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

+ ITA 195/2006

LUNAR ELECTRICALS Appellant
Through Mr. S. Krishnan, Advocate.

versus

ASSISTANT COMMISSIONER OF INCOME TAX
..... Respondent
Through Mr. Sanjeev Rajpal, Advocate.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R.V.EASWAR

% **ORDER**
22.03.2012

In this appeal by the assessee, which pertains to assessment year 1997-98, the following two substantial questions of law were formulated for determination vide order dated 14th February, 2006:

“1. Whether the Tribunal erred in law in sustaining the orders of the lower authorities holding that the loss of Rs.4,10,783/- returned by the appellant did not arise from NBCC job contract in accordance with the mercantile system of accounting in the assessment year 1997-98?

2. Whether the Tribunal was right in law in sustaining the order of assessment when the requirement of Section 144 of the Act



has not been complied with by the Assessing Authority?”

2. The factual position as found by the Income Tax Appellate Tribunal (tribunal, for short) with regard to question No. 1 is that the assessee was awarded a works contract by NBCC for doing electrical work vide contract dated 27th September, 1991. The payments received/bills raised and the expenditure incurred were not included in the profit and loss account, but were shown in the balance sheet under the head “running payment against work in progress” and “running expenses under work in progress”. This was because work was not complete and was continuing. The assessee under the said two heads for the work in question had shown receipts of Rs.18,62,599/- and expenses incurred of Rs.22,73,383/- upto 31st March, 1994. Disputes had arisen between the appellant and NBCC, which were referred to arbitration. It is stated at the Bar by the learned counsel for the appellant that the arbitration proceedings are still continuing.

3. The Assessing Officer during the course of assessment proceedings asked the appellant to furnish full details of the 12 projects, including NBCC project, which were complete or were continuing. The Assessing Officer held that the assessee cannot adopt project completion method after amendment of



Section 145 of the Income Tax Act, 1961 (Act, for short) with effect from assessment year 1997-98. He held that project completion method would amount to adopting an hybrid system of accounting, which was prohibited and barred by the said amendment. On the basis of the details furnished by the assessee, the Assessing Officer drew up a statement of profit, i.e., income and expenditure account for the period ending 31st March, 1997. He calculated the average rate of profit on the value of 11 contracts and applied the rate of profit on value of work in progress for the NBCC project. Accordingly, the income of the assessee was enhanced from Rs.4,02,810/- to Rs.12,93,976/-. The assessment order records that it was passed under Section 143(3) and 144 of the Act.

4. The CIT(Appeals) rejected the plea raised by the assessee regarding “project completion method”, inter alia, recording as under:-

“The Ld. Counsel of the appellant has specifically invited my attention to the words “regularly followed”. It has been claimed that this should be read as being followed from year to year. The Ld. Counsel has pleaded that upto asstt. Year 1996-97 the appellant was following hybrid system of accounting. Only because of amendment to Section 145, the appellant had to shift to mercantile system of accounting for financial year 1996-



97. Therefore, it has been pleaded that the expression “regularly followed” was inapplicable to the case of the appellant. On careful consideration of rival submissions and after verifying the relevant provisions of law, I find that the word “regularly” appearing in sub-section (3) of Section 145 does not refer to the history of the case. It clearly refers to the asstt. year for which books are being examined by the A.O. The A.O. has only to verify whether accounting standards in respect of a method of accounting have been followed in a regular manner for any particular asstt. year. If there are any violations of these accounting standards in respect of any entry made in the books of account, then he could reject the books of accounts. Therefore, I find no merit in this ground of appeal taken by the appellant which is rejected.”

5. In the same order the CIT(Appeals) also dealt with the contention of the assessee in regard to computation of profit relating to NBCC and held as under:-

“10. It has been explained that the appellant did not accept the calculations made by the NBCC Ltd and referred the matter for arbitration to Project Engineer vide letter dated 2.1.95 i.e. financial year 1994-95 and asstt. year 1995-96. Since then, the dispute is stated as pending before the arbitrator. It has been stated that after 31.3.94 further expenditure of Rs.49,941 had been incurred which included expenses on litigation and on some labour. During the asstt. year under appeal, expenses only amounting to Rs.331 in respect of conveyance and photostate regarding



arbitration proceedings has been debited which is ignored being petty. Repeated opportunities were allowed to the appellant to give justification for claiming the loss during the asstt. year under appeal from NBCC project. Neither any work was done during the previous year nor any payments were received. Neither the dispute had been referred to the arbitrator during the previous year nor the decision of the arbitrator had been received. In fact, the dispute is still pending before the arbitrator. Under such circumstances, the only reasonable course of action would be to carry forward the debit as well as credit to succeeding years till such time as the arbitration award is received. Thus, during the asstt. year under appeal, neither the loss would be allowable as deduction nor the profit could be estimated for addition. Actually, the entries relating to NBCC project would have to be excluded altogether from the works account. The consequences of this action would be as under.

11. Loss amounting to Rs.4,10,783 claimed by crediting Rs.18,62,599 and by debiting Rs.22,73,383 in NBCC account, would be disallowed. This would result in addition of Rs.4,10,783 to the income of the appellant. Thus, addition to this extent is sustained. However, estimated profit of Rs.2,94,959 added by the A.O. would be deleted. Consequently, out of total addition of Rs.8,92,606 made by the A.O., addition to the extent of Rs.5,95,747 (184964+410783) is confirmed resulting in relief of Rs.2,94,859 to the appellant.”

6. A reading of paragraph 10 would show that the



CIT(Appeals) had observed that both the billings/receivable as well as the expenditure had to be excluded from the debit and the credit side of the profit and loss account. This was necessary as per the CIT(Appeals), because the matter was pending arbitration. In other words, the CIT(Appeals) contrary to what has been held and quoted earlier, observed that the project completion method could be adopted. However, he again contradicted himself in paragraph 11 of the same order. He observed that the loss amounting to Rs.4,10,783/- which was claimed by the assessee should be disallowed. He forgot that the assessee had never claimed loss of Rs.4,07,483/- and he was following the project completion method and both the receivable, i.e., Rs.18,62,599/- and the expenditure, i.e., Rs.22,73,383/- had not been included either in the debit or the credit side of the profit and loss account.

7. When the matter was taken up by the assessee before the tribunal, they approved the findings recorded by the CIT(Appeals) with reference to paragraph 10 of his order. The relevant portion of the order of the tribunal reads:-

“9. It is undeniable that under a mercantile system of accounting, the expenditure or loss incurred by the assessee in relation to a transaction is to be allowed on the basis of



its accrual in contrast of cash system of accounting wherein such loss or expenditure is to be allowed only when it is actually paid for. The system of accounting for the year under consideration, as had been accepted by the assessee, is mercantile basis. However, the dispute before us is not to test the claim merely on the basis of mercantile system of accounting, as advanced by the assessee. In cases where income generating contracts are a subject matter of dispute, even before the completion of the contracts, it cannot be said that any income or for that matter, any loss appropriates to the assessee before such dispute is finally settled or till such time the contract is terminated. For that proposition, parity of reasoning enunciated by the Hon'ble Apex Court in the case of Hindustan Housing & Land Development (supra) is relevant for consideration. In the instant case, neither has the NBCC contract been completed nor has the arbitration proceedings culminated in a settlement of dispute during the year under consideration in the absence of either of the aforesaid happenings a) it cannot be deduced as to what incomes devolve on the assessee and, b) as to how much expenditure is liable to be incurred by the assessee on this contract. Therefore, not only the right to receive the contract receipts is inchoate but even the expenditure incurred or likely to be incurred by the assessee remain in realm of contingency. Therefore, on this ground, we are unable to conclude that the impugned loss has either accrued or crystallized in the hands of the assessee during the year under consideration. Hence, we sustain the decision of the first appellate authority on this issue.”



8. The only confusion, which is created by the aforesaid paragraph and the reasoning given by the tribunal, is regarding the clarification which was required in respect of paragraph 11 of the order of the CIT(Appeals). Accordingly, we clarify that in case the assessee had not claimed loss of Rs.4,10,783/- in the profit and loss accounts, the same will not be reduced. In case he had claimed this loss, it will be disallowed. We will also clarify that both entries of Rs.18,62,599/- and Rs.22,73,383/- will be excluded from the credit and debit side of the profit and loss account. We accordingly answer the question No. 1 partly in affirmative and partly in negative and in terms of what has been directed above.

9. The next aspect relates to rejection of books of accounts because the assessee was following completed contract method. We do not think completed contract method is contrary and cannot be adopted and applied when an assessee follows mercantile system of accounting. This issue was examined by the Madras High Court in ***Commissioner of Income Tax versus SAS Hotels and Enterprises Limited***, (2011) 334 ITR 194 (Mad.) and it has been held that the said method confirms and can be adopted by an assessee. In fact, we find that there is a



contradiction in the orders of both the CIT(Appeals) and the tribunal on the said aspect. With regard to NBCC contract, both of them have held that the receivables and expenses should be excluded as the contract was incomplete. But, at the same time they have held that completed contract method cannot be adopted for the purpose of accounts/computing taxable income as the assessee is following mercantile system of accounting. We may notice here that while examining the question of rejection of books of accounts, the CIT(Appeals) in his finding, which have been quoted above, was ambivalent and did not deal with the real issue and question whether or not the completed contract method is permitted and can be adopted by the assessee following mercantile system of accounting. The tribunal also went on certain other aspects relating to service of notice in the first proviso to Section 145 and did not deal with the issue and question accordingly. On the second question, therefore, we hold and observe that completed contract method can be adopted under Section 145 of the Act when an assessee follows mercantile system of accounting. However, we remand the matter to the tribunal to examine the other aspects relating to computation of taxable income on the basis of completed



contract method. Question No. 2 is accordingly answered partly affirmative and partly in negative.

10. The appeal is disposed of. No order as to costs.

11. To cut short the delay, the parties are directed to appear before the Assistant Registrar of the Tribunal on 30th April, 2012, when a date of hearing will be fixed.

SANJIV KHANNA, J.

R.V. EASWAR, J.

MARCH 22, 2012
VKR