



MAJESTY LEGAL  
Advocates & Solicitors

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**HYPOTHETICAL INCOME IS NOT REAL INCOME AND THUS, NOT CHARGEABLE TO TAX**

**"PRINCIPAL COMMISSIONER OF INCOME TAX, SHILLONG VERSUS M/S NORTH EASTERN ELECTRIC POWER CORPORATION LIMITED"**

Hon'ble Meghalaya High Court in case of *Principal Commissioner of Income Tax, Shillong Versus M/s North Eastern Electric Power Corporation Limited*<sup>1</sup> observed that entries of hypothetical income that occurred in the books of the company would not be considered as a 'real income' to levy 'income tax'. "Income-tax is a levy on income. In this case, Appellant averred that assessee-company was following method of Hybrid System of accounting, which is a mixture of Cash Basis and the Accrual Basis of Accounting, cannot be adopted by the Company as per the provisions of Section 145(1) of the Income Tax Act, 1961.

Hon'ble Court referred to decision of Hon'ble Supreme Court's case of *Commissioner of Income-tax Vs. Shoorii Vallabhdas and Co.*<sup>2</sup>, wherein it was held that a Hypothetical income is not a real income as it doesn't result in the receipt of income. Furthermore, it observed that though the Income-tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt, yet the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a "hypothetical income", which does not materialize.

Accordingly, Hon'ble Court dismissed the appeal.

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<sup>1</sup> IT A No.2/2024

<sup>2</sup> (1962) 046 ITR 0144

<sup>3</sup> Majesty legal is a LAW FIRM established in 2013 by Ms. Mahi Yadav. Objective of this legal update is to provide insights on law, statutes and is personal in nature, not to be deemed as legal advice.

**Serial No.08**  
**Regular List**



**HIGH COURT OF MEGHALAYA**  
**AT SHILLONG**

ITA No.2/2024

Reserved on: 15.05.2024  
Pronounced on: 08.07.2024

Pr. Commissioner of Income Tax, Shillong,  
Aayakar Bhawan, M.G. Road,  
Shillong - 793 001.

... Appellant

-vs-

M/s North Eastern Electric Power Corporation Limited,  
Brookland Compound,  
Lower New Colony,  
Shillong - 793 003.

... Respondent

**Coram:**

**Hon'ble Mr. Justice S. Vaidyanathan, Chief Justice**  
**Hon'ble Mr. Justice W. Diengdoh, Judge**

**Appearance:**

For the Appellant

: Mr. S.C. Keyal, Adv with  
Mr. S. Pandey, Adv

For the Respondent

: Mr. Ved Jain, Adv with  
Mr. Nischay Kantoor, Adv  
Mr. S. Dodeja, Adv  
Mr. S. Jindal, Adv

i) Whether approved for reporting in Law journals etc.: Yes

ii) Whether approved for publication in press: Yes

**J U D G M E N T**

**(Made by Hon'ble, the Chief Justice)**

This Income Tax Appeal has been filed by the Department, challenging the order dated 12.12.2022 passed by the Income Tax Appellate Tribunal, Kolkata-Guwahati 'e-Court', Kolkata in

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I.T.A.No.45/(Gau)/2019 and in I.T.A.No.418/(Gau)/2019 for the assessment year 2014-2015, in and by which, while I.T.A.No.418/(Gau)/2019 was allowed, the other one, namely, I.T.A.No.45/(Gau)/2019 was dismissed as infructuous.

2. For the sake of brevity, the parties would be referred as 'the Department' and 'the Company'.

3. The case put forth by the Company before the Income Tax Appellate Tribunal was that it was established in the year 1976, which is operating a largest hydro power plant in North Eastern Region. The Principal Commissioner of Income Tax, Shillong observed that Mercantile System had been followed by the Company, as per which, transactions are recorded, when they arise and the incomes are recorded in the books of the accounts, when it is earned, irrespective of the fact that it is received or accrued and therefore, Hybrid System of accounting, which is a mixture of Cash Basis and the Accrual Basis of Accounting, cannot be adopted by the Company as per the provisions of Section 145(1) of the Income Tax Act, 1961 (in short 'the Act, 1961').

3.1. The Principal Commissioner of Income Tax, Shillong set aside the order of assessment under Section 263 of the Act, 1961 on 12.12.2018 for the year 2014-2015 for re-computing the income of the Company, as per which, the income was reassessed vide order

Sd/-



dated 31.01.2019 after making an addition of Rs.84,82,34.839/- and assessed under Section 154 of the Act, 1961 as Rs.383,77,29,947/-. Aggrieved by the same, the Company filed an appeal before the Commissioner of Income Tax (A), Shillong, in which the order of re-assessment was upheld by an order dated 26.07.2019. Again two appeals in I.T.A.No.45/(Gau)/2019 and in I.T.A.No.418/(Gau)/2019, have been preferred by the Company against the orders dated 12.12.2018 and 31.01.2019, in and by which, the Income Tax Appellate Tribunal, quashed the revisionary proceedings carried out under Section 263 of the Act, 1961 dated 12.12.2018 and closed the other appeal as infructuous. Dissatisfied with the order of the Tribunal, the Department is before this Court.



4. Learned counsel for the Department submitted that in this appeal, though four substantial questions of law had been raised, the Department has been canvassing this appeal in respect of Issue No.3 alone and for the sake of convenience, the four substantial questions of law are extracted below:

“1. “Whether the Hon’ble Tribunal has erred in law and facts in quashing the revisionary proceedings carried out u/s 263 of the Act by the Ld.PCIT, Shillong in concluding that the order of the A.O. is neither erroneous nor prejudicial to the interest of revenue?”

2. Whether the Hon’ble Tribunal has erred ignoring the fact that the assessee company followed mercantile system of

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accounting and Rs.791.90 crores were shown as trade receivables?

3. Whether the Hon'ble Tribunal has erred in law and facts in allowing the appeal of the assessee which is following hybrid system of accounting with respect to "interest on debtors on cash basis" in contravention of the provisions of Section 145 of the IT Act, 1961?

4. Whether the Hon'ble Tribunal has erred in law and facts in taking a view that the assessee was bound to adhere to the direction of the Ministry of Power to account for interest on cash basis?

5. Learned counsel for the Department further submitted that the method of Late Payment Surcharge (LPS) on cash basis had all along been followed by the Company from the year 2003-2004 and similar views of accepting such method of LPS on cash basis even when the books of account are maintained on Mercantile System have been recognized through various judicial pronouncements. Therefore, the order of re-assessment made by the Assessing Officer is neither erroneous nor prejudicial to the interest of the Department and the order of the Tribunal warrants interference by this Court, as it was obligatory on the part of the Company to adhere to the directions issued by the Ministry of Power then and there to account for interest on cash basis.

6. Learned counsel for the Company contended that there is no substantial question of law raised in this appeal, as the Issue No.3 pertains to a question of fact, which had already been decided by the

Sd/-



Punjab and Haryana High Court in the case of *The Commissioner of Income Tax, Hisar Vs. Dakshin Haryana Bijli Vitran Nigam Ltd., Hisar [ITA-209-2014 (O&M)] decided on 01.10.2014*, by holding that as and when the assessee receives payment of surcharge, it would be obliged to pay tax on such amount and dismissed the appeal of the revenue and the Supreme Court also confirmed the order dated 01.10.2014 in Petition for Special Leave to Appeal (C) No.18187 of 2015 dated 17.07.2019. The relevant paragraphs of the judgment of the Punjab and Haryana High Court are extracted below:

“We have duly considered the arguments but are unable to accept the contentions advanced by counsel for the appellant. Admittedly, Rs.2,25,18,23,535/- was added by the assessing officer as reflecting levy of surcharge on delayed payment of bills.

Admittedly, this amount has neither been paid nor recovered by the assessee. Admittedly, the surcharge is a disputable item and may at any time be reduced or waived and, therefore, despite the fact that the assessee maintains a mercantile system of accounting, the ITAT and the CIT (Appeals) have rightly set aside the order passed by the assessing officer adding surcharge to the income of the assessee. It would be appropriate to point out that income tax is fundamentally a levy on income and though the Act may prescribe different points in time at which liability to taxation enures still remains a tax on receipt of income. A hypothetical income that may or may not materialise should not be made subject matter of tax merely because of an entry in the accounts books maintained by an assessee. A reference in this regard may be made to a judgment of the Hon'ble Supreme Court in *“Commissioner of Income-tax Vs. Shoorji Vallabhdas and Co.” [1962] 046 ITR 0144*, wherein it has held as follows:-



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“Income-tax is a levy on income. Though the Income-tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt, yet the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a “hypothetical income”, which does not materialize. Where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account.”

In view of what has been recorded hereinabove, we find no error in the impugned orders and while dismissing the appeal record that as and when the assessee receives payment of surcharge, it would be obliged to pay tax on such amount.”

7. Learned counsel for the Company referred to a judgment of the Supreme Court in the case of Commissioner of Income Tax vs. M/s Excel Industries Ltd., and Mafatlal Industries P.Ltd., reported in 2013 (10) TMI 324, wherein it was held as under by referring to the judgment of the Supreme Court in [1962] 46 ITR 144 (supra):

“27. Applying the three tests laid down by various decisions of this Court, namely, whether the income accrued to the assessee is real or hypothetical; whether there is a corresponding liability of the other party to pass on the benefits of duty free import to the assessee even without any imports having been made; and the probability or improbability of realisation of the benefits by the Assessee considered from a realistic and practical point of view (the assessee may not have made imports), it is quite clear that in fact no real income but only hypothetical income had accrued to the assessee and Section 28(iv) of the Act would be inapplicable to the facts and circumstances of the case.



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Essentially, the Assessing Officer is required to be pragmatic and not pedantic.

28. Secondly, as noted by the Tribunal, a consistent view has been taken in favour of the assessee on the questions raised, starting with the assessment year 1992-93, that the benefits under the advance licences or under the duty entitlement pass book do not represent the real income of the assessee. Consequently, there is no reason for us to take a different view unless there are very convincing reasons, none of which have been pointed out by the learned counsel for the Revenue.

29. In *Radhasoami Satsang Saomi Bagh v. Commissioner of Income Tax*, (1992) 193 ITR 321 (SC) this Court did not think it appropriate to allow the reconsideration of an issue for a subsequent assessment year if the same "fundamental aspect" permeates in different assessment years. In arriving at this conclusion, this Court referred to an interesting passage from *Hoystead v. Commissioner of Taxation* 1926 AC 155 (PC) wherein it was said:

“Parties are not permitted to begin fresh litigation because of new views they may entertain of the law of the case, or new versions which they present as to what should be a proper apprehension by the court of the legal result either of the construction of the documents or the weight of certain circumstances. If this were permitted, litigation would have no end, except when legal ingenuity is exhausted. It is a principle of law that this cannot be permitted and there is abundant authority reiterating that principle. Thirdly, the same principle, namely, that of setting to rest rights of litigants, applies to the case where a point, fundamental to the decision, taken or assumed by the plaintiff and traversable by the defendant, has not been traversed. In that case also a defendant is bound by the judgment, although it may be true enough that subsequent light or ingenuity might suggest some traverse which had not been taken.”

30. Reference was also made to *Parashuram Pottery Works Ltd. v. Income Tax Officer*, (1977) 106 ITR 1 (SC) and then it was held:

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We are aware of the fact that strictly speaking res judicata does not apply to income-tax proceedings. Again, each assessment year being a unit, what is decided in one year may not apply in the following year but where a fundamental aspect permeating through the different assessment years has been found as a fact one way or the other and parties have allowed that position to be sustained by not challenging the order, it would not be at all appropriate to allow the position to be changed in a subsequent year.

“On these reasonings in the absence of any material change justifying the Revenue to take a different view of the matter – and if there was no change it was in support of the assessee – we do not think the question should have been reopened and contrary to what had been decided by the Commissioner of Income Tax in the earlier proceedings, a different and contradictory stand should have been taken.

31. It appears from the record that in several assessment years, the Revenue accepted the order of the Tribunal in favour of the assessee and did not pursue the matter any further but in respect of some assessment years the matter was taken up in appeal before the Bombay High Court but without any success. That being so, the Revenue cannot be allowed to flip-flop on the issue and it ought let the matter rest rather than spend the tax payers' money in pursuing litigation for the sake of it.



32. Thirdly, the real question concerning us is the year in which the assessee is required to pay tax. There is no dispute that in the subsequent accounting year, the assessee did make imports and did derive benefits under the advance licence and the duty entitlement pass book and paid tax thereon. Therefore, it is not as if the Revenue has been deprived of any tax. We are told that the rate of tax remained the same in the present assessment year as well as in the subsequent assessment year. Therefore, the dispute raised by the Revenue is entirely academic or at best may have a minor tax effect. There was, therefore, no need for the Revenue to continue with this litigation when it was quite clear that not only was it fruitless (on merits) but also that it may not have added anything much to the public coffers.

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33. For the aforesaid reasons, we dismiss the civil appeals with no order as to costs, but with the hope that the Revenue implements its litigation policy a little more practically and a little more seriously.”

Thus, it was prayed by the learned counsel for the Company that the order of the Tribunal is perfectly justified and the present appeal is liable to be dismissed.

8. Heard the learned counsel for the parties and perused the documents, including various judgments produced by the parties.

9. It was the case of the Company that there was no real income accrued to the Company and in fact, the income accrued was only hypothetical, as the transaction recorded under the advance licences or under the duty entitlement passbook do not represent the real income of the assessee and as such, the re-assessment order of the Authority concerned on the basis of Hybrid System of accounting has no legs to stand.

10. In this case, the Assessing Officer had passed an order under Section 263 of the Act, 1961, which was admittedly set aside by the Principal Commissioner of Income Tax, Shillong and thereafter, the order of reassessment was passed by the Assessing Officer under Section 263 r/w 143(3) of the Act, 1961. Once the order under Section 263 of the Act, 1961 has become final and stood quashed, no question of passing another order will arise in view of



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the fact that the subsequent order passed by the Assessing Officer is invalid in the eye of law, as the opinion formed by the Assessing Officer is not sustained on the reasoning that revision under Section 263 is not permissible. When the order of assessment is found to be erroneous and prejudicial to the interest of Revenue, the right vests with the Principal Commissioner to review the order and since the said stipulation has not been satisfied, the order passed under Section 263 cannot stand on its leg. For the sake of clarity, Sections 263 and 143(3) of the Act, 1961 are reproduced hereunder:

**“263. Revision of orders prejudicial to revenue.—** (1) The Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may call for and examine the record of any proceeding under this Act, and if he considers that any order passed therein by the Assessing Officer or the Transfer Pricing Officer, as the case may be, is erroneous in so far as it is prejudicial to the interests of the revenue, he may, after giving the assessee an opportunity of being heard and after making or causing to be made such inquiry as he deems necessary, pass such order thereon as the circumstances of the case justify, including,—

(i) an order enhancing or modifying the assessment or cancelling the assessment and directing a fresh assessment; or

(ii) an order modifying the order under section 92CA; or

(iii) an order cancelling the order under section 92CA and directing a fresh order under the said section].

Explanation 1.— For the removal of doubts, it is hereby declared that, for the purposes of this sub-section,—

(a) an order passed on or before or after the 1st day of June, 1988] by the Assessing Officer [or the Transfer Pricing Officer, as the case may be,] shall include—

(i) an order of assessment made by the Assistant Commissioner or Deputy Commissioner or the Income-tax Officer on the basis of the directions issued by the Joint Commissioner under section 144A;



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(ii) an order made by the Joint Commissioner in exercise of the powers or in the performance of the functions of an Assessing Officer [or the Transfer Pricing Officer, as the case may be,] conferred on, or assigned to, him under the orders or directions issued by the Board or by the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or Principal Commissioner or Commissioner authorised by the Board in this behalf under section 120;

(iii) an order under section 92CA by the Transfer Pricing Officer;]

(b) "record" shall include and shall be deemed always to have included all records relating to any proceeding under this Act available at all the time of examination by the Principal Chief Commissioner or Chief Commissioner or Principal] Commissioner or Commissioner;

(c) where any order referred to in this sub-section and passed by the Assessing Officer or the Transfer Pricing Officer, as the case may be,] had been the subject matter of any appeal filed on or before or after the 1st day of June, 1988, the powers of Principal Commissioner or Commissioner under this sub-section shall extend and shall be deemed always to have extended to such matters as had not been considered and decided in such appeal.

Explanation 2.—For the purposes of this section, it is hereby declared that an order passed by the Assessing Officer or the Transfer Pricing Officer, as the case may be, shall be deemed to be erroneous in so far as it is prejudicial to the interests of the revenue, if, in the opinion of the Principal [Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner,—

(a) the order is passed without making inquiries or verification which should have been made;

(b) the order is passed allowing any relief without inquiring into the claim;

(c) the order has not been made in accordance with any order, direction or instruction issued by the Board under section 119; or

(d) the order has not been passed in accordance with any decision which is prejudicial to the assessee, rendered by the jurisdictional High Court or Supreme Court in the case of the assessee or any other person.

Explanation 3.— For the purposes of this section, "Transfer Pricing Officer" shall have the same meaning as assigned to it in the Explanation to section 92CA.



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(2) No order shall be made under sub-section (1) after the expiry of two years from the end of the financial year in which the order sought to be revised was passed.

(3) Notwithstanding anything contained in sub-section (2), an order in revision under this section may be passed at any time in the case of an order which has been passed in consequence of, or to give effect to, any finding or direction contained in an order of the Appellate Tribunal, National Tax Tribunal, the High Court or the Supreme Court.

Explanation - In computing the period of limitation for the purposes of sub-section (2), the time taken in giving an opportunity to the assessee to be reheard under the proviso to section 129 and any period during which any proceeding under this section is stayed by an order or injunction of any court shall be excluded."

"143 (3) - On the day specified in the notice issued under sub-section (2), or as soon afterwards as may be, after hearing such evidence as the assessee may produce and such other evidence as the Assessing Officer may require on specified points, and after taking into account all relevant material which he has gathered, the Assessing Officer shall, by an order in writing, make an assessment of the total income or loss of the assessee, and determine the sum payable by him or refund of any amount due to him on the basis of such assessment."

11. Moreover, learned counsel for the Department canvassed his argument with regard to Issue No.3 alone (reproduced below once again), in which question of fact is involved and this Court cannot interfere with the finding of fact dealt with by the Tribunal at this moment:



"3. Whether the Hon'ble Tribunal has erred in law and facts in allowing the appeal of the assessee, which is following hybrid system of accounting with respect to "interest on debtors on cash basis" in contravention of the provisions of Section 145 of the IT Act, 1961?"

12. It is true that the term '*res judicata*' cannot be blindly applied to the income-tax proceedings as held by the Supreme Court in the case of *Parashuram Pottery Works Ltd., Vs. Income Tax*

Sd/-

Officer, reported in (1977) 106 ITR 1 (SC), but at the same time, in the absence of challenge to the fundamental aspect permeated through different assessment years, no attempt could be made to alter the position in the subsequent year. That apart, the Punjab & Haryana High Court elaborately dealt with this aspect, which got the assent from the Supreme Court as well. Thus, in the considered opinion of this Court, the order of the Tribunal is wholly justified, as we do not find any infirmity or irregularity in the order.

13. In the result, *ITA No.2/2024 is dismissed* as devoid of merits.

No costs.

Sd/-  
(W. Diengdoh)  
Judge

Sd/-  
(S. Vaidyanathan)  
Chief Justice

Meghalaya  
08.07.2024  
"Lam DR-PS"

PRE-DELIVERY JUDGMENT IN  
ITA No.2/2024



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