

आयकर अपीलीय अधिकरण “सी” न्यायपीठ मुंबई में।
IN THE INCOME TAX APPELLATE TRIBUNAL “C” BENCH, MUMBAI
BEFORE SHRI SANJAY ARORA, AM AND SHRI AMARJIT SINGH, JM

आयकर अपील सं./I.T.A. No. 2334/Mum/2013

(निर्धारण वर्ष / Assessment Year: 2009-10)

CMI FPE Limited Mehta House, Plot No. 64, Road No. 13, MIDC, Andheri (E), Mumbai-400 093	बनाम/ Vs.	Asst. CIT-LTU, World Trade Centre-I, 28 th Floor, Cuffe Parade, Mumbai – 400 005
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. AAACF 0252 F		
(अपीलार्थी /Appellant)	:	(प्रत्यर्थी / Respondent)
अपीलार्थी की ओर से / Appellant by	:	Shri K. K. Ved
प्रत्यर्थी की ओर से/Respondent by	:	Shri S. Pandian
सुनवाई की तारीख / Date of Hearing	:	17.03.2016
घोषणा की तारीख / Date of Pronouncement	:	10.06.2016

आदेश / ORDER

Per Sanjay Arora, A. M.:

This is an Appeal by the Assessee directed against the Order by the Commissioner of Income Tax (Appeals)-24, Mumbai ('CIT(A)' for short) dated 12.12.2012, partly allowing the Assessee's appeal contesting its assessment u/s.143(3) of the Income Tax Act, 1961 ('the Act' hereinafter) for the assessment year (A.Y.) 2009-10 vide order dated 19.12.2011.

2. The only issue arising in the instant appeal is with regard to the confirmation of the disallowance toward provision for loss on contracts made by the assessee in its' accounts for Rs.125.39 lacs. The assessee is a domestic company and its principal

activities comprise manufacturing and installation of cold rolling mills, galvanizing lines, colour coating lines, tension leveling lines, skin pass mills, acid regeneration plants and pickling lines for ferrous and non-ferrous industries worldwide. For the year under reference, it has changed its system of accounting in certain areas to fall in line with the Accounting Standards for these areas. Accordingly, provision for Rs.1,25,39,456/- was made in respect of fixed price contracts undertaken by it following the Accounting Standard-7 (issued by ICAI), since notified by the Government of India, Ministry of Corporate Affairs vide G.S.R. No. 739(E) dated 07.12.2006 by the Government of India, Ministry of Corporate Affairs (PB pgs. 89-92). The provision was explained to be made on the basis of technical assessments carried out by the company of the individual projects, based on their nature, estimated expenses, cost escalation, etc. The Revenue, however, found the assessee's claim as being not in terms with the requirements of law. Firstly, the Accounting Standards were notified by the Government in December, 2006, while the assessee had effected a change only w.e.f. 01.4.2008. When the assessee had not recognized the revenue from the said contracts, the question of allowing the so-called estimated loss in respect of some of them would not arise because that would lead to lop-sided results, which the Id. CIT(A) found to be so with reference to the losses stated (by the assessee before him) to arise on the said projects for A.Ys. 2009-10 to 2011-12. The assessee had filed different cost estimates for these years, so that the estimation of expenses has been changing from year to year, not only for one project but for the several projects. The assessee's claim to have made the estimation of loss on scientific basis, thus, did not hold. Besides, only the provision for liabilities which had not crystallized during the year, and which was evident from the fact that the assessee did not contest the addition for the same amount made while computing its' book profit u/s. 115JB. The case law relied to by the assessee was found distinguishable by him on facts. Aggrieved, the assessee is in second appeal.

3. We have heard the parties, and perused the material on record.

3.1 The assessee is a manufacturer of heavy industrial machinery, which has a gestation period of two to three years. It follows accrual system of accounting, which is mandatory for it under its' governing Act, i.e., the Companies Act, 1956. It follows percentage completion method for recognition of revenue. The fundamental accounting principle of prudence, providing for all known liabilities and losses (even though the amount thereof cannot be determined with certainty and represents only a best estimate in the light of available information), would validate the assessee's claim. The said principle, along with 'substance over form' and 'materiality', constitute the principal considerations for the selection of the accounting policies. As such, irrespective of the stage of completion of the project, where, on the basis of the facts and data, a project stands to incur a loss on its' completion, the same is to be provided in the first instance, and which has been provided for by the assessee on proportionate basis. The said principle stands advocated by both the Accounting Standard (AS-1) issued by ICAI as well as AS-I issued u/s. 145 by CBDT, both since notified, so as to assume the force of law. The same would entail carrying out a cost-benefit analysis, which may itself involve several estimates, called accounting estimates. The same have to be reliable, based on verifiable and/or empirical data, which we regard as a second, albeit integral, aspect – the assessee's claim for loss meriting an in principle approval or acceptance. True, in a given case, the loss itself may arise only on account of inflated cost, so that on facts there is no application of the principle, but that would not detract from the fact that such a loss, where properly made, cannot be denied. Further, the estimate may itself change from time to time, i.e., as time goes by and more and more work, incurring cost, is undertaken, so that it is only the balance (uncompleted) work, i.e., which is yet to be completed, *qua* which the costs are to be estimated. The cost estimate is again bound to vary on the basis of and in light of the available information. That (variation), rather, is the norm, as inflow of information, having both qualitative and quantitative implications, and

which aspects are themselves interrelated, is a continuous phenomenon. To contend, therefore, as does the Id. CIT(A), that there has been a variation, and inferring on that basis that the estimates are not scientific or not based on reliable data, is misconceived. In fact, the variation, as reported (refer para 4 of the impugned order), is itself quite insignificant, so that it should not have, even on that basis, led to the inference of rejection of the estimates.

The Revenue can no doubt, and it is indeed duty bound to, verify the assessee's claim *qua* both the cost and the revenue estimates. Why, in a given case, the actual costs, incurred subsequently, may itself form a valid ground or basis to verify the veracity of the assessee's claim/s, even as we have clarified that the estimates are bound to undergo change with time in light of the available information and experience, *so that the principle involved would be that the estimate or assessment as made is explainable with reference to the available information.*

3.2 The Revenue misdirects itself when it, relying on the decision *Rotork Controls India Private Ltd. vs. CIT* [2009] 314 ITR 62 (SC), refers to the statement of law by the Hon'ble Apex Court in respect of claim for deduction *qua* a liability. The two, i.e., a 'liability' and 'loss', though *para materia* from the stand-point of prudence, may not be so as regards provision therefor. The provision of loss would be justified on a factual basis to arrive at the conclusion that the estimated expenditure (for the work to be undertaken or the services to be rendered), together with the actual cost already incurred thereon, shall exceed the estimated revenue from the project. The question, thus, is principally of the reliability of the estimate, given the explicit terms of the accounting standards, statutorily mandated, so that the same have the force of law, with the Apex Court in fact emphasizing time and again that in the absence of any specific provision of law to the contrary, the principles of commercial accounting shall apply. Reference in this regard may also be made with profit to its' celebrated decision in *Calcutta Co. Ltd. vs. CIT* [1959] 37 ITR 1 (SC). Once, on the basis of the

facts and the information on record, the loss is likely to arise, the same has to be provided for under the prudence mandate, which is what AS-7 (also notified by the Central Government) in substance provides under the segment 'Recognition of expected losses' vide paras 35 and 36, reproduced as under:

'Recognition of Expected Losses

35. When it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

36. The amount of such a loss is determined irrespective of:

- a) whether or not work has commenced on the contract;
- b) the stage of completion of contract activity; or
the amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance with paragraph 8.'

A liability, on the other hand, arises on account of a contractual or statutory obligation.

3.3 As regards the reliance by the Revenue before us on *CIT vs. Kamani Metals & Alloys Ltd.* [1994] 208 ITR 1017 (Bom), the same, in our view, shall not govern the facts or the issue involved in the present case, even as admittedly the accountancy principle of valuation of inventories is also based on the principle of prudence. In that case, the assessee-company, a manufacturer of copper and copper based alloys, strips and coils of various specifications, valued its raw materials, being virgin metals (viz. copper, zinc, tin), following the valuation principle of cost or replacement value, whichever is less. On that basis, it claimed the reduction in the raw material (copper cathode) price post December 31, 1974, the valuation date, for which the purchase order was issued in August, 1974. The Hon'ble Court upheld the order by the tribunal, restricting the valuation to that as per the rate obtaining as on 31.12.1974, i.e., in principle. Further, however, as the goods had not been received by December 31, 1974, so that there was no closing stock as on that date, the Hon'ble Court held that

the reduction in the price with reference to the contract date even as on 31.12.1974 also could not allowed. Further, even though the value of the raw material cost may have decreased, the firm may stand to earn profit on the basis of the net realizable value of the finished goods, i.e., on the basis of the ruling price less cost of realization thereof. The prices of finalized goods may or may not move in sympathy with that of the raw materials, depending upon the demand and supply forces in the relevant market. Two, even the raw material price may stand to reverse, and may not be irreversible so as to conclude that the loss had indeed been incurred. Thirdly, and most importantly, it is the profit (or loss) for the relevant year that is to be assessed and brought to tax for that year – each year being an independent unit of assessment. The decline in the market price, even where relevant and material, i.e., with reference to the price obtaining as at the year-end, would therefore fall to be considered as and form part of the profit (or loss) of the subsequent year. This also explains the standard prescription for valuing raw material at historical cost (refer AS-2 issued by ICAI). The project/s in the instant case, on the other hand, spread over 2-3 years, and it is on account of this that the loss thereon, the enterprise following percentage completion method (for recognizing income), the profit (or loss) on the entire project, estimating the costs yet to be incurred, is required to be reckoned, booking the same proportionately. AS-7, on the other hand, clearly provide for reporting profit on the basis of proportionality when the project is likely to yield a profit, while booking the loss where not so, and which in the present case, as we understand, has been provided for on a proportionate basis. *The reliability of the estimate is indeed very relevant and crucial to the claim for loss, lest any amount could be claimed under the garb of the likely loss, and which brings us to the next aspect of the matter.*

3.4 The Revenue, moving on the premise that the assessee's claim is both factually and legally untenable, has rejected the same. We find no exercise conducted by it at any stage to verify the assessee's claim, which we have found acceptable in principle.

In this respect, the Id. AR would before us contend that the assessee has also, and only rightly so, taken into account the likely cost escalations; the projects being scheduled to be completed only over a period of two to three years. True, but the same would also have been similarly factored into while negotiating the contract rates. The matter would require being examined for the veracity of the estimations, and particularly *qua* cost escalations, as also with reference to the relevant clauses, if any, of the contract, i.e., as regards the cost escalation, which could also be made operative where the project is delayed beyond a particular time line. Reference in this context may also be made to paras 22, 23 and 31 of AS-7.

4. In view of the foregoing, we uphold the assessee's claim in principle, i.e., *qua* the provision for loss on contracts likely to arise on its ongoing projects, which though would have to be substantiated. Further, the fact that the assessee did not contest the claim for loss, similarly made, while computing its' book profit, though surprising, cannot by itself prevail so as to be regarded as conclusive of the matter, and can at best provide a clue to the Revenue that the assessee's claim with regard to cost escalation/s may require a closer examination, which the AO is even other obliged to, even as to be fair to the assessee the loss stands provided for in the audited accounts, so that it has been subject to both internal as well as external scrutiny. The same though cannot bind the A.O. We decide accordingly. The appeal is accordingly disposed on the above said terms.

5. In the result, the assessee's appeal is allowed for statistical purposes.

Order pronounced in the open court on June 10, 2016

Sd/-
(Amarjit Singh)

न्यायिक सदस्य / Judicial Member

मुंबई Mumbai; दिनांक Dated : 10.06.2016

Sd/-
(Sanjay Arora)

लेखा सदस्य / Accountant Member

व.नि.स./Roshani, Sr. PS

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent
3. आयकर आयुक्त(अपील) / The CIT(A)
4. आयकर आयुक्त / CIT - concerned
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard File

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai