

Commissioner of Income Tax-VI v. Virtual Soft Systems Ltd.

Civil Appeal No. 4358 of 2018 and connected proceedings (full list below)

[2018] 5 SCR 595 | 2018-04-24

Whether the lessor may bifurcate finance-lease rentals into capital recovery and finance income by the ICAI Guidance Note method, with lease-equalisation treatment, despite no express deduction provision bearing that name.

145

Two-judge bench | R. K. Agrawal, J. | Abhay Manohar Sapre, J.

Assessment years: 1999-2000

Historical finance-lease method, not blanket reserve deductibility

This AY 1999-2000 decision accepts the identified ICAI method for measuring real finance-lease income. Verify the lease substance, full capital-recovery/depreciation reconciliation and applicable later accounting and tax rules. It does not authorize arbitrary reserves or certify present-law treatment.

01 FACTS OF THE CASE

For AY 1999-2000 Virtual Soft filed a return declaring a loss of Rs. 70,24,178 and claimed Rs. 1,65,12,077 as lease-equalisation charges. The Assessing Officer disallowed the claim and the Commissioner (Appeals) affirmed. The Tribunal allowed the assessee's appeal; the Delhi High Court sustained that result. The Supreme Court used these lead facts for the common legal question in the connected appeals (paragraphs 2-3).

Revenue argued that the adjustment was an artificial extra deduction in addition to book depreciation and that the whole lease receipt was income. The assessee described it as the method of measuring real finance-lease income under the ICAI Guidance Note (paragraphs 5-7).

Source: [reported judgment / paragraphs 2-7 / PDF pages 5, 6, 7 / judicial text](#)

02 DISCUSSION BY THE HON'BLE COURT

The Court considered ICAI's statutory expertise and the historical section 211 framework. It examined the 1995 revised Guidance Note on Accounting for Leases, including separate leased-asset and lease-adjustment disclosures, statutory depreciation, annual lease charges and the calculation of finance income. This was analysis of a finance-lease income-measurement method, not approval of any account labelled a reserve (paragraphs 8-11).

The annual lease charge recovered the lessor's net investment; finance income represented the reward for that investment, measured at a constant periodic return on the outstanding net investment. Distinguishing those components captured the substance of the transaction. Without the distinction, non-revenue capital recovery would also be taxed as income (paragraphs 12-13).

The Court rejected the claim that the bifurcation was artificial. It compared principal recovery and interest within a bank instalment: only the revenue component constitutes income. Section 145 read with the Companies Act accounting framework allowed the method in the absence of an express tax-law bar. The Guidance Note did not itself create an independent statutory deduction; it supplied a valid way of identifying real taxable income in the historical setting (paragraphs 14-17).

Source: [reported judgment / paragraphs 8-17 / PDF pages 7, 8, 9, 10, 11, 12 / judicial text](#)

03 JUDICIAL DECISION

The assessee was entitled to bifurcate lease rentals according to the ICAI accounting method considered. The Court declined to interfere with the High Court, dismissed the lead appeal with parties bearing their own costs, and disposed of the connected appeals accordingly (paragraphs 16-18).

Source: [reported judgment / paragraphs 16-18 / PDF pages 12 / judicial text](#)

04 OUTCOME / IN WHOSE FAVOUR

In whose favour: Assessee

Lead Revenue appeal dismissed; connected appeals disposed of accordingly; parties bear their own costs

Final substantive allowance of the finance-lease rental bifurcation considered

Tied to the relevant finance-lease substance and ICAI methodology for AY 1999-2000. It does not permit arbitrary reserves, duplicate capital recovery or an accounting rule to override an express tax-law bar; it does not decide revision limitation.

Source: [reported judgment / paragraphs 16-18 / PDF pages 12 / judicial text](#)

05 AKHB REVIEW POINT

Reconcile the lease contract, opening and closing net investment, finance-income schedule, statutory/book depreciation and lease-adjustment entries. The allowed method separates investment recovery from income; the label lease equalisation alone cannot justify a reserve or duplicate deduction. Check that the real transaction and complete accounting treatment correspond to the methodology considered.

Keep this substantive AY 1999-2000 ruling distinct from Alagendran Finance (27 July 2007). A bounded reread of Alagendran confirms that it decided section 263 limitation where lease equalisation had not been reopened in the reassessment; it did not decide the underlying deductibility merits. Virtual Soft neither cites nor purports to overrule that procedural ruling.

Later accounting standards, notified tax-computation rules and the relevant statutory version need a separate review. The judgment does not establish that an ICAI guidance document overrides an express tax provision or automatically governs another accounting period or the Income-tax Act, 2025.

Source: [reported judgment / paragraphs 11-18; editorial application / PDF pages 8, 9, 10, 11, 12 / judicial text; reported judgment / paragraphs 2-3 and 12-16: section 263 limitation, not lease-equalisation deductibility / PDF pages 3, 10, 11, 12 / judicial text](#)

APPEAL AND PROCEEDING NUMBERS

Civil Appeal No. 4358 of 2018 / Civil Appeal Nos. 4359, 4360, 4361, 4365, 4362, 4363, 4364, 4366-4367, 4368, 4370, 4369, 4371, 4372, 4373, 4375, 4374 and 4376 of 2018 / Lead appeal arising from SLP (Civil) No. 25006 of 2012

DETAILED DISPOSITION AND CONNECTED GROUPS

Issue results

1.

Issue: Capital-recovery/finance-income bifurcation

Result: Valid measurement of real income in the finance-lease setting considered

In whose favour: Assessee

Pinpoints

1.

Source url: [Open cited source](#)

Pdf pages: 8; 9; 10; 11; 12

Paragraphs: 11-17

Source role: judicial text

2.

Issue: Absence of an express lease-equalisation deduction provision

Result: Not fatal: Guidance Note method identifies taxable income rather than creating an independent deduction

In whose favour: Assessee

Pinpoints

1.

Source url: [Open cited source](#)

PDF pages: 11; 12

Paragraphs: 16-17

Source role: judicial text

ADDITIONAL STATUTORY CONTEXT, NOT SEPARATE HOLDINGS

145(3)

OTHER GOVERNING STATUTES

1.

Act: Companies Act, 1956

Sections: 211; 211(3C)

Role: Historical accounting-standard framework read with section 145

2.

Act: Chartered Accountants Act, 1949

Sections:

Role: Statutory basis of ICAI as an expert body

JUDICIAL AUTHORSHIP AND SEPARATE OPINIONS

R. K. Agrawal, J.

ACT IDENTIFIED IN THE REVIEWED SOURCE

Income-tax Act, 1961

EDITORIAL DISTINCTIONS FROM RELATED CASES

1.

Case id: sc-2007-07-27-alagendran-finance

Relationship: editorial distinction between substantive accounting and revision limitation

Not a judicial treatment claim: True

Evidence

1.

Source url: [Open cited source](#)

PDF pages: 3; 10; 12

Paragraphs: 2, 12 and 15-16

Source role: judicial text

SOURCE & VERIFICATION

[Hon'ble Supreme Court source PDF \(reported judgment\)](#)

Identified source rendition: 12 PDF pages; SHA-256

852f7c1a26275e02b5a9ac752fbac450727ce32852f9e5b36b129d0777544d23. Original bytes preserved.

Judicial paragraphs 1-18 on physical PDF pages 5-12; earlier pages are editorial headnote, reported identity, jurisdiction and appearances. No adjacent judgment.

Open cited source rendition

Reported SCR title/date/bench and jurisdiction checked in preserved PDF. Catalogue-supplied retrospective INSC identifier is not treated as an independently verified neutral citation.

1999-2000 is the assessment year stated for the lead factual case; separate assessment years for connected appeals are not identified in the bounded judgment.

Section 145 is the Court's statutory income-computation link. Section 145(3) appears in the assessee's submission; the Court does not lay down a separate comprehensive code for rejection of accounts. No section 263 limitation issue is decided.

The source must be distinguished from any other Virtual Soft litigation; the identity here is the 24 April 2018 finance-lease judgment in Civil Appeal No. 4358 of 2018 and companions.; In paragraph 11's quoted Guidance Note, physical page 8 prints less than minimum statutory depreciation both for the charge and the following credit condition. This source-internal inconsistency was visually checked. The note does not reproduce it as an executable accounting formula or silently repair it.; Paragraph 12's expression inflated cost of interest is awkward. The clear operative explanation distinguishes capital recovery from finance income, and that is the proposition summarized.; Section 145(3) appears in counsel's paragraph 7 submission, not as a separately reasoned holding setting every ground for rejection of accounts.; The Punjab Stainless Steel extract in paragraph 15 contains a tax-audit section label. It is not treated as an independent holding on that section.; Alagendran is included only for an expressly bounded editorial subject-matter comparison. No claim is made that Virtual Soft discusses or overrules it.

STATUTORY SCOPE

Historical assessment-year and statutory setting. No automatic mapping to the Income-tax Act, 2025; check applicable statutory text and subsequent treatment independently.

LATER TREATMENT

Source checked 2026-10-04. No comprehensive subsequent-treatment or present-law audit. Any expressly identified bounded comparison is limited to the cited passages.

IDENTIFIED SOURCE LINKS

[reported judgment - PDF pages: 12](#)

SHA-256: 852f7c1a26275e02b5a9ac752fbac450727ce32852f9e5b36b129d0777544d23

[reported judgment - PDF pages: 12](#)

SHA-256: 65796ac5ab6f2d9f95730dd305a0494cae4dae99b5f476f3f338cc02bb5254b5

[Related note: Commissioner of Income Tax, Chennai v. M/s. Alagendran Finance Ltd.](#)

AI DISCLOSURE

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