

A NATIONAL HYDROELECTRIC POWER CORPN. LTD.
v.
COMMISSIONER OF INCOME TAX
(Civil Appeal No. 6 of 2010)

JANUARY 5, 2010

B [S.H. KAPADIA AND AFTAB ALAM, JJ.]

Income Tax Act, 1961: s.115JB, Explanation-I Clause (b)
– *Applicability of – Advance against depreciation (AAD) –*

C *Held: AAD is a timing difference – It is not carried to profit and loss account – It is income received in advance subject to adjustment in future and not a reserve and hence clause (b) of Explanation (I) to s.115JB is not applicable.*

D **Assessee is supplier of electricity at notified tariff rate. The sale price included Advance against Depreciation (AAD) which is shown by assessee as sales in its profit and loss account. While computing the book profit, assessee deducted the AAD component from total sale price and took only balance amount into the profit and**
E **loss account.**

According to the Authority for Advance Rulings, reduction of AAD from the sales was reserve which had to be added back on the basis of Clause (b) of
F **Explanation-I to Section 115JB of the Income Tax Act, 1961.**

Allowing the appeal, the Court

HELD: On reading Explanation-I, to Section 115JB of
G **Income Tax Act, 1961, it is clear that to make an addition under clause (b), the two conditions which must be jointly satisfied are that there must be a debit of the amount to the profit and loss account and the amount so**

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debited must be carried to the reserve. Since the amount of AAD is reduced from sales, there is no debit in the profit and loss account. The amount did not enter the stream of income for the purposes of determination of net profit at all, hence clause (b) of Explanation-I was not applicable. Further, "reserve" as contemplated by clause (b) of the Explanation-I to Section 115JB of the Act is required to be carried through the profit and loss account. There are broadly two types of reserves, viz. those that are routed through profit and loss account and those which are not carried via profit and loss account, for example, a Capital Reserve such as Share Premium Account. AAD is not a reserve. It is not appropriation of profits. It is an amount that is under obligation, right from the inception, to get adjusted in the future, hence, cannot be designated as a reserve. It is nothing but an adjustment by reducing the normal depreciation includible in the future years in such a manner that at the end of useful life of the Plant (which is normally 30 years) the same would be reduced to nil. At the end of the life of the Plant, AAD will be reduced to nil. In fact, Schedule XII-A to the balance sheet for the financial years 2004-05 onwards indicates recouping. AAD is "income received in advance". It is a timing difference and represents adjustment in future which is in-built in the mechanism notified on 26.5.1997. This adjustment may take place over a long period of time. [Paras 10 and 11] [20-A-H; 21-A]

CIVIL APPELLATE JURISDICTION : Civil Appeal Nos. 6 of 2010.

From the Judgment & Order dated 17.12.2004 in AAR 550 of 2010 of the Authority for Advance Rulings (Income Tax), New Delhi.

Soli Dastur, Nishant Thakker, Sunita Dutt, Rajiv Mehta for the Appellant.

A Parag P. Tripathi, ASG, D.K. Singh, Kunal Bahri, Rahul Kaushik, B.V. Balaram Das for the Respondent.

The Judgment of the Court was delivered by

B **S.H. KAPADIA, J.** 1. Leave granted.

2. In this civil appeal filed by the assessee we are concerned with accounting treatment of Advance Against Depreciation ("AAD", for short).

C 3. We are concerned with assessment year 2001-02.

4. Assessee is a public sector enterprise registered under the Companies Act, 1956. Its accounts are prepared in accordance with Parts II and III of Schedule VI to the Companies Act. The entire shareholding of the assessee is with
D Government of India. Its accounts are audited by Comptroller and Auditor General of India. They are laid before both the Houses of Parliament.

5. Assessee is required to sell electricity to State Electricity
E Board(s), Discoms etc. at tariff rates notified by CERC. The tariff consists of Depreciation, AAD, Interest on loans, Interest on working capital, Operation and Maintenance Expenses, Return on equity.

6. On 26.5.97, GOI introduced a *mechanism* to generate
F additional cash flow by allowing generating companies to collect AAD by way of tariff charge. It was decided that the year in which Normal Depreciation fell short of original scheduled loan repayment installment (capped at 1/12th of the original loan) such shortfall would be collected as Advance against Future
G Depreciation. In other words, once the loan stood re-paid, the Advance so collected would get reduced from the Normal Depreciation of the later years, and such reduced depreciation would be included in the tariff, in turn lowering the tariff.

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7. How to account for such an advance is the issue before us? A

8. According to the Authority for Advance Rulings (AAR), the assessee supplied electricity at the tariff rate notified by CERC and recovered the sale price; which became its income; that, in future the said sale price was neither refundable nor adjustable against the future bills; that, the sale price (which includes AAD) was shown as "sales" in the profit and loss account; that, it was received in terms of the invoice raised by the assessee and, therefore, it was "income" in the year of receipt. However, according to AAR, when it came to computation of book profit, assessee deducted the AAD component from total sale price and only the balance amount net of AAD was taken into profit and loss account and book profit. Consequently, AAR ruled (which is challenged herein) that reduction of AAD from the "sales" was nothing but a reserve which has to be added back on the basis of clause (b) of Explanation- I to Section 115JB of the Income-tax Act, 1961 ("1961 Act", for short). B
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9. We quote hereinbelow Explanation-I to Section 115JB of the 1961 Act which reads as under: E

"Explanation 1 - For the purposes of this section, "book profit" means the net profit as shown in the profit and loss account for the relevant previous year prepared under sub-section (2), as increased by — F

- (a) xxx
- (b) the amounts carried to any reserves, by whatever name called, other than a reserve specified under section 33AC; or G

xxx

if any amount referred to in clauses (a) to (h) is debited to the profit and loss account, and as reduced by ..."

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A 10. We find merit in this civil appeal. On reading Explanation-I, quoted above, it is clear that to make an addition under clause (b) two conditions must be jointly satisfied:

B (a) There must be a debit of the amount to the profit and loss account.

(b) The amount so debited must be *carried to* the reserve.

C 11. Since the amount of AAD is reduced from sales, there is no debit in the profit and loss account. The amount did not enter the stream of income for the purposes of determination of net profit at all, hence clause (b) of Explanation-I was not applicable. Further, “reserve” as contemplated by clause (b) of the Explanation-I to Section 115JB of the 1961 Act is required *to be carried through the profit and loss account*. At this stage D it may be stated that there are broadly two types of reserves, viz, those that are routed through profit and loss account and those which are not carried via profit and loss account, for example, a Capital Reserve such as Share Premium Account. AAD is not a reserve. It is not appropriation of profits. AAD is E not meant for an uncertain purpose. AAD is an amount that is under obligation, right from the inception, to get *adjusted* in the future, hence, cannot be designated as a reserve. AAD is nothing but an *adjustment* by reducing the normal depreciation includible in the future years in such a manner that at the end F of useful life of the Plant (which is normally 30 years) the same would be reduced to nil. Therefore, the assessee cannot use the AAD for any other purpose (which is possible in the case of a reserve) except to adjust the same against future depreciation so as to reduce the tariff in the future years. As G stated, above, at the end of the life of the Plant AAD will be reduced to nil. In fact, Schedule XII-A to the balance sheet for the financial years 2004-05 onwards indicates recouping. In our view, AAD is “income received in advance”. It is a timing difference. It represents adjustment in future which is in-built in the mechanism notified on 26.5.1997. This adjustment may H

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take place over a long period of time. Hence, we are of the view A
that AAD is not a reserve.

12. For the aforestated reasons, we hold that AAD is a
timing difference, it is not a reserve, it is not carried through
profit and loss account and that it is "income received in B
advance" subject to adjustment in future and, therefore, clause
(b) of Explanation-I to Section 115JB is not applicable.
Accordingly, the impugned ruling is set aside and the civil
appeal filed by the assessee stands allowed with no order as
to costs.

D.G.

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Appeal allowed.