(2013) 03 BOM CK 0002

In the Bombay High Court

Case No : Income Tax Appeal (Lodging) No. 2107 of 2012

Commissioner of Income Tax APPELLANT

Vs

Uhde India P. Ltd. RESPONDENT

Date of Decision : 06-03-2013

Acts Referred:

Citation : (2013) 358 ITR 395

Hon'ble Judges : Vivek Varma, Member;M.S. Sanklecha, J;J.P. Devadhar, J

Bench : Full Bench

Advocate : Tejveer Singh, for the Appellant; F.B. Andhyarujina and Atul K. Jasani, for the Respondent

Judgement

Vivek Varma, Member (J)

1. The instant appeal has been filed by the assessee against the order of the Commissioner of income tax (Appeals) 22, Mumbai, dated October 9, 2009, wherein the assessee has raised the following grounds of appeal:

1. On the facts and in the circumstances of the case and in law, the Commissioner of income tax (Appeals) erred in disallowing the provision for costs on completed contracts and the provision for loss on incomplete contracts-

Without appreciating the fact that the provisions were made of identified, determined and ascertained present liabilities payable in respect of completed contracts and incomplete contracts.

2. On the facts and in the circumstances of the case and in law, the Commissioner of income tax (Appeals) failed to appreciate the reality of the situation that liabilities actually arose during the year and the fact that the provision/liability was actually existing as on March 31, 2004, and were determined on the basis of technical assessment made by the project manager up to acceptance of plant by the clients.

3. On the facts and in the circumstances of the case and in law, the

Commissioner of income tax (Appeals) erred in withdrawing the credit for TDS amounting to Rs. 3,384,649 by wrongly interpreting the provisions of section 199 of the income tax Act.

4. On the facts and in the circumstances of the case and in law, the Commissioner of income tax (Appeals) erred in disallowing the software expenses of Rs. 5,926,204 and treating the same as capital in nature.

5. On the facts and in the circumstances of the case and in law, the Commissioner of income tax (Appeals) erred in disallowing deduction u/s 80HHB of Rs. 3,405,207 (wrongly taken as Rs. 3,755,005 by the Assessing Officer) on the ground that the company has a business loss by treating the income and miscellaneous receipts as income from other sources, and by excluding the profit on foreign exchange translation from business income.

6. On the facts and in the circumstances of the case and in law, the Commissioner of income tax (Appeals) erred in confirming the levy of interest u/s 234D of Rs. 1,631,798.

The first ground of appeal is with regard to the disallowance of provisions of costs on completed contracts at Rs. 4,99,78,935 and provisions for loss on incomplete contracts at Rs. 62,16,974, aggregating to Rs. 5,61,95,909. According to the grounds of appeal the provisions were made of identified, determined and ascertained present liabilities.

2. During the course of the assessment proceedings, the Assessing Officer noticed the provisions aggregating to Rs. 5,61,95,909 had been claimed. The Assessing Officer asked the assessee to justify the same. Accordingly, the assessee submitted the party-wise provisions details, which are as under:

3. Since the dispute is with regard to the allowability of the provisions, where, the assessee''s version that each provision is ascertained and on the other hand, the Department''s version that the provisions are not ascertained to be examined.

4. From the details, as per the written submissions made before the Addl. Commissioner of income tax, dated December 14, 2006, each provision is detailed as under:

(a) Uhde GmbH--(66-0074) Rs. 7,253,588,

The company had received an order from Krupp Uhde GmbH for setting up of a urea formaldehyde plant for Qafco Fertilizer Company, SAQ, Doha, Qatar. The contract started on December 1, 2001. The scope of the contract included rendering of basic and detail engineering services, supply of equipment/ machinery for the plant and supervision services during erection up to the acceptance of the plant.

The above plant was commissioned and handed over to in September, 2003, to Uhde Germany. However, to complete the contractual obligations, the company had to request M/s. Uhde GmbH to procure/fabricate and supply certain items from Europe. Also certain items had to be additionally procured since the original supplies were not fully in compliance with the technical requirements of the plant.

The company had received an interim claim from Uhde, Gemany towards compensation for the efforts put in by them as well as for the various purchases made by them on behalf of the company such as:

Further, in order to comply with certain technical requirements of the plant, the company had to additionally procure a new heater, dosing unit and vibration switches. The additional expenditure on this account was expected to be to the tune of Rs. 4,200,000.

There had been delays in procurement and supply of various items as well as delay in completing the plant mechanically as per the schedule guaranteed. The liquidated damages for delay works out to 8 per cent. of the contract price, i.e., USD 289,980 equivalent to Rs. 13,491,100. In addition to the above there had been delays in ordering of spares and the compensation payable for such delay worked out to USD 24,624 equivalent to Rs. 1,354,300. Considering the claims made by Uhde Germany and a final settlement of the various claims/ procurement of items, a total cost provision of Rs. 45,581,300 had to made as on March 31, 2004. Of the above Rs. 39,000,000 had been made as on March 31, 2003. Hence, the balance of Rs. 7,253,588 was made during the year ended March 31, 2004.

We find that an exact amount of liability has been arrived at Rs. 72,53,588 as on March 31, 2004. Since the issue before us is to determine ascertained provision and ascertained liability, this can be said to be ascertained provision, hence allowable as on March 31, 2004.

(b) Sanjana Cryogenic Storages Ltd.--(Rs. 10,158,338)

The contract was for setting up of a 10 MT ammonia storage tank and associated handling facilities at Haldia, West Bengal. The scope of services included supply of equipment and complete design and engineering including civil and structural design engineering, soil investigation, pre-commissioning, commissioning and guarantee test run and complete project management services including logistic management for imported supplies. During the year ended March 31, 2004, the electrical power supply Le the LT supply could accommodate only one additional compressor. Even with this addition, it was not definite whether the guaranteed unloading rate could be achieved or not. In such a situation there was a probability that the compressor may have to be replaced with that of a higher capacity which would also require converting the power supply from LT to HT. In view of this, provision of Rs. 4.15 Mio. towards replacement of higher capacity compressor and HT electrical equipment was required to be made. An additional provision of Rs. 6 mio was required towards engineering hours of 82 hours expected on the contract, supply of insulation, compressor, flare tip modification and other sundry purchases, which were yet to be effected and travel and site expenses expected to be incurred.

This, according to us, cannot be held to be ascertained as no exact figure has been arrived at, hence cannot be allowed.

(c) The Andhra Sugars Ltd. (Rs. 543,695)

The contract was for phase-II of caustic soda plant expansion in Andhra Pradesh and imported and indigenous supplies for cell elements. The scope of services included engineering services and supervision services for assembly of the plant. The company had used the services of a foreign delegate from M/s. Uhde Nora who had visited the ASL site for site supervision for commissioning of the plant. The bill for the said services was not received as on March 31, 2004, hence a provision of Rs. 0.54 mio. was made for the same.

Since the submission says that the final bill is yet to be ascertained, no finality can be arrived at, hence, the provision cannot be allowed.

(d) Larsen and Toubro Ltd. (Rs. 2,220,433)

The contract was for supply of truck loading machines. As on March 31, 2004, some supplies had not yet been effected, hence the cost of the same was provided for at Rs. 1.45 mio. A further provision was made towards procurement hours of Rs. 21,000 and towards sub-contracting costs of Rs. 7,00,000 and towards other expenses of Rs. 49,400. Thus, a total provision of Rs. 2.22 mio. was made as on March 31, 2004.

Since the final figure arrived as on March 31, 2004, has been ascertained the provision can be said to be allowable.

(e) Larsen and Toubro Ltd. (Rs. 12,55,690)

The contract was for supply of bag diverters-and belt conveyors and the scope of work involved design, construction features, manufacture, inspection and testing at shop, delivery properly packed for transportation to site, performance testing at site. As on March 31, 2004, some supplies had not yet been effected the cost of the same was provided for at Rs. 7.00 mio. A further provision was made towards procurement hours of Rs. 40,000 and towards sub contracting costs of Rs. 5,00,000 and towards other expenses of Rs. 38,900. Thus, a total provision of Rs. 1.25 mio. was made as on March 31, 2004.

Since the final figure arrived as on March 31, 2004, has been ascertained the provision can be said to be allowable.

(f) Kanoria Chemicals and Industries Ltd. (Rs. 232,501)

The company had entered into a contract with Kanoria Chemicals and Industries Ltd. for the preparation of detailed feasibility report. This contract was expected to result in a loss considering the expected cost till the completion and contract revenue. The final loss on the contract was Rs. 284,638 which is higher than the initial estimation of Rs. 232,501. Thus, the loss of Rs. 0.23 million has already crystallized as on March 31, 2004 (cost booked = Rs. 717,501 less proceeds realized = Rs. 485,000) been provided for in the year ended March 31, 2004. The provision was based on the estimates made by the project implementation team.

Since the final figure arrived as on March 31, 2004, has been ascertained the provision can be said to be allowable.

(g) Kirloskar Pneumatic Co. Ltd. (Rs. 146,211)

The company had entered into a contract with Kirloskar Pneumatic Co. Ltd. for rendering detailed engineering services for ONGC Gandhinagar project in Gujarat. This contract was expected to result in a loss considering the expected cost till the completion and contract revenue. The final loss on the contract was Rs. 1,48,866 which is higher than the initial estimation of Rs. 146,211. A further expenditure of Rs. 2,655 is expected and, therefore, the final loss on this contract would be Rs. 148,866. Thus, the loss of Rs. 0.14 million has already crystallized as on March 31, 2004 (cost booked = Rs. 406,211 less proceeds realized Rs. 2,60,000) been provided for in the year ended March 31, 2004. The provision was based on the estimates made by the project implementation team.

Since the description talks about estimates, no finality can be said to have been arrived at, hence, cannot be allowed.

(h) Uhde GmbH--(66-6252) Rs. 23,548,956

The company had entered into a contract for rendering engineering services for Qafco--IV ammonia urea project at Qatar. The scope of detailed engineering services for the above project was completed as on March 31, 2004, but the plant was yet to be commissioned by Uhde GmbH. Also the final documentation was expected to be completed by the company only by July, 2004. In the meantime, the company had received an interim claim from Uhde, Germany pointing out deficiencies/defects in the services rendered and claiming compensation from the company for the defects amounting to Rs. 45.9 mb. However, contractually the liability of the company towards repair, modification, and replacement of any equipment arising out of faulty or insufficient engineering was limited to a maximum of Euro 330,000 which was 10 per cent. of the contract value. In addition to the above, for wrong or deficient engineering the company was obligated to carry out necessary engineering free of cost. Considering the above aspects and also the hours required for completion of documentation the following cost provisions were made as on March 31, 2004-

Since the final figure arrived as on March 31, 2004 has been ascertained the provision can be said to be allowable.

(i) Asean Bintulu Fertilizer Sdn. BHD--(66-6259) Rs. 2,581,462

The contract was entered into with ABF for revamp of ammonia plant to a capacity of 1350 MTPD and the urea plant to a capacity of 2250 MTPD and the granulation facility to a capacity of 2400 MTPD with necessary modifications in the utility facilities in ABE plant, in Bintulu, Sarawak. The scope of work is mainly includes detailed engineering services. A provision of Rs. 2.58 mio. was made as on March 31, 2004, which was estimated as follows:

The provision for engineering costs was made for as-build documentation and attending site queries.

Since the final figure arrived as on March 31, 2004, has been ascertained the provision can be said to be allowable.

(j) Sanjana Cryogenic Storages Ltd. (Rs. 2,332,406)

The contract was for setting up of a 10 MT ammonia storage tank and associated handling facilities at Haldia, West Bengal. The scope of services included erection and installation of the ammonia storage tank and cross-country pipelines (under third party inspection) and equipment, electrical and instrumentation. The scope also included planning, managing, supervising, scheduling and monitoring all insulation and civil works including foundations, buildings, sheds, roads, drains, pavements, supports/pipe racks inside the batten limits and along cross-country pipelines. During the year ended March 31, 2004, a provision of Rs. 2.33 mio was required towards engineering hours expected on the contract, supplies to be effected and other expenses expected to be incurred as detailed herein below:

The provision for escalation of costs looks to be definite, hence, we feel, can be allowed.

(k) VVF Ltd.--(Rs. 2,694,733)

The company had entered into a contract with VVF Ltd. for engineering, procurement, inspection, expediting and construction supervision services for their 60,000 TPA fatty alcohol plant at Taloja. This contract was expected to result in a loss considering the expected cost till the completion and contract revenue. Till March 31, 2006, the company has suffered a loss of Rs. 11,649,443 which is much higher than the initial estimation of Rs. 9,298,588. Thus, the loss of Rs. 9.29 million has already crystallized as on March 31, 2004 (cost booked = Rs. 42,687,788 less proceeds realized = Rs. 33,389,200). Of the above loss Rs. 6,603,855 has been already provided for during the year ended March 31, 2003, and the balance loss of Rs. 2,694,733 has been provided for in the year ended March 31, 2004. The provision was based on the estimates made by the project implementation team.

Since it talks about estimates, no finality can be said to have been arrived at, hence, provision cannot be allowed.

(L) ISCO--KNPC--(Rs. 1,103,204)

5. The company had entered into a contract with ISCO-KNPC for enhancement of local marketing and distribution facilities. This contract was expected to result in a loss considering the expected cost till the completion and contract revenue. The loss of Rs. 1.10 million has already crystallized as on March 31, 2004 (cost

booked = Rs. 20,622,704 less proceeds realized = Rs. 19,519,500) been provided for in the year ended March 31, 2004. The provision was based on the estimates made by the project implementation team.

6. Since it talks about estimates, no finality can be said to have been arrived at, hence, provision cannot be allowed.

7. On these observations, we set aside the order of the Commissioner of income tax (Appeals) on the impugned issue and direct the Assessing Officer allow the provisions, as per our findings in each case.

8. Ground No. 2 is linked to ground No. 1, being consequential, therefore, no separate adjudication is required.

9. Ground No. 3 pertains to withdrawal of TDS amounting to Rs. 33,84,649. The issue has been in contention with the assessee in the earlier years as well. During the course of hearing before us, senior counsel submitted that the business of the assessee being setting up of projects which involve over lapping years, is thus fully covered by the decision taken in the case of (2006) 100 TTJ 373 , wherein the co-ordinate Bench at Mumbai held as under:"...one is bound to take note of the expression ''income'' and the expression ''profits'' in its contextual perspective as explained by the learned senior counsel. The execution of a project is a continuing process. The income/loss arising there from also generates contemporaneously/simultaneously, even though such income/loss is finally measured as profit/loss only at the end of the project for the reason that the assessee is following the project completion method for the recognition of profit/loss. In this context, it is always useful to remember that courts have held that ''income'' also includes loss. The set off of TDS would arise only when, the income results in profits. Therefore, it is all the more clear that the income whether profit or loss, impregnated in the value of working in progress is finally summed up to be the profit/loss of the contract which is answerable to the assessment to be made on the assessee. Therefore, in every assessment year, even though the final result is, ascertained only on the completion of the project, an element of income is latent in the yearly working result, The distinction between the above conceptual profit and the ultimate de facto assessment of profit is because of the fine distinction existing between ''income'' and ''profits''.

10. Therefore, in the facts and circumstances of the case, the provisions of law contained in section 199 do not stand in the way of the claim made by the assessee-company for credits in respect of TDS made during the relevant previous year. As such, it is our finding that the Assessing Officer should give credit for the TDS amounting to Rs. 2,28,37,491. This issue is, therefore decided in favour of the assessee". On the other hand, the senior counsel conceded that in the assessee''s own case in the assessment year 2003-04, the co-ordinate Bench decided the case against the assessee, holding, "income in question on which TDS is made, is not assessable during the assessment year 2003-04".

11. The Assessing Officer in the assessment order came to a finding that TDS of

Rs. 33,84,849 pertains to income falling in the assessment year 2005-06. The Commissioner of income tax (Appeals), too, sustained the observations of the Assessing Officer. Aggrieved with the decisions of the Revenue authorities, the assessee is now before the income tax Appellate Tribunal.

12. We have heard the submissions advanced by the senior counsel and have also gone through the decision of the co-ordinate Bench in Toyo (supra) and also the decisions in the assessee''s own cases before the co-ordinate Benches. The distinguishing decisions taken on the impugned issue, in the case of the assessee, by the Revenue authorities as well as by the co-ordinate Benches, had been on the premise that the TAS is on incomes, not pertaining to the current year. In the instant year, as well, the impugned TDS does not pertain to the current/instant year, and the circumstances for disallowance has not changed, wherein we ignore the decisions in the assessee''s own case and take into consideration the decision taken by the co-ordinate Bench in Toyo Engineering.

13. Since the TDS does not pertain to the impugned year, we are in agreement with the observations of the Revenue authorities and respectfully following the decision of the co-ordinate Bench in the assessee''s own case in the preceding year, we hold that credits cannot be given for the TDS of Rs. 33,84,649 in the instant year. This ground is, thus rejected.

14. Ground No. 4 pertains to the disallowance of Rs. 59,26,204 being software development, holding the same to be capital in nature.

15. The assessee has filed details of expenses debited under the head software development (APB 84). From the heading itself, we find, the expenses booked are software maintenance expenses and all the expenses are either in the nature of annual maintenance contracts, upgradation and installation of antivirus, which, according to us, cannot in any circumstance be held to be enduring in nature and called capital expenses. These are expenses which are used for smooth running of the computers. Thus, we hold the same to be allowable.

16. Ground No. 5 pertains to disallowance of Rs. 34,05,207. The Commissioner of income tax (Appeals) noted the facts and reproduced the same in the order passed by him, wherein, the Commissioner of income tax (Appeals) observed: "The Assessing Officer has noted that the business of the assessee includes interest, profit on foreign exchange and miscellaneous receipts. Out of this, interest income and miscellaneous income fall under the head ''Income from other sources'' and, hence, not eligible for deduction. Regarding foreign exchange translation, the Assessing Officer noted that the assessee has failed to establish that the said exchange gain/translation relates to receipts from projects against which convertible foreign exchange received during the year for which no details or documentary evidence have been filed. Hence, after exclusion of these income no deduction was allowed since the profit showed the negative figure. Before me, it has simply been stated that the projects undertaken outside India are eligible for deduction u/s 80HHB without furnishing any details as was the

position before the Assessing Officer. Regarding the interest income and miscellaneous receipt, it was stated that the interest income as emanated from the surplus funds of the company''s business and, hence, should be treated as profit derived from the assessee''s business. However, in view of the judgments of the Hon''ble courts as relied upon by the Assessing Officer and also the decision of the apex court in the case of Pandian Chemicals Ltd. Vs. Commissioner of Income Tax, , I do not agree with the claim of the appellant. The appellant also raised an objection regarding the different method of calculation of deduction under sections 80HHB and 80HHC. However, in my opinion, the method of calculation does not make much difference since the words ''Profit derived by the assessee'' has been used in both sections. The Hon''ble courts in the above decisions have held that interest income and miscellaneous income is not a profit ''derived'' from business, in view of this, I am of the opinion the Assessing Officer was justified in denying deduction u/s 80HHB to the appellant which is sustained".

17. The senior counsel has relying upon the following decisions in The Commissioner of Income Tax Vs. Rachna Udhog, , CIT v. Syntel Ltd., CIT v. United Riceland Ltd. unreported-IT Appeal No. 6997 of 2010-Bombay High Court) and the co-ordinate Bench of the income tax Appellate Tribunal, at Mumbai in I.T.A. No. 5338/Mum/2008 in Asst. CIT v. Macro Bars and Wires India Pvt. Ltd., pleaded that interest is a part of business income on the contracts executed outside India. But beyond this no further detail has been filed. The reason for disallowance has been that the details have not been provided, here once again, before us, no details have been filed. We find that the assessee is an engineering company having contracts in foreign countries and the question of earning income from source other than business is remote, therefore, in the interests of justice, we restore this issue to the file of the Assessing Officer, wherein the assessee shall provide for all the details as asked for, with regard to its claim on deduction u/s 80HHB. The Assessing Officer is thus directed to examine the issue afresh after giving a reasonable opportunity of being heard. In the result, the order of the Commissioner of income tax (Appeals) is set aside on this issue and the Assessing Officer is directed to follow the above direction.

18. In the result, ground No. 5 is treated as allowed for statistical purposes.

19. Ground No. 6 is against the levy of interest of Rs. 16,31,798 u/s 234D.

20. The issue is consequential, therefore, the Assessing Officer is directed to give consequential effect in accordance with law.

21. In the result, the appeal filed by the assessee is treated as allowed in part.

22. Order pronounced in the open court on this day of August 8, 2012.

23. Office objections waived.

24. In this appeal by the Revenue for the assessment year 2004-05, the following questions of law have been proposed for our consideration.

(a) Whether, on the facts and in the circumstances of the case and in law, the Tribunal was right in holding that the provisions made are on account of ascertained liabilities?

(b) Whether, on the facts and in the circumstances of the case and in law, the Tribunal was right in holding that software development charges are revenue in nature?

25. In so far as question (a) is concerned, the Assessing Officer disallowed the claim of provisions made aggregating to Rs. 5.61 crores in respect of contracts on the ground that they were not ascertained liabilities. The Commissioner of income tax (Appeals) upheld the order of the Assessing Officer. On further appeal, the Tribunal on examining each of the contract entered into between the respondent-assessee and its clients has recorded a finding of fact with regard to the provisions made and determined that some of the provisions are made on the basis of ascertained liabilities, while others are not. The Tribunal on the basis of the results of its examination of the facts allowed the provisions made to the extent they were ascertained in nature and disallowed those which were made on the basis of the estimates. Since the finding of the Tribunal is essentially a finding of fact, we see no reason to entertain question (a) as proposed.

26. In so far as question (b) is concerned, the Tribunal has held that the expenses incurred on account of software development was in the nature of software maintenance expenses, i.e., in the nature of annual maintenance contracts, upgradation and installation of antivirus. In the aforesaid facts, the Tribunal concluded that these expenses cannot result in any benefit of enduring nature so as to be called capital expenses as contended by the Revenue. In these circumstances, the aforesaid expenses were allowed as revenue expenditure. As the finding of the Tribunal is based on finding of fact, we see no reason to entertain question (b) as proposed. Accordingly, the appeal is dismissed with no order as to costs.