receivable after the end of the third year, i.e., Rs.1,331/-, is only that reckoned per the FDR agreement, i.e., Rs.100, Rs.110 and Rs.121 for each of the three intervening years and, further, as it stands to be accounted for in the books of account of the investor company following accrual method of accounting (section 145). 'Discounting', thus, stands built into the arrangement, ensuring that the income/return for each unit of time (year), or part thereof comprising the investment period, is not uniform even as the investment (or the principal) amount is the same. Reference in this regard may be made to *Madras Industrial Investment Corporation Ltd.* (supra).

Right to receive

4.6 We may next address the issue of the 'right to receive' as not leading to crystallisation of any debt in favour of any assessee-company, a contention raised by the assessee while arguing non-accrual. Firstly, the said question should arise no longer in view of our findings arrived at up till now, which we may enlist as under:

- a) The shareholder's agreement, though for subscription to, and transfer of shares acquired in a company by the assessee-company, is essentially an arrangement whereby the parent of the investee company seeks to secure investment in its Indian arm for a particular period at a particular cost, and which is itself spread

into two components, both defined in terms of *percentage (ratio)* of the investment and, further, *the period of holding*.

- b) The right to receive is for a future date, cast in definitive terms, giving rise to a defined increase in the value of the holding, i.e., as a function of time, so that it increases (in geometric progression) with the period of holding. The same could have an implication *qua* the valuation (of the right). So, however, the consideration (for investment) has a built-in component for the delayed receipt of the income for the earlier period, so that the right, as also emphasized earlier, is not dormant. No adjustment in the value is accordingly called for, i.e., in the right to receive.
- c) The increased value of the holding, so that the income is realised only on its liquidation, is admittedly business income.

Coming back to our earlier discussion, the debt only implies the manifestation of a right. It cannot be that though a right exists, or has come into existence, there is no corresponding 'debt', which is thus to be understood as implying a receivable, even if realizable at a future date. The same does not imply and is not to be confused with a debt *in praesenti*, i.e., *so that the amount is due for payment*, often referred to as the 'due date'. The debt accruing is a debt realizable at a later, subsequent date. We have already, per the accounting entries pertaining to transactions of interest on deposit and sale of goods, sought to emphasize and explain the difference between 'accrual' and 'due' (for payment). Rather, how can, it may be asked, an amount which is itself periodically, i.e., at intervals of time, reinvested, or regarded as so, fetching returns, be due for payment in the interim period. Further, it does not and need not, in order to signify accrual or of having arisen, imply a debt legally enforceable as soon as the right is created. It would though be incorrect to say that the debt so arising is not a legally enforceable debt – the debt, with all its attributes, including as to its realizability and legal enforceability, accrues or arises simultaneously with the accrual or creation of the corresponding right to receive. However, its' realizability being contracted for a future date, the same would stand to be legally enforced only upon the debt becoming liable to be redeemed/discharged. We see no contradiction between the two aspects of the matter, i.e., the character of the debt as a legally enforceable right,

which is relatable to the contract whereby and in pursuance to which it arises or accrues and, thus, to the period of the accrual thereof under the said agreement, on one hand, and the legal enforcement of its realizability, where disputed. Where, though, the accrual of the right (to receive) is itself a subject matter of dispute, the same can without doubt be subject to judicial determination during the period of the subsistence of the contract, as also at any time later; the right, in the view of one of the parties, having arisen.

4.7 We may also consider the issue from the stand point of accrual of the corresponding expenditure. This is as it cannot be that while the right to receive, even if at a future date, has come into existence and, accordingly, income accrued, the corresponding liability has not accrued. Reference with profit may in this regard be made to the decision in *Madras Industrial Investment Corporation Ltd.* (supra), wherein the Hon'ble Court explaining the concept of accrual of expenditure, held as under:

‘The expression “Profits or gains” has to be understood in its commercial sense; and there could be no computation of such profits and gains until the expenditure which is necessary for the purpose of earning the receipt is deducted therefrom, whether the expenditure is actually incurred or the liability in respect thereof has accrued even though it may have to be discharged at some future date. Thus "expenditure" is not necessarily confined to the money which has been actually paid out. It covers a liability which has accrued or which has been incurred although it may have to be discharged at a future date. However, a contingent liability which may have to be discharged in future cannot be considered as expenditure.’

Further, accrual cannot be in vacuum. Just as in the case of income, the expenditure has to be ‘incurred’ or ‘sustained’ by a ‘person’. We have already explained the issue with reference to and by taking some common day examples of interest on deposit (say, with a bank) or sale of goods. Though the reference point thereat was the depositor or the seller, the said entries or, rather, the mirror image of those entries, would be equally valid for the corresponding party, i.e., the person incurring the

corresponding expenditure, even as indicated thereat, being the depositor (bank) or the purchaser of goods (or recipient of services) in the present case. In either case, the expenditure and the corresponding liability, even if payable in future, stands incurred. We may for better comprehension, state the relevant entries as under:

(Amt. in Rs.)

- | | | | |
|---|-----|-------------|-------------|
| 1) Interest A/c | Dr. | 100/110/121 | |
| To Interest accrued but not due A/c | Cr. | | 100/110/121 |
| (to amount of interest account on loan of Rs.1000 – for year 1/2/3) | | | |
| 2) Interest accrued and due | Dr. | 331 | |
| To interest accrued but not due | Cr. | | 331 |
| (being amount of interest accrued on FDR, transferred to due account on maturity of the FDR) | | | |
| 3) FDR A/c | Dr. | 1000 | |
| Interest accrued and due A/c | Dr. | 331 | |
| To bank account | Cr. | | 1331 |
| (to the maturity proceeds of FDR transferred to the saving bank account of the depositor on its maturity) | | | |
| 4) Purchase A/c | Dr. | 1000 | |
| To Bills/Trade payable A/c | Cr. | | 1000 |
| (to amount of Bill No..... dated of, due for payment on | | | |
| 5) Bills/Trade payable A/c | Dr. | 1000 | |
| To supplier (by name) A/c | Cr. | | 1000 |
| (Bill No..... dated....., credited to the account of the supplier on it becoming due) | | | |
| 6) Supplier A/c | Dr. | 1000 | |
| To Bank A/c | Cr. | | 1000 |
| (on payment to the supplier) | | | |

The foregoing entries, as shall be evident, are the mirror images of the entries that stand to be passed in the case of the provider of the service or, as the case may be, seller of goods.

4.8 We may also address the assessee's objection that the right to receive would enure only on the sale (transfer) of shares and not at any time earlier. The argument is only a rephrasing of what stands stated earlier, i.e., that the right to receive shall arise only on the exercise of the option by either party, resulting in transfer of shares. The argument, thus, does not amount to a new or a different plea. Why, the right to receive either enures to the assessee, i.e., prior to the due date, or not, and which is in substance the issue, so that the same shall be required to be considered, irrespective of the plea/s raised by either side. The same, as would be evident, is a mixed question of fact and law. In this regard, we may also add that we are conscious that the agreement has not been doubted by the Revenue and the same shall, accordingly, have to be given its legal effect. As also explained earlier, notwithstanding the investment being admittedly in shares, i.e., called risk capital as it entails risk, the assessee company is, by the terms of the arrangement, insulated from the consequence of holding such capital, i.e., does not bear any risk. Its' return is contractually defined and, accordingly, the shareholding *sans* the attributes of risk capital or of such an investment. Irrespective of the performance of the investee company during the holding period, or the intrinsic or the market value of its shares as on the date of transfer, the assessee is to, on the exercise of the option, or alternatively by AT&T, entitled to a (contractually agreed) price calculated to give a predetermined yield. *That is, the said option is inconsistent with investment in risk capital?* Then, again, why, for example, should the parent AT&T Global, a shareholder itself, bear the risk of the fall in the price of the shareholding of the assessee-company? The assessee-company also does not partake of any (higher) return, and in case the value of shares at the time of divesture, on the basis of intrinsic value, is higher, the assessee would be entitled only to pre-determined price, which in that case – due to legal restrictions, be purchased by

a Qualified Investor (QI) specified by AT & T (clause 8.13). *The investment thus can only be regarded or euphemistically termed as in equity shares, and for all intents and purposes, or in substance, is an investment held in the form of shares for a definite period at a particular return – cost to the transferee of shares, toward the time value of the funds.* The transfer of shares is, thus, only the manner in which either party exercises the right, being the right to receive and, correspondingly, the right to acquire shares - nothing more and nothing less. Till then, it is an open contract, and the income shall continue to accrue to the assessee by elapse of time. We do not, when we state so, in any manner, hold or mean that the investment in shares is not to be regarded as such. But only that, nevertheless, the right to receive the income, which stands to be embedded in the increased value of shares, liable to be sold (transferred) after a maximum holding period of three years, the income on the said investment accrues to the assessee with time, i.e., to the same extent and in the same proportion as the value of the shareholding is stipulated to increase with time. That is, only represents the form in which the income manifests itself. The investment in shares, it may be noted, is to be considered in conjunction with the shareholders agreement, giving rise to, and defining the respective rights of both the parties thereto.

4.9 Then, one could state that the sale (transfer) of shares is not a definite event in-as-much as agreement only gives the right to either party to purchase or, as the case may be, sell shares at a particular price. True, commencing three years after the capitalization date, or at any time earlier if the relevant policy guidelines of the GOI stand relaxed, allowing a higher FDI, the option to purchase/sell shares, which is irrevocable and binding on the other party, can be made by either party. Once the threshold (lock-in) period of three years is over, and the assessee can, at its option, realize its' investment along with the accrued return thereon, the question of no definite (read maximum) time limit for exercise of the option being prescribed is rendered as of no consequence. The agreement, in our view, evenly balances the interest of both the sides. If the assessee perceives the return of 16.5% p.a.,

compounded (received) annually, as lower, it shall take steps to realise its' investment. If, on the other hand, it considers it as good a return as it can get, or is otherwise satisfied therewith, it may well continue to hold the investment for as long as AT & T so wishes. That is, as long as it does not exceed or is within its cost perception, or is otherwise acceptable thereto. The non-realization of income is, under the circumstances, only at the assessee's option and, therefore, it is only where it is so chooses that it shall stand not to be realized (during a particular period). The question, in the given facts of the case, of non realization of right by definite date does not arise. Rather, the correct way to interpret this is to say that the right to receive can be fructified, realizing the income on every single day after the completion of three years of the holding period. That is, each day after the lock-in period is or, at the option of the parties, convertible into a due date.

Nature of Income

4.10 A question may arise as to the nature of income. Income is a term of wide amplitude, so that anything that can conform to the notion of a gain or benefit, i.e., that appeals to the concept thereof, is income, as used or understood in the common parlance, with the Act only listing down, per the defining section (s. 2(24)), inexhaustively, the various types of income. Reference in this context be made to *Emil Webber vs. CIT* [1993] 200 ITR 483 (SC). The nature of income which falls to arise to the assessee is to be in the facts and circumstances of the case, including the fact that the investment under reference only represents an opportunity to the assessee to earn income from an investment, made in the course of its business as an investment company, returning the income by way of 'call option fee' as business income, only business income. *There is, in fact, no question of the assessee earning or being entitled to 'call option fee' otherwise, where it acquires the shares in the investee-company as a stakeholder (promoter).* We have, further, found the two 'returns' as *para materia*. This aspect is in fact not in doubt, and the only question of concern is of the time of accrual of income. Its' nature is referable and ascertainable with reference

to the rights inuring, and it is in that respect, only in the nature of interest income, which arises or accrues with a lapse of time. Interest is defined in AS-9 (supra) as a charge for the use of cash resources or the amount due to the enterprise, and is well settled to accrue on a day-to-day basis, i.e., irrespective of when it is due for payment (refer, *Smt. Rama Bai vs. CIT* [1990] 181 ITR 400 (SC)). This is precisely the case here, calling it interest or dividend or by any other name would be of little moment, as long as it is understood that it inures by lapse of time, as in the case of interest, which is commonly understood as the time cost of funds. Reference toward this, may be made to s. 2(28A) of the Act, defining 'interest'. The same includes in its compass interest – *payable in any manner*, in respect of borrowing or debt incurred (including a deposit, claim or obligation), and also includes service fee (or other charge) in respect of debt incurred. The call option fee, being for not exercising the call option, would also qualify as interest u/s. 2(28A). In fact, the example of bank FDRs is particularly relevant and applicable in-as-much as in that case too the return (called 'interest') is, as in the instant case, contracted to be received along with the return of capital, i.e., on the redemption/maturity of the FDR.

Matching Principle

4.11 In our view of the income, which can also be called 'interest', accruing to the assessee in the present case over time, in fact, in geometric progression, is also in agreement with the concept of the matching principle. The concept is an accounting concept and, therefore, may be argued as not strictly applicable to income determination under the Act. The argument, appealing at first blush, fails on judicial scrutiny. Firstly, the principles of commercial accounting, as explained with reference to the decisions by the Hon'ble Apex Court, shall hold for tax purposes, that is, for the purposes of the Act as well in the absence of any specific prescription to the contrary therein. Two, accrual method of accounting is legally mandated under AS-I notified under section 145(2) of the Act. When both the income and the corresponding expenditure are accounted for on accrual basis, it automatically gives rise to the

matching principle, so that it is nothing but an accounting expression for both revenues and costs, being accounted for on accrual basis. In the facts of the case, the assessee has incurred borrowing cost ranging from 10% to 14% per annum, which in fact led the AO to ascertain the assessee's revenue model and the corresponding income streams. Clearly, the assessee stands allowed all interest incurred in relation to the borrowed capital for the purpose of the investment under consideration as business expenditure. The corresponding revenue, whether realized during the current year or not, is liable to be recognized as income. Of course, there must be no significant uncertainty as to its ultimate collection, and which does not exist – being not contended at any stage in the present case. We do not, when we say so, mean that in every case of accrual of income and the corresponding expenditure (or vice versa), the same would lead to a matching. But only that, firstly, the said accounting concept stands statutorily accepted, being only being only an expression of a recognized principle of the commercial accounting, as well as judicially recognized (refer: *Calcutta Co. Ltd. vs. CIT* [1959] 37 ITR 1 (SC) and *Madras Industrial Investment Corporation Ltd.* (supra)) and, two, that in the facts and circumstances case, the nature of income and expenditure being the same, that is, in the nature of interest, both accrue on a day-to-day basis and, therefore, the matching principle is a concomitant of accrual.

Case law

4.12 We have perused the case law cited by the parties, to find that the facts as well as the ratio laid down in each of them as being consistent with what has been held by us, i.e., income in the nature of the interest income, i.e., which accrues on time basis, arises in the facts and circumstances of the case. In the facts of each of the case relied upon, which we shall discuss separately. The Hon'ble Court has clarified the inclusion of the income in which the right to receive accrues or arises to the 'assessee'.

In *A. Gajapathy Naidu* (supra), the Government, acceding to the representation of the assessee to compensate him for the loss sustained in the supply of bread to a

Government Hospital during f.y. 1948-49, *made after the close of the said year*, directed payment of sum of Rs.12,447/- by way of compensation, received during fy 1950-51, i.e., relevant to A.Y. 1951-52. The assessee disclosed it as income for that year. The Revenue sought to tax it for A.Y. 1948-49, i.e., the assessment year relevant to year in which supplies were made and the loss sustained. This was negated as the right to receive the compensation had arisen to the assessee only subsequently. Clearly, the right arose only on the direction by the Government, granting the assessee's request, and there could be no question of it relating it back to the year in which the loss arose. We may also here add that this decision, though apparently so, does not violate the matching principle. The compensation though for the loss sustained, represent two separate and distinct events. What the matching principle, on the other hand, postulates is that both the income and expenditure relating to a particular period are taken into account so as not to reflect a distorted picture - the benefit of the expenditure arising, or the expenditure referable to the benefit, in measurable terms, spreading, across years. In this case, the excess expenditure resulting in loss stood already set off against the income accruing, which is as much the operating result of the enterprise as would be a positive income. The right to compensation arose in a subsequent year and is distinct from incurring the loss itself. The position would be different had the Government been contracted and, accordingly, obliged to compensate the assessee for the loss, if any, arising to it on the relevant supplies.

In *State Bank of Travancore* (supra) another three member constitution decision, the Apex Court, in ratio, clarified that whether the income had really accrued or arisen to the assessee must be judged in the light of the reality of the situation, including the conduct of the parties. Further, the concept of real income, which is certainly applicable, cannot be extended to negate accrual, particularly where it has already accrued, i.e., is to be applied with care and within well recognized limits. The terms of the contract are plain and clear. There is also nothing inconsistent in the conduct of the parties therewith. In the reality of the situation, regard for which it is to be made, the assessee is irrevocably entitled to transfer, and AT & T Global

irrevocably obliged as well as entitled to acquire, the shares of the latter's Indian subsidiary (AT & T India) at a price, the increase in the value of which is to enure to the assessee as a function of time over the holding period, at any time after the stipulated holding period of a maximum of three years. The income by way of return on its investments accrues, and the exercise of option, and the transfer of shares which follows in consequence, are only incidental to realizing its' right, since accrued, by the assessee-company.

In *E. D. Sassoon and Co. Ltd.* (supra) relied upon by the assessee, the question that arose was whether income by way of remuneration for rendering of services arose to the assessee company on the transfer of the managing agency. As per the terms of the managing agency agreement, the agency commission was reckoned as a certain percentage per annum of the annual net profit of the particular company (U), and due on 31st March each year. The assessee-company assigned the agency to another company (S) for a consideration, on December 1, 1943, so that the question was if any part of the remuneration had accrued to the assessee-company. The Apex Court explained that the profits would only accrue to the U company at the end of the calendar year, which was the *terminus a quo* for making up the accounts and the net profits earned by the company ascertained. The amount of commission received by assignee-company was not liable to be apportioned between the period of service prior to and subsequent to the date of assignment during the calendar year (i.e., between the assignor (assessee-company) and the assignee company (S)). We are unable to see as to how the said decision adversely impacts the decision by the Revenue, which we have confirmed, or as to how the same is inconsistent therewith. The contract of assignment is a contract separate and distinct from that of the managing agency, a capital asset, which stood assigned for a consideration. Profits, it explained, can only be ascertained by comparing the value of the assets of the business at two dates, the increase shown at the later date representing the profits of the business during the year. This is precisely what was reiterated and elaborated by the Hon'ble Court in

Ashokbhai Chimanbhai (supra). The commission at a defined rate (7 ½ %) of the annual net profit of the U company, thus, arose only to the assignee-company on the conclusion of the calendar year 1943; the calendar year being the accounting year. The moment it is realized that the managing agency agreement, where-under the income by way of agency commission accrues on the rendering of the services, and the assignment agreement where-under the office of the managing agency – a business, stands assigned, are separate and distinct agreements, it shall become plain that no part of the income under the former (managing agency agreement) could enure to the assignor of the managing agency business. The said decision is not applicable.

In *Canara Bank* (supra), the assessee, a banking company, closing its accounts on December 31 every year, reflected interest accrued as on December 31, 1981, as interest relatable to the relevant period. The interest was, however, payable only after December 31, 1981. The same was held as not accrued for the relevant year, following *Vijaya Bank Ltd. vs. CIT* [1991] 187 ITR 541 (SC), in which case the appellant bank purchased securities, the price of which was contended as determined with reference to their actual value as well as the interest that had accrued on the securities till the date of purchase. The Apex Court found that the price paid was in the nature of capital outlay, so that no part of it could be set off as expenditure against income accruing on those securities. In fact, the securities would yield income by way of interest whereat section 18 of the Act would stand attracted. It was with reference to this that it was held by the Hon'ble High Court that the income fructifies to the assessee only when the securities yield interest and that it is only in such a situation section 18 is attracted, and the securities did not yield any income during the broken period of the year.

Without doubt, the purchase of the securities by the bank is only a capital outlay, so that considering any part of it as liable to be set off against interest income on securities, defined to accrue u/s. 18 of the Act, since omitted – nay, the relevant Chapter, prescribing a head of income, itself no longer part of the Act, does not arise. The question that arose for consideration for and stood answered by the Hon'ble

Court was with reference to applicability of sec. 18 of the Act, and is to be considered in that context and light only. The same cannot be considered as laying down any general proposition with regard to accrual of interest, or income in the nature of interest income. The same has to be in fact considered in light of the general principles of accrual, as explained, with rather the interest income/expenditure being itself the subject matter of adjudication from the stand point of accrual, as in the case of *Smt. Rama Bai* (supra) and *Madras Industrial Investment Corporation Ltd.* (supra), referred to earlier. It is again trite law that a precedent is an authority only for what it actually decides and not what may remotely or even logically follow from it (refer: *Goodyear India Ltd. vs. State of Haryana and Another* [1991] 188 ITR 402 (SC) and *Blue Star Ltd. v. CIT* (1996) 217 ITR 514 (Bom)).

In sum

5. The assessee following the accrual method of accounting for finalizing its accounts as well as reporting income - being in fact legally obliged to do so, the said concept, i.e., accrual, a fundamental accounting assumption – so that the accounts cannot be considered as reflecting a true and fair state of affairs until the same is adopted, was examined in light of the judicial precedents and Accounting Standards, since legally mandated. Only to find a complete harmony between the two, i.e., as judicially explained and as defined in accountancy, the commercial principles of which would even otherwise hold in the absence of anything to the contrary under the statute. The question to examine is if the right to receive the return (or income) on the shares had accrued to the assessee during the relevant year. The same flowing from the shareholder's agreement entered into by it with a parent (foreign) company of the investee-company, a resident, the said agreement stands examined in detail, even as no dispute or doubt with regard to the scope or meaning of its provisions is available on record, i.e., only with a view to ascertain the nature of the rights accruing to or vesting in the assessee per the same. The Agreement was found to unequivocally and unambiguously convey the right to receive the return on its investment (in shares) to

the assessee-company and, further, that income therefore accrued to it in the same manner and to the same extent as the increase in the value of its' share holding in the investee-company, at a defined rate per unit of time over the holding period, which was further fixed at a minimum of three years (or such lower time) as occasioned by the elimination of the Indian Government regulation on foreign equity holding levels. This is as the assessee had an irrevocable right to transfer, and the parent company (AT&T) an irrevocable right to acquire the assessee's shareholding in its Indian subsidiary (AT&T India) either to itself or through its affiliates (which have right to first refusal), at a predetermined price, called option price, which shall continue to increase with time, i.e., at the defined rate (11% p.a.), to be compounded annually, so that the agreed return shall continue to obtain, resulting in a continuous growth in option price over time. The transfer of shares in the manner afore-said, including the price determined there-under, is made the essence of the agreement, so that any contravention thereof constitutes a breach thereof, which may result in its termination. The assessee-company, which has no right to management, cannot sell, assign, transfer or otherwise dispose of its' shares (or interest therein) in any manner, or otherwise encumber the same in any manner. The assessee's investment in shares, has to be considered in conjunction with the said agreement, being in fact itself only pursuant thereto, i.e., having regard to the reality and the entirety of the facts and circumstances of the case. The same, as evident, is qualitatively very different from the shareholding of, or the rights as a shareholder of, AT&T. The provision of 'call option fee' and 'compounding' in the Agreement are considered inconsistent with investment in shares proper. It is the substance that is to prevail over form. The arrangement is accordingly found to be the only a manner of investment, akin to a financing arrangement, yielding return (income) as a function of time. No doubt or uncertainty with regard to the realization or the ultimate collection of the income – by way of option price on transfer of shares, obtaining (i.e., reckoned in a realistic manner), the income (by way of return on investments in shares) is found to have accrued by way of inflow of or giving rise to a receivable. The arrangement is in fact

– AT & T not requiring any financier, but entering the arrangement all the same only to comply with the GOI policy as to a cap on the foreign equity participation in the telecom sector for the time being, not even a financing arrangement. The agreement and the rights accruing thereby was further examined from the stand point of and in the light of a provision of the compound rate of return (on annualized basis – so that the same increases in geometric progression with time); discounting for net present value, only to find further endorsement of the said view and, further, of not impacting the valuation (of the right to receive) or the accrual of the income in any manner. Even *de hors* the character of the arrangement as a financing arrangement or any other, the nature of the investment would not be of much consequence as long as there is accrual of income in the facts and circumstances of the case, i.e., by way of right to receive – a receivable, resulting in a debt, realizable even if in future.

The right to receive, if construed as a right to receive *in praesenti*, it may be appreciated, would obliterate the difference between the ‘right to receive’ and ‘due for payment’. Or, in fact, between ‘accrual’ and ‘receipt’, used in contradistinction, even as explained in *Ashokbhai Chimanbhai* (supra). It is only the realizability of the right accrued that is postponed to a later, defined date, signified as the due date, which is at convenient or agreed dates of time. It is only because the debt has arisen and accrued that it becomes liable to be realized, even if at a later date. That, in fact, forms the fundamental or the quintessential difference between cash and accrual systems of accounting, legally recognized and judicially well explained. It would, as such, be incorrect to say that the right (to receive) that vests in the assessee with a passage of time is not a legally enforceable right. It is, further, only when the said right to receive culminates under the terms of the agreement into a realizable right, i.e., which is by a defined date and for a definite sum, that it can be said to mature for payment in favour of the recipient of income. It is only upon this that, where not (being) received, despite the compliances with the stipulations made in its respect by the assessee, that the right can be legally enforced by it. Of-course, whether the income at a definitive rate has been earned and, accordingly, accrued, is itself a subject matter of dispute, i.e., under

the terms of the arrangement/contract, the same can be subject to judicial determination. How, then, it is wondered, has the income not accrued or arisen to or, correspondingly, the right to receive not vested in, the assessee – a question which, being a mixed question of fact and law, has to be considered on a realistic assessment and consideration of the entirety of the facts and circumstances of the case, with we observing no dispute as regards facts. The fact that the income is realizable as a part of the sale price of shares, i.e., an investment by the assessee, a investment company, as a part of and in regular course of its business, to fetch return, i.e., along with redemption or liquidation of the investment, as only representing the form in which the income, imbedded in the increased share value, is realized. The same is only a manner of realization of the income, since accrued, as is the case (in other common day examples of) with interest on (cum) debentures or Bank FDR, et. al. and, thus, by itself of little moment. Could it be material, one may ask, if the interest of Debenture or FDR stands to be received, over the tenure of the investment, separately, or along with redemption of the investment? The increase in the share price to the defined extent would arise irrespective of the performance of the company during the holding period or its' intrinsic value (net worth) at the time of transfer of shares. Would it therefore matter even if (say) some management rights were also attached to the shareholding – which we observe as not. In our view – not. The investment is in a private company, shares in which are severely restricted for transfer, making it highly illiquid, i.e., but for the arrangement, in pursuance to which only in fact the investment in shares stands made. That is, considerable uncertainty would otherwise exist as to the realizability of the income. The income being also in agreement with the matching principle of accountancy, also judicially approved, is thus found to accrue from year to year, i.e., on time basis and, thus, for the relevant year. The same, further, is only by way of business income, i.e., as assessed, on which we again observe no dispute; rather, the two returns ensuing on investment, i.e., by way of call option fee (returned and assessed as business income) and the annualized return (over the holding period), found to be *para materia*, forming part of an integrated revenue

model and, further, only in the nature of interest income as defined both in the accountancy as well as by statute. There is no law that interest could be assessed only as 'income from other sources', partake as it does its' character from the underlying transaction from which it arises (*CIT vs. Govinda Choudhury* [1993] 203 ITR 881 (SC)). The case law cited stands also considered, only to find the same to be in agreement with the view expressed herein, confirming the stand of the Revenue, being essentially a question of fact, to be determined on an appreciation of the facts of the case, with the law being well settled. Finally, we observe the income arising has not been worked out by the A.O. in the manner provided for in the agreement, i.e., @ 11% p.a., compounded annually with reference to the date of the investment. The A.O. shall do so, of-course after allowing opportunity to present its working with regard thereto and consider the same. We consider ourselves competent to issue such a direction (refer: *Ahmedabad Electricity Co. Ltd. vs. CIT* [1993] 199 ITR 351 (Bom) (FB)).

6. In the result, the assessee's appeal is dismissed.

Order pronounced in the open court on May 24, 2016

Sd/-
(Joginder Singh)

न्यायिक सदस्य / Judicial Member

Sd/-
(Sanjay Arora)

लेखा सदस्य / Accountant Member

मुंबई Mumbai; दिनांक Dated : 24.05.2016

व.नि.स./Roshani, Sr. PS

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent
3. आयकर आयुक्त(अपील) / The CIT(A)
4. आयकर आयुक्त / CIT - concerned
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard File

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai