



Tax Flash News



7 November 2024

KPMG. Make the Difference.

Non-refundable maintenance charges received in advance are taxable in the year of receipt

Executive summary



There has been a controversy with regard to the year of taxability of amount received in advance under a maintenance contract spilling over more than one financial year.

The taxpayers defer the recognition of the revenue over the contract period based on the matching principle as the expenditure to provide the services will be incurred in the ensuing financial year(s).

The tax authorities take the position that the entire revenue is taxable in the year of receipt.

In the case of *Johnson Lifts*¹, the Madras High Court held that the maintenance charges collected in advance should be recognized as income at the time of receipt regardless of the year of rendition of the services.

The decision is rendered in the context where the maintenance charges received by the taxpayer were non-refundable and there was no uncertainty regarding the amount of consideration accruing from the rendition of the service.

¹ *CIT v. Johnson Lifts Pvt Ltd* (TCA No. 54 of 2015). Source: Taxsutra

Facts of the case



The taxpayer was engaged in the business of manufacturing and supplying lifts.

It also provided maintenance services for the lifts installed and commissioned by it.

For the maintenance services, it collected non-refundable annual maintenance charges (AMC) in advance from the customers.

It treated a part of these charges as income received in advance, classifying it as a current liability in its books of account as the services were to be provided by the taxpayer partly during the ensuing financial year. Accordingly, such part of charges was not offered to tax in the year of receipt.

The tax officer treated the entire amount as taxable in the year of receipt.

Taxpayer's contentions



The advance collection of AMC should be attributed to the period covered by the maintenance contract and recognized as income when the service is rendered, adhering to the accrual system of accounting and the matching principle².

The taxpayer's position was in line with the Accounting Standards notified under the Income-tax Act, 1961 which supports the recognition of income as it is earned.

When the taxpayer has assumed the obligation for maintaining the lifts for a particular period of time and collects fee for such services in advance, it is incumbent upon the taxpayer to provide the liability for unexpired period from the total advance collections made from the customers.

² Recognising/ reporting revenue at the same time as the cost it is related to.

Revenue's contentions



The entire amount of AMC received in advance should be treated as income in the year it is received, regardless of when the services are to be rendered.

The taxpayer is following a mercantile system of accounting and has received the entire AMC amount in advance without any clauses for refunding the same, which justifies its inclusion in taxable income for the year of receipt.

The customer had deducted tax at source on these payments and had also paid service tax, indicating recognition of these receipts as income.

Decisions relied by the taxpayer are distinguishable

The taxpayer relied on the decisions in the case of *Coral Electronics and TVS Electronics*³.

In those decisions, the customer had a right to terminate the contract if the services rendered by the vendor were not to the satisfaction of the customer and get a refund for the unexpired period.

It was highly uncertain as to whether the amount collected would at all remain as income of the taxpayer.

The amount received by the taxpayer at the time of entering into contract was nothing but an advance, which on the progress of each day got converted into revenue. The income was accruing on a day-to-day basis based on the progress of time.

In the instant case, there is no clause for the cancellation of contract by the customer.

The decision of the Special Bench of the Tribunal in the case of *Mahindra Holidays*⁴ is also distinguishable as in that case, the unexpired period of the contract therein was very long and the income was spread over 33 or 25 years depending on the scheme whereas in the present case, the contract period was only one year.

The Revenue relied on the Madras High Court decision in the case of *G.S.R. Krishnamurthy*⁵ where there was no obligation to refund the amount collected.

³ *CIT v. Coral Electronics (P) Ltd* [2005] 274 ITR 336 (Mad) and *DCIT v. TVS Electronics Ltd* [2012] 22 taxmann.com 215 (Chennai)

⁴ *ACIT v. Mahindra Holidays Resorts India Ltd* [2010] 3 ITR(T) 600 (Chennai) (SB)

⁵ *CIT v. G.S.R. Krishnamurthy* [2003] 262 ITR 393 (Mad)

High Court decision



The Supreme Court in the case of *J.K. Industries*⁶ held that if the accounting standards are properly applied, accounting income is to be adopted as the taxable income of a taxpayer. The adoption of accounting standards and of accounting income as taxable income would avoid distortion of accounting income which is the real income.

However, if a taxpayer fails to adopt accounting standards properly for the computation of income and the method adopted by the taxpayer results in distortion of profits, the tax officers⁷ has the discretion to complete the assessment to the best of their judgment.

In the instant case, the treatment of the AMC as a current liability was incorrect and led to a distortion of the true state of its income.

As per the accounting standards, only the uncertainties regarding the determination of amount may influence the timing of recognition of income.

As the spare parts and software of the lift installed by the taxpayer are not available in the open market, the customers will have no choice to opt for other service provider.

There was no significant uncertainty regarding the amount of consideration that would be derived from rendering the service.

In such a situation, if the amount is received, the taxpayer cannot stagger the recognition of income to a future date merely because service is to be provided during the ensuing financial year.

Accordingly, the AMC collected in advance should be recognized as income at the time of receipt, even if mercantile system of accounting was followed.

The conclusion may be different if there was a possibility to refund the charges to the customer based on the terms of the agreement.

The matching principle is not an absolute principle invariably applicable in each and every case.

⁶ *J.K. Industries Ltd v UOI* (2007) 13 SCC 673

⁷ Under section 145(3)

Our comments



The Supreme Court in the case of *E.D. Sassoon*⁸ has held that the income accrues when the taxpayer acquired a right to receive the income. There must be a debt owed to him by somebody.

This decision underscored the need to evaluate the terms of the maintenance agreement and accordingly, determine the year of taxability of the maintenance charges.



⁸ *E.D. Sassoon & Co. Ltd. vs. CIT* [1954] 26 ITR 27 (SC)

KPMG in India addresses:

Ahmedabad

Commerce House V, 9th Floor,
902, Near Vodafone House, Corporate Road, Prahlad Nagar, Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Hyderabad

Salarpuria Knowledge City, 6th Floor, Unit 3, Phase III, Sy No. 83/1, Plot No 2, Serilingampally Mandal, Ranga Reddy District, Hyderabad – 500 081.
Tel: +91 40 6111 6000

Noida

Unit No. 501, 5th Floor, Advant Navis Business Park, Tower-A, Plot# 7, Sector 142, Expressway Noida, Gautam Budh Nagar, Noida – 201 305.
Tel: +91 0120 386 8000

Bengaluru

Embassy Golf Links Business Park, Pebble Beach, 'B' Block, 1st & 2nd Floor, Off Intermediate Ring Road, Bengaluru – 560071 Tel: +91 80 6833 5000

Jaipur

Regus Radiant Centre Pvt Ltd., Level 6, Jaipur Centre Mall, B2 By pass Tonk Road, Jaipur – 302 018.
Tel: +91 141 - 7103224

Pune

9th floor, Business Plaza, Westin Hotel Campus, 36/3-B, Koregaon Park Annex, Mundhwa Road, Ghorpadi, Pune – 411 001.
Tel: +91 20 6747 7000

Chandigarh

SCO 22-23 (1st Floor), Sector 8C, Madhya Marg, Chandigarh – 160 009.
Tel: +91 172 664 4000

Kochi

Syama Business Centre, 3rd Floor, NH By Pass Road, Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Chennai

KRM Towers, Ground Floor, 1, 2 & 3 Floor, Harrington Road, Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Kolkata

Unit No. 604, 6th Floor, Tower – 1, Godrej Waterside, Sector – V, Salt Lake, Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai

2nd Floor, Block T2 (B Wing), Lodha Excellus, Apollo Mills Compound, N M Joshi Marg, Mahalaxmi, Mumbai- 400011 Tel: +91 22 3989 6000

Vadodara

Ocean Building, 303, 3rd Floor, Beside Center Square Mall, Opp. Vadodara Central Mall, Dr. Vikram Sarabhai Marg, Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada

Door No. 54-15-18E, Sai Odyssey, Gurunanak Nagar Road, NH 5, Opp. Executive Club, Vijayawada, Krishna District, Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

Gurugram

Building No.10, 8th Floor, DLF Cyber City, Phase II, Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

[kpmg.com/in](https://www.kpmg.com/in)

Follow us on:

[kpmg.com/in/socialmedia](https://www.kpmg.com/in/socialmedia)



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000

© 2024 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

This document is meant for e-communication only.