
(1976) 04 KL CK 0004

In the High Court Of Kerala

Case No : Income-tax Reference No's. 72 and 73 of 1974

Janatha Contract Co.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 08-04-1976

Acts Referred:

Income Tax Act, 1961 — Section 260(1)

Citation : (1976) 105 ITR 627

Hon'ble Judges : P. Govindan Nair, C.J.; P. Subramonian Poti, J

Bench : Division Bench

Advocate : K. Velayudhan Nari, V.S. Moothath, N.R.K. Nair and T.K.M. Unnithan, for the Appellant; P.A. Francis and P.K.R. Menon, for the Respondent

Judgement

Govindan Nair, C.J.—The Income Tax Appellate Tribunal, Cochin Bench, has stated a case and referred the following question to this court for its opinion :

"Whether, on the facts and in the circumstances of the case, the Tribunal is justified in law in treating Rs. 1,14,071- (Rs. 2,17,546--Rs. 1,03,475) which represented the amounts withheld by the engineering department as per the terms of contract between the assessee and the department, as income which accrued to the assessee and in including the said sum in the total income of the assessee for the account year ended 31st March, 1964?"

2. The assessment year was 1964-65 and the corresponding accounting period was that which ended on March 31, 1964.

3. The assessee is a firm of contractors carrying on contract work consisting of levelling sites, constructing buildings, etc., at Idikki and construction of roads, buildings, etc., for the Medical College at Kottayam. For the accounting period that ended on March 31, 1964, the assessee had filed a return showing an income of Rs. 1,30,469 and the return was accompanied by a profit and loss account and balance-sheet. The total receipts seen from the profit and loss account were Rs. 20,48,083. The Income Tax Officer on enquiry with the

executive engineers found that the assessee had received Rs. 25,99,353 in the course of the accounting year. There was thus a difference of Rs. 5,51,270. The assessee was, therefore, asked to explain the difference. He gave his explanation regarding a sum of Rs. 30,214 consisting of three cheques as well as a second group of items amounting to Rs. 2,17,546 which represented the amounts withheld by the engineering department. This reference relates only to a part of the sum of Rs. 2,17,546. This amount was split up as follows :

Rs.

"Hire charges for machines deducted since they are payable to the Govt. 8,628

Stocking charges of rubbles 94,847

1,03,475

Balance representing amount under clause 9 of the contract 1,14,071 "

4. No question now arises with regard to the above sum of Rs. 1,03,475. In regard to the sum of Rs. 1,14,071 the explanation given by the assessee was in these terms:

"Rs. 1,14,071 represents money retained by the department to be subsequently appropriated wholly or partly by them or paid off to the contractor after the final checking and acceptance of the works. The appellants are of the opinion that under the terms of the contract, they establish a right to receive this amount only after the checking is completed."

5. Clause 9 of the contract which has been adverted to and which was extracted in the statement of the case was in these terms:

"The bill above alluded to shall be submitted in exact accordance with the form supplied by the executive engineer and the rates at which the value of the work is calculated shall be those entered in the attached schedule of rates. To allow of a guarantee fund being formed on the part of the Government a deduction of 10% from all payments to contractors is to be made by the executive engineer at the time of payments. But the amount so held as retention plus the security deposit of 4% as per Clause (1) shall not at any time exceed 8% of the contract amount. This retention amount will not be released before the expiry of 3 months (6 months in the case of road works) after the issue of certificate or otherwise of completion of work or the final bill has been prepared and passed whichever is later."

6. The executive engineer explained the retentions on the following terms :

"The amount retained by the department is noted as cash. The amounts are retained for several reasons, i.e., retention to fulfil the security, recovery on account of storage charges of materials, hire charges of tools and plants and other disputed items of recovery, etc., are retained from the bills which are

accounted as cash payment, of which the retention for the satisfactory fulfilment of the contract will be released on completion of the work. It is also clarified that the payments shown as cash are also to be treated as payment made to the contractor at the moment of passing the bills. In other words payments accounted by cash means the recoveries to be made from the contractors were transfers credited from their bills."

7. According to the assessee, the sum of Rs. 1,14,071 had not accrued due to him. Whether that amount or a lesser amount will become due will be determined only after the final checking and acceptance of the works and the right to receive the amount will arise only after the checking is completed. This matter has been dealt with by the Tribunal in paragraph 17 of its order, which is annexure "C" to the statement of the case.

"17. We cannot accept the assessee's contention in so far as the retention moneys are concerned. These moneys are appropriated out of the bill amount due to the assessee. The income accrued to the assessee on the completion of the work and on the submission of the bills. But certain amounts are appropriated out of such bills by the engineering department for proper fulfilment of the contract. The assessee could have as well given the security separately. We hold that the assessee is maintaining its accounts on mercantile basis and therefore these amounts should have been brought into account and treated as receipts of the year. We uphold the Appellate Assistant Commissioner's decision in this respect."

8. It is no doubt accepted that the assessee has been following the mercantile system of accounting. If the money had become due during the accounting period it will be income which would have to be taken into account in determining the total income of the assessee. But the question whether the money had become due or whether income had accrued will depend upon the terms of the contract. By reading Clause 9 alone, it is not possible finally to conclude that the money had become due. On the other hand the provision therein that "this retention amount will not be released before the expiry of 3 months (6 months in the case of road works) after the issue of certificate or otherwise of completion of work or the final bill has been prepared and passed whichever is later" seems to indicate that the money retained had not become due,

9. A mere checking of the amount of work done has been held not to be a certificate of satisfaction.

"In contracts in which a sum is provided to be retained for repairs or is to be kept back for a certain period after completion, the kind of certificate or certificates required depends on the wording of the contract."

(See at page 266 of Hudson on Building Contracts, seventh edition). The illustration given to the above passage appears to be relevant

10. In building contracts there can be two types of certificates "Interim or Progress" Certificates. This was referred to in Emden and Gill's Building Contracts and Practice, seventh edition, at page 206, in the following terms:

"Nature of Progress Certificates.---In most building and engineering contracts provision is made for the making of interim payments to the builder or contractor during the progress of the works on production of certificate to the effect that so much is due to the contractor on account. In the case of contracts not otherwise entire, such a provision is not necessary for the protection of the builder, as payments would accrue due from time to time even in its absence; on the other hand, the insertion of such a provision would be desirable in the interest and for the protection of the building owner. These progress certificates are merely in the nature of approximate estimates by the contractor of the value of the work done, and are not conclusive in favour of either party either as an expression of satisfaction with the quality of the work done or as a determination of its quantity or price. Progress certificates are subject to readjustment at the final settlement between the parties."

11. In the same book, at page 235, there is the following passage dealing with the question when final payment is due :

"When final payment due.---When a whole work is completed in accordance with the contract, payment becomes due to the contractor except where there is a stipulation postponing the time for payment of the whole or part of the balance, e.g., until after the expiration of a period during which the contractor is liable for defects or for repairs.

Retention money.--As interim payments to the contractor are sometimes made at the rate per cent. of the value of work done or of materials supplied or both, there remains on each of these values a balance unpaid. Such balances constitute what is called "retention money", which is retained in the power of the employer as a security for the due performance of the work and as a fund to be drawn upon should occasion arise either to complete the work or to rectify defects upon failure of the contractor to do so".

12. The above passage indicates that when there is a stipulation postponing the time for payment of the whole or part of the balance, until after the expiration of a period during which the contractor is liable for defects or for repairs, payment would not have become due to the contractor. The explanation given by the executive engineer which has been extracted above seems to indicate that at least part of the money retained was of that kind. He has said "The amounts are retained for several reasons, i.e., retention to fulfil the security, recovery on account of storage charges of materials, hire charges of tools and plants and other disputed items of recovery, etc.", are retained from the bills which are accounted as cash payment, of which the retention for the satisfactory fulfilment of the contract will be released on completion of the work". What is the nature of the contract and whether money had become due will have to be ascertained by

interpreting all the relevant terms of the contract and finding out the exact practice followed by the department. Whether there was a certificate for payment, if so whether it was a final certificate, and even in cases where there has been a final certificate, whether there was a further stipulation for retention, will all have to be examined to find out whether money had become due. These aspects have not been adverted to or considered by the Tribunal. We are, therefore, left with no alternative but to adopt the procedure employed by the Supreme Court in the two decisions in Commissioner of Income Tax, Bombay City I Vs. Greaves Cotton and Co. Ltd., and COMMISSIONER OF Income Tax, WEST BENGAL I Vs. INDIAN MOLASSES CO. P. LTD., .

13. Though there are two Income Tax references there is a really only one reference at the instance of the assessee questioning the decision of the Tribunal on the appeal taken by the assessee before the Tribunal, relating to the sum of Rs. 1,14,071. The other reference has been taken from the decision in the appeal taken by the department against the decision of the Appellate Assistant Commissioner which counsel for the assessee stated need not be considered as no question arises from that.

14. The Appellate Tribunal has reached the conclusion that the sum of Rs. 1,14,071 represented income of the assessee without adverting to or considering the relevant factors and material which ought to have been taken into account. The question of law referred to the High Court cannot therefore be answered.

15. In such circumstances two courses are open to this court: to call for a supplementary statement of the case from the Tribunal, or decline to answer the question raised by the Tribunal and leave the matter to the Tribunal to take appropriate steps to adjust its decision u/s 260(1) of the Income Tax Act, 1961, in the light of what, we have stated in this judgment. We decline to answer the question because the relevant materials are not before us and these have not even been considered by the Tribunal before reaching the conclusion that it did. It will be open to the Tribunal to rehear the appeal and dispose of the appeal in accordance with law bearing in mind the observations in this judgment. The Tribunal may remand the case to the Appellate Assistant Commissioner or the Income Tax Officer and further may take additional evidence or direct additional evidence being taken. The Income Tax referred cases are disposed of on the above terms. There will be no direction regarding costs.

16. A copy of this judgment under the seal of the court and the signature of the Registrar will be sent to the Income Tax Appellate Tribunal, Cochin Bench.