
(2013) 07 GUJ CK 0016
In the Gujarat High Court
Case No : Tax Appeal No. 641 of 2012

Commissioner of Income Tax-1

APPELLANT

Vs

Neo Structo Construction Ltd.

RESPONDENT

Date of Decision : 09-07-2013

Acts Referred:

Citation : (2013) 218 TAXMAN 24

Hon'ble Judges : Sonia Gokani, J; Mukesh R. Shah, J

Bench : Division Bench

Advocate : Manav A. Mehta, for the Appellant;

Judgement

Mukesh R. Shah, J.—Present Appeal has been preferred by the Revenue challenging the impugned judgment and order passed by the Income Tax Appellate Tribunal (hereinafter referred to as "the ITAT") dated 24.2.2012 raising following question:- Whether the Hon"ble Tribunal has erred in law by allowing encashment of bank guarantee as business expenditure as per section 37(1) of the I.T. Act?

The facts leading to the present appeal in nutshell are as under:-- 2.1 The assessee company is engaged in the business of construction and erection of plants excluding civil instrumentation and electric works mainly in respect of public sector units like ONGC, HPCL, KRIBHCO, CRL etc. and also for private sector.

2.2 That the assessee filed return for the Assessment Year 2006-07 showing total income of Rs. 7,05,44,680/-.

2.3 That the assessee company debited Profit & Loss Account by Rs. 70,75,392/- towards encashment of bank guarantee by ONGC. On being questioned about the aforesaid expenditure being laid out or expended wholly exclusively for the purpose of business or profession, it was stated on behalf of the assessee that during the year under scrutiny, the company accepted one off-shore job-work with ONGC. However, due to some technical reasons, company was not able to

complete the job in time and was incurring heavy expenses on it, and therefore, as a prudent business policy, company decided to give up that job for which ONGC encashed bank guarantee even at the time of accepting the job and the same was debited to the Profit and Loss Account as expenses.

2.4 That the Assessing Officer held that the expenditure claimed towards encashment of the bank guarantee by the contractee (ONGC) is not admissible as business expenses u/s 37(1) of the IT Act and, therefore, while passing the order of assessment, amount of Rs. 70,75,392/- came to be disallowed and added to the total income of the assessee.

2. Feeling aggrieved by and dissatisfied with the order passed by the Assessing Officer in disallowing the aforesaid amount of Rs. 70,75,392/- as business expenditure and adding it to the total income of the assessee, the assessee preferred the appeal before CIT(Appeals) and CIT(Appeals), by order dated 23.9.2009, partly allowed the said appeal. However, CIT(Appeals) dismissed the appeal with respect to the disallowance of the aforesaid amount of Rs. 70,75,392/-

3. Feeling aggrieved by and dissatisfied with the order passed by CIT(Appeals) dated 23.9.2009, the assessee preferred appeal before the ITAT and by the impugned judgment and order, the ITAT has allowed the said appeal by holding that during the continuity of the business, if in a particular contract, the assessee had to compensate for its own default, by offering performance guarantee, which was a contractual obligation, and that the said business continued later on, then the disallowance for a particular contract be not considered separately, that too, to treat the same as capital expenditure and consequently it is held that the assessee was entitled to the deduction of Rs. 70,75,392/- u/s 37(1) of the I.T. Act and consequently directed to delete the disallowance of aforesaid amount and adding the same in the total income of the assessee.

4. Feeling aggrieved by and dissatisfied with the impugned judgment and order passed by the ITAT, the Revenue has preferred the present appeal raising the aforesaid question of law.

5. Heard Mr. Manav Mehta, learned counsel appearing for the Revenue.

6. At the outset it is required to be noted that the assessee entered into contract with ONGC and at the time of entering into the contract "performance guarantee" was given to ONGC. Due to certain technical reasons, it was felt by the assessee that it will not be possible for them to perform the contract, and therefore, as a prudent business policy they took a decision not to proceed further with the contract and informed ONGC accordingly and due to non-performance, ONGC encashed bank guarantee of Rs. 70,75,392/- which was given as "performance guarantee". Thus, the aforesaid amount was recovered by ONGC by encashing the bank guarantee due to non-performance of the contract by the assessee. The assessee claimed the aforesaid amount of Rs. 70,75,392/- as deduction u/s 37(1) of the I.T. Act. Relying upon the decision of the Full Bench of Punjab and

Haryana High Court in the case of Jamna Auto Industries Vs. The Commissioner of Income Tax, , wherein the High Court held that damages for breach of contract is allowable as business expenditure if not incurred for contravention of any law. The ITAT has allowed the appeal and held that the assessee shall be entitled to the deduction of the aforesaid amount u/s 37(1) of the I.T. Act.

7. Identical question came to be considered by the Hon''ble Supreme Court in the case of M/s. Prakash Cotton Mills Pvt. Ltd. Vs. Commissioner of Income Tax (Central), Bombay, It is held by the Hon''ble Supreme Court in the said decision that deduction u/s 37(1) of the I.T. Act can be allowed when it is found that it is wholly compensatory. It is held by the Hon''ble Supreme Court in the said decision that;--

Whenever any statutory impost paid by an assessee by way of damages or penalty or interest is claimed as an allowable expenditure u/s 37(1) of the income tax Act, 1961, the assessing authority is required to examine the scheme of the provisions of the relevant statute providing for payment of such impost notwithstanding the nomenclature of the impost as given by the statute, to find whether it is compensatory or penal in nature. The authority has to allow deduction u/s 37(1) wherever such examination reveals the concerned impost to be purely compensatory in nature. Wherever such impost is found to be of a composite nature, that is, partly of compensatory nature and partly of penal nature, the authorities have to bifurcate the two components of the impost and give deduction of that component which is compensatory in nature and refuse to give deduction of that component which is penal in nature.

8. Dealing with the identical question, the Full Bench of Punjab and Haryana High Court has held as under:--

"In view of the authoritative pronouncements of the apex court and also of this court, it would thus, be concluded that whenever an assessee has indicated any amount, which had been paid either by way of damages or penalty, to be an allowable expenditure u/s 37(1) of the Act, the assessing authority is obliged to discover the nature of such amount vis-?-vis two prominent aspects whether it is compensatory or penal. The assessing authority would there upon permit the amount as an allowable deduction that may be discovered to be purely of compensatory nature as payment of damages. However, any statutory amount paid by the assessee which is sought to be claimed as an allowable expenditure on account of penalty, in that eventuality, the same shall be disallowed being payment of infraction of law. A situation may arise where an assessee might have to make a composite payment being "compensatory" and "penal character" both. In that situation, the assessing authority would, of course, be required to segregate the amount containing two characters. After undertaking this exercise, the amount that is held to be of compensatory nature shall be countenanced as allowable expenditure whereas the other portion of the amount, which is penal in nature, shall be refused to be an allowable expenditure."

9. Considering the aforesaid decision of the Hon"ble Supreme Court and the Full Bench decision of the Punjab and Haryana High Court and the facts of the case under our consideration it appears that ONGC encashed the bank guarantee, which was furnished by the assessee (performance guarantee) due to the non-fulfilment of the contract by the assessee. It can be said to be compensatory in nature and not penal in nature, the ITAT has rightly held that the assessee would be entitled to the deduction of the same as business expenditure u/s 37(1) of the I.T. Act. Considering the aforesaid facts and circumstances of the case, we are also of the opinion that the assessee will be entitled to the deduction of the amount by way of the encashment of bank guarantee as business expenditure u/s 37(1) of the I.T. Act as the same is compensatory in nature. We see no reason to interfere with the impugned judgment and order passed by the ITAT as there is no question of law, much less any substantial question of law that arises in the present appeal and hence the present Tax Appeal deserves to be dismissed and the same is accordingly dismissed.