* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA No. 346 of 2009**

Reserved On: September 08, 2010

% *Pronounced On: November 29, 2010*

COMMISSIONER OF INCOME TAX . . . Appellant

through : Ms. Prem Lata Bansal, Advocate

VERSUS

TRIVENI ENGINEERING & INDUSTRIES LTD. . . .Respondent

through: Mr. Ajay Vohra, Advocate with Ms. Kavita Jha, Ms. Akansha Aggarwal and Mr. Somnath Shukla, Advocates

CORAM :-
HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MS. JUSTICE REVA KHETRAPAL

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. Though various questions of law were proposed in this appeal, the appeal was admitted on the following substantial questions of law:

> "(i) Whether ITAT was correct in law in allowing provision made by the assessee for future losses that may occur on account of different project works undertaken by it?
>
> (ii) Whether ITAT was correct in law in holding that the provision for losses was allowable as the assessee was following completed contract method of accounting?"

2. The facts germane to the aforesaid questions need only be noted and the same are capitulated hereunder.

3. This appeal pertains to the Assessment Year 2000-01. For t Assessment Year, the respondent assessee had filed the return declaring a loss @ ₹12.58 Crores. During the assessment proceedings, the Assessing Officer (AO) noticed that the assessee had debited a sum of ₹139 lacs to the Profit and Loss Account as provision for losses, which occur for different projects undertaken by it. These projects had been substantially completed during the said year and revenue gain had also been recognized during the year. The AO was of the view that the provision had been made against a liability, which may arise in future due to any defect noticed in the project and liabilities incurred by removing those defects. According to him, such a liability to be incurred by a future date, was a contingent liability and therefore, he refused to acknowledge this liability and give the allowance thereof to the assessee.

4. View of the AO was confirmed by the CIT (A) in the appeal preferred by the assessee holding that this liability provided by the assessee was of a contingent nature and was not allowable under Section 37(1) of the Income Tax Act (hereinafter referred to as 'the Act').

5. Not satisfied with the view taken by the AO as well as CIT (A), the assessee went in appeal before the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal'). The Tribunal has allowed the provision made by the assessee for aforesaid losses on the ground that the assessee was following completed contract

method and provision had been made on account of losses, wh may occur for the different project works undertaken by it and those projects having been substantially completed during the year. It was more so when the assessee had also recognized revenue gain on such project during this year itself. View of the Tribunal, thus, was that this cannot be called as liability of contingent nature and was allowable as business expenditure having regard to the consistent method followed by the assessee. This is how the Revenue is in appeal challenging the *raison d'etre* and the conclusion recorded by the Tribunal.

6. It would be advisable first to take note of the basis on which the aforesaid debit entry towards projected losses is made by the assessee in the Profit and Loss Account. In this behalf, it is explained on the basis that the respondent assessee is engaged, *inter alia*, in the manufacture and sale of sugar, turbines, etc., and in project related activities in the field of setting up of sugar plants, water treatment plants and mini hydel power projects. The assessee is following 'revenue recognition' accounting policy consistently, as per which profit on project related activities are recognized on completion or on substantial completion of the project. The year in which the projects are completed or substantially completed, the final accounts in respect of those projects are taken in that year and on that basis, it is ascertained as to whether any profit/losses made on those projects. While doing so in that particular year, the provision is also made for foreseeable losses in respect of those projects which have been

substantially completed. Even the revenue gain is recognized that year. Therefore, the relevant previous year, in respect of projects completed/substantially completed in that year, income in respect thereof was credited to the profit and loss account, taking into account unbilled revenue as well. While recognizing the profit/loss in respect of the said projects, the respondent assessee made provision for expenses to be incurred upto the stage of completion to the extent of ₹1.39 Crores.

7. Learned counsel for the assessee explained that the estimates of the expenses to be incurred up to the stage of completion was based on the consistent accounting policy. This was so stated under Clause (b)(iv) of Significant Accounting Policies forming part of "Notes to Accounts and Significant Accounting Policies", is as under:

> "Revenue Recognition
>
> ... .
>
> iv) Profit on project related activities are recognized on completion or on substantial completion of the project. Provision is, however, made for foreseeable losses, if any, in respect of projects which have been substantially completed."

As per Accounting Standard (AS) 7 (Accounting of Construction Contracts) as applicable at the relevant time under the completed contact method, revenue is recognized only when the project is complete or substantially complete. Till that date, all costs incurred and accumulated as part of work in progress and on account payments received are shown as current liabilities. In the year, when the project is complete/substantially complete,

(i) Revenue on the project is recognized included balan billing left,

(ii) All costs taken as part of work in progress are debited to the profit and loss account and

(iii) additionally, anticipated costs till completion are also debited to the profit and loss account,

to determine the profit/loss on the particular project. It is claimed that the aforesaid method of accounting consistently and regularly followed by the respondent assessee has been accepted by the Revenue all along.

8. It is not in dispute that the AO accepted the method of accounting. However, he did not allow the aforesaid expenses on the ground that the same were contingent in nature.

9. Ms. P.L. Bansal, learned counsel appearing for the Revenue, was vehement in her submission that the approach of the AO, as affirmed by the CIT(A), were perfectly justified, legal and valid as the same accorded with the provision of the Act. She argued that as no such expenditure was in fact incurred in the said year and it was only on the basis of some purported estimates that such an expenditure may arise in future, which was claimed in this year and this according to her, was not allowable under Section 36 or Section 37 of the Act. Her submission in this behalf was that as the expenses were yet to be incurred, the liability thereof could not be said to have accrued so as to allow under the mercantile

system of accounting, as it was not a liability *in praesenti*. S also pointed out that the explanation given by the respondent assessee before the AO was that the assessee had provided for "anticipated losses". Such anticipated losses or anticipated expenses, which were unascertainable as on that date were unallowable. She referred to the various decisions of the Supreme Court and certain High Courts in support of her aforesaid arguments. These are as under:

(i) ***Indian Molasses Company Pvt. Ltd.*** Vs. ***Commissioner of Income Tax*** **[37 ITR 66 (SC)];**

(ii) ***Shri Sajjan Mills Ltd.*** Vs. ***Commissioner of Income Tax*** **[156 ITR 585 (SC)];**

(iii) ***Commissioner of Income Tax*** Vs. ***Lachhman Das Mathura Das*** **[124 ITR 411(All)],**

(iv) ***Commissioner of Income Tax*** Vs. ***Seshasayee Industries Ltd.*** **[242 ITR 691 (Mad)].**

10. Mr. Ajay Vohra, learned counsel appearing for the assessee, countered the aforesaid submissions of the learned counsel for the Revenue. He supported the decision of the Tribunal by articulating his submission with finesse, in the following manner:

1) There was a consistent and regular method accounting followed by the assessee, which was recognized and accepted by the Income Tax Department also for all previous years. It was argued that under Section 28(i) of the Act, profits and gains of business which was carried on by the assessee at any time during the previous year are chargeable under the head "profit and gains of business or profession". For calculating these profits and gains of business, Section 145 of the Act provided the

method of accounting, as per which such profits a gains were computed in cash or mercantile system of accounting regularly employed by the assessee. It was a submission that no doubt, the AO was not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting had not been followed by the assessee. In the present case, the assessee had followed consistently mercantile method of accounting. In respect of project related activities, the assessee had consistently and regularly followed the completed contract method in terms of Accounting Standard (AS) 7 issued by the ICAI. This method had been accepted by the Revenue all along. Even in this year, this method was not rejected from which it would be evident that the AO was satisfied with the correctness and completeness of the accounts of the assessee and further with the method of accounting regularly employed as being scientific and rationale. In such circumstances, argued the learned counsel for the assessee that it is not open to the AO to deviate from the regularly and consistently followed method of accounting followed by the assessee and accepted by the Revenue. He argued that the Courts have highlighted the primacy of the method of accounting and held that the consistent and regular method of accounting is supreme unless the AO finds that accounts of the assessee are not correct or complete or that the method of accounting is not

regularly followed/not in accordance with the notifi accounting standards. For this, he relied upon the following judgments:

(i) ***CIT vs. Bilhari Investment P. Ltd.* [299 ITR 1];**

(ii) ***CIT vs. Realest Builders and Services Limited* [307 ITR 202]**

(iii) ***CIT vs. Woodward Governor India P. Limited* [312 ITR 254]**

2) His another facet of submission was based on the proposition that being a company incorporated under the Companies Act, it was obligatory on the part of the assessee that it is the accounts must conform to the mandatory accounting standards issued by the ICAI. Referring to Para 16 of Accounting Standard-I relating to "Disclosure of Accounting Policies". He submitted that the same provides the accounting policy adopted by and assessee should be such so as to represent a true and fair view of the state of affairs of the business of the assessee. Para 9 of the said Accounting Standard – I further provides that the fundamental accounting assumptions relating to going concern consistency and accrual must be followed in preparation of the financial statements. The expressions "going concern", "accrual" and "consistency" have been defined in Para 10 which reads as under:

> "10. The following have been generally accepted as fundamental accounting assumptions:-

a. Going concern. The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the sale of the operations.

b. Consistency. It is assumed that accounting policies are consistent from one period to another.

c. Accrual refers to the assumption that revenues and costs are accrued, that is, recognized as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate"

Para 17 of the said Accounting Standard further provides that selection and application of accounting policy must be governed, *inter alia,* by "prudence", which has been explained in the following terms:

> "(i) Prudence: Provisions should be made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information."

He thus, argued that as per Section 145(2) of the Act, it as mandatory that the assessee follows the accounting standard that may be notified by the Central Government and referred to the Notification No.SO 69(E) dated 25.1.1996. He submitted that the Central Government had notified Accounting Standard – I relating to Disclosure of Accounting Policies and therefore, following the aforesaid Accounting Standard prescribed by ICAI became mandatory even for the purposes of income tax in view of the aforesaid provisions.

3) Invoking the principle of matching cost with revenue, was also the submission of Mr. Vohra that this principle justified the manner in which accounts were maintained by the assessee following revenue recognition in respect of project related activities as otherwise the accounts would give distorted figure of profits and losses. His submission was that when the entire revenue from the contract is recognized in the year under appeal, including unbilled revenue for which invoices have been raised in the succeeding year, on the principle of matching costs with revenue, too, the expenditure to the incurred in future, within the scope of the contract, has to be provided for and allowed deduction against the revenues from the contract. He also relied upon the case of the Supreme Court in the case of the Supreme Court in the case of ***Calcutta Company Limited*** Vs. ***Commissioner of Income Tax*** **[37 ITR 1]** that the present case was parallel to the said case where matching principle was applied by the Apex Court.

4) Last weapon which is used by Mr. Vohra from his armoury was that the issue raised by the Revenue, in any case, was only academic as the entire exercise was revenue neutral.

11. After considering the submissions, the counsel on the either side, in the given facts, we are of the *prima facie* view that arguments of the learned counsel for the assessee to prevail. The learned

counsel for the Revenue may be correct in stating the propositi of law, generally. No doubt, unless the expenditure is actually incurred or it is accrued in the relevant year, it would not be allowed as deduction. Such a liability has to be in praesenti. However at the same time, in the given scenario where in relation to the project works undertaken by the assessee, completed contract method of accounting is followed, which is consistent with the Accounting Standards and these accounting standards also lay down the norms indicating the particular point of time when the provisions for all known liabilities and losses has to be made, the making of such a provision by the assessee appears to be justified moreso when the assessee had recognized gain as well on such project during this year itself. This appears to be in consonance with principle of matching cost and revenue as well. However, in the projected scenario of this case after taking stock of the entire situation, we are of the opinion that it is not necessary to conclusively answer the aforesaid questions formulated. It is because of the reason that we find that the entire exercise is revenue neutral. It may be pointed out that it is a matter of record that against the provision of ₹139 lacs, the assessee had to actually incur expenditure of ₹218.03 lacs, i.e., more than the provision made. It is undisputed that the expenditure incurred by the assessee on the project is admissible deduction. The only dispute that the Revenue seeks to raise is regarding the year of allowability of expenditure. Considering that the assessee is a company assessed at uniform rate of tax, the

entire exercise of seeking to disturb the year of allowability expenditure is, in any case, revenue neutral.

12. We are reminded of the classic observations made by Justice Tendolker in the case of the ***Commissioner of Income-tax, Delhi, Ajmer, Rajasthan and Madhya Bharat*** Vs. ***Nagri Mills Co. Ltd.*** **[33 ITR 681]**, which reads as under:

> "We have often wondered why the Income-tax authorities, in a matter such as this where the deduction is obviously a permissible deduction under the Income-tax Act, raise disputes as to the year in which the deduction should be allowed. The question as to the year in which a deduction is allowable may be material when the rate of tax chargeable on the assessee in two different years is different; but in the case of income of a company, tax is attracted at a uniform rate, and whether the deduction in respect of bonus was granted in the assessment year 1952-53 or in the assessment year corresponding to the accounting year 1952, that is in the assessment year 1953-54, should be a matter of no consequence to the Department; and one should have thought that the Department would not fritter away its energies in fighting matters of this kind. But, obviously, judging from the references that come up to us every now and then, the Department appears to delight in raising points of this character which do not affect the taxability of the assessee or the tax that the Department is likely to collect from him whether in one year or the other."

13. The aforesaid observations of the Bombay High Court were reiterated by this Court in the case of ***Commissioner of Income Tax*** Vs. ***Shri Ram Pistons and Rings Ltd.*** **[220 CTR 404]**, as under:

> "Finally, we may only mention what has been articulated by the Bombay High Court in Commissioner of Income Tax, Delhi, Ajmer, Rajastha and Madhya Pradesh vs. Nagri Mills Co. Ltd. [1958] 33 ITR 681 as follows:
>
> ... .

In the reference that is before us there is no doubt that the Assessee had incurred an expenditure. The only dispute is regarding the date on which the liability had crystallized. It appears that there was no change in the rate of tax for the Assessment Year 1983-84 with which we are concerned. The question, therefore, is only with regard to the year of deduction and it is a pity that all of us have to expand so much time and energy only to determine the year of taxability of the amount."

14. In such circumstances, we are of the view that insofar as present appeal is concerned, substantial questions of law that need to be answered does not arise. We, therefore, dismiss this appeal on this ground alone.

(A.K. SIKRI)
JUDGE

(REVA KHETRAPAL)
JUDGE

NOVEMBER 29, 2010
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