

**IN THE INCOME TAX APPELLATE TRIBUNAL: 'J' BENCH, MUMBAI
BEFORE SHRI N.V.VASUDEVAN (J.M)& SHRI MEHAR SINGH (A.M)**

ITA NO. 335/MUM/07(A.Y. 2002-03)
ITA NO.336/MUM/07(A.Y. 2003-04)

Jacobs Engineering India Pvt. Ltd., (Formerly known as Jacobs H&G Pvt. Ltd.), Jacobs House, Ramkrishna Mandir Road, Kondivita, Andheri (East) Mumbai – 59. P.A. No.AAACH 0456J (Appellant)	Vs.	The ACIT 8(2), Mumbai. (Respondent)
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ITA NO 7017/MUM/06(A.Y. 2002-2003)
ITA NO.7018/MUM/06(A.Y.2003-2004)

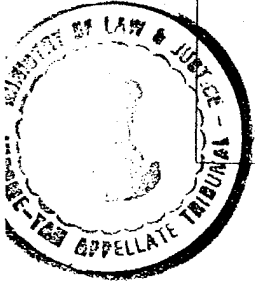
The DCIT 8(2), Room No.216, Aaykar Bhavan, M.K.Road, Mumbai – 20. (Appellant)	Vs.	Jacobs Engineering India Pvt. Ltd., (Formerly known as Jacobs H&G Pvt. Ltd.), Jacobs House, Ramkrishna Mandir Road, Kondivita, Andheri (East) Mumbai – 59. P.A. No.AAACH 0456J (Respondent)
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Assessee by: S/Shri Sunil M. Lala & Aliasger Rampurwala
Respondent by: Shri Ajay

ORDER

PER MEHAR SINGH,A.M,

The assessee as well as revenue are in cross appeals against the separate orders of Id. CIT(A) VIII, Mumbai dated 26/10/2006 & 31/10/2006, for the assessment year 2002-03 and 2003-04 respectively, passed under section 250(6) of the Income-tax Act, 1961. The grounds of appeal raised by the assessee as well as revenue for both the years are reproduced hereunder :-



Grounds Assessee's Appeal A.Y 2002-03.

"1. On the facts and in the circumstances of the case, the learned Commissioner of Income-tax (Appeals) [CIT(A)] has legally erred in confirming the disallowance of the foreseeable losses of Rs. 18,73,568. It is prayed that the learned Assessing Officer(A.O) be directed to allow foreseeable losses.

2. On the facts and circumstances of the case, the learned CIT(A) has erred in partially confirming the disallowance on account of expenditure on computer software to the extent of Rs. 71,47,404. It is prayed that the learned AO be directed to grant deduction of the said expenditure on computer software."

Grounds Assessee's Appeal A.Y 2003-04.

"1. . On the facts and circumstances of the case, the learned CIT(A) has erred in partially confirming the disallowance on account of expenditure on computer software to the extent of Rs. 31,16,486. It is prayed that the learned AO be directed to grant deduction of the said expenditure on computer software."

"2. 1. On the facts and in the circumstances of the case, the learned Commissioner of Income-tax (Appeals) [CIT(A)] has legally erred in confirming the disallowance of the foreseeable losses of Rs. 5,83,038. It is prayed that the learned Assessing Officer(A.O) be directed to allow foreseeable losses."

3. On the facts and circumstances of the case, the learned CIT(A) has erred in confirming the action of A.O. in reducing unabsorbed depreciation of earlier years while computing 'profits from the business' when granting deduction under section 80 HHE of the Income-tax Act. (the Act) It is prayed that the learned A.O. be directed to compute the deduction under section 80 HHE of the Act considering the profits and gains of the year under consideration.

Grounds of Revenue's Appeal for A.Y. 2002-03:

"On the facts and in the circumstances of the case and in law, the ld. CIT(A) erred in directing the A.O. to treat Rs. 21,72,808/- spent on purchase of computer software as revenue expenditure."

Grounds of Revenue's Appeal for A.Y. 2003-04

"On the facts and in the circumstances of the case and in law, the ld. CIT(A) erred in directing the A.O. to treat Rs. 1,34,28,461/- spent on purchase of computer software as revenue expenditure."

2. In Ground No.1, of A.Y 2002-03 and Ground No2 of A.Y.2003-04, the assessee contended that the Id. CIT(A), has erred in confirming the disallowance of the foreseeable losses of Rs. 18,73,568/-, for A.Y 2002-03 and Rs. 5,83,038/-, for A.Y.2003-04.

3. The brief facts of the issue in question, for the A.Y 2002-03 are that the A.O. disallowed a sum of Rs.18,73,568/-, claimed by the assessee as provisions for foreseeable losses. The A.O. examined the percentage completion method followed by the assessee and concluded that provision for such future losses could not be allowed as contemplated in the decision of the Apex Court, in the case of Tuticorin Alakali Chemcial & Fertilizers Ltd., 227 ITR 172. The A.O. also observed that it does not represent actual loss and under mercantile system of accountancy, what is deductible is only liability existing and not the liability which will come into existence, when certain events take place.

3.1 Before the Id. CIT(A), the assessee contended that the system of accounting followed by it had been accepted by the Hon'ble Tribunal in ITA No. 9701/Bom/91 dated 10/8/2001. The Id. CIT(A), observed that a careful perusal shows that the Id. CIT(A) had in the year 2000-01, taken into account a particular contract which was completed by 90.92%. It was under such circumstances that he concluded and stipulated that the loss cannot be allowed. On perusal of the order of Hon'ble Tribunal, it is clear that what was before the Honourable Tribunal was whether the accounting system followed could be challenged by the A.O. and whether section 145 of the I.T. Act would be attracted or not. The Hon'ble Tribunal had in its order held that section 145 was not applicable and that the method of accounting followed by the appellant was as per law. For easy reference the extract of the order of the CIT(A) and that of the Hon'ble ITAT is given as under:-




" I have carefully considered the submissions of the appellant. I find that the assessee has been consistently following the method of accounting which has the due approval of the accounting policy laid down by the institute of the C.As. This methodology has also been approved by the CBDT. It is also to be taken into account that more than 90% of the contract was complete during the year, and therefore, as per the accounting policy there was nothing wrong in considering the anticipated losses. Considering the facts and circumstances, and taking into account that the appellant had consistently followed this method of accounting, the addition of Rs. 75,218/- is deleted."

"After considering the submissions, the CIT(A) came to the following conclusions.

- (1) The varying rates of profits earned by the assessee is due to the varying nature of the contracts.
- (2) The profit in a fixed price contract differs from the profits in a fixed rate contract.
- (3) The contracts have yielded higher profits at the later states than at the earlier stated.

He therefore, came to the conclusion that there is nothing wrong with the method of accounting followed by the assessee and therefore, there was no justification for invoking the provisions of section 145. Since the provisions of section 145 are not attracted, the CIT(A) deleted the additions of Rs. 7,80,091/-.



The Revenue is in appeal. We have heard the rival contentions. None of the findings recorded by the CIT(A) on the basis of the detailed submissions made before him by the assessee has been challenged or found fault with before us on behalf of the revenue. No flaw was also pointed out against the submissions made by the assessee before the CIT(A). They were not sought to be contradicted on facts on the basis of any material on record. The Ld. Counsel for the assessee also stated before us that the assessee's accounts have hitherto been accepted in all the assessment and also in subsequent assessments and it is only for this year that the AO has sought to reject the accounts by invoking section 145. On a careful consideration of the matter, we are of the view that having reared to the factual aspects of the matter, which have been very elaborately presented before the CIT(A) and accepted by him and which have not been challenged before us on behalf of the Revenue, there is no justification for disturbing the findings, reasons and conclusion of the CIT(A). We therefore, uphold his order on this point and dismiss the ground."

3.2 Finally, the CIT(A), held on the issue in question as under:-

Now coming to the facts of the present case, what is in dispute is, whether or not the appellant even after following the mercantile system of accounting and the percentage completion method can claim deduction of "foreseeable losses" against the contracts. First and foremost, it is not the case of

appellant that the contracts in hand during the year under consideration were complete. In fact this is not the case of the appellant at all for the year under consideration, in as much as it is apparent that the work completed during the year under consideration was not a major part of the contract. Thus, to provide in the books of account of "foreseeable loss" on apparently only partially completed works appears to be incorrect as it cannot be established that such loss has been fully anticipated. In the case where a very small percentage of the work remains incomplete, the appellant can justifiably argue that certain events are so proximate and so determinable that the loss or gains can be easily accounted for and provided. It is on these circumstances that my predecessor in office had concluded that the anticipated loss could be allowed. Before him the contract was complete to the extent of 92%. Further, the extract of the case before the Hon'ble Tribunal itself shows that this specific issue had not been taken into account by the Hon'ble Tribunal and therefore, reliance placed by the learned counsel on this decision cannot come to its aid.

To conclude, therefore, I agree with the view of the AO that such anticipated loss cannot be allowed in as much as several parameters are accounted for only on estimate and therefore, it was not plausible to anticipate result. In view of the above, disallowance of loss made by the A.O. is upheld."

4. The Id. CIT(A) confirmed the finding of the A.O. that anticipated loss cannot be allowed in as much as several parameters are accounted for only on estimate, and, therefore, it was not plausible to anticipate results.

5. The Id. 'A.R' placed reliance on para 13.1 of accounting standard – 7, which permits the contractor to book the losses where estimated loss is indicated. The provisions are reproduced as under.

"13.1 When current estimates of total contract cost and revenue indicate a loss, the provision is made for the entire loss on the contract irrespective of the amount of work done and the method of accounting followed. In some circumstances, the foreseeable losses may exceed the costs of work done to date. The provision is nevertheless made for the entire loss on the contract."

Para 19 which is also relevant, reads as under:

"19. A foreseeable loss on the entire contract should be provided for in the financial statements irrespective of the amount of work done and the method of accounting followed.

Therefore, it clearly shows that in the case of foreseeable losses, the same can be booked to the profit and loss account.

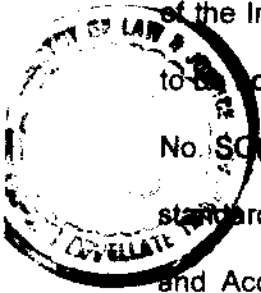


Assessee company engaged in the business of works contracts, regularly valuing its closing work-in-progress as per AS-7 as laid down by the Institute of Chartered Accountants of India, the IT authority had no option or jurisdiction to meddle with the matter.

Pronouncement of accounting bodies /Accounting standards are relevant in determining commercial profits.

6. The Id. 'A.R' further placed reliance on the decision of DCIT vs. OTIS Elevator Co. India Ltd. , 284 ITR 173 (AT)(Mum), Aarts Module vs. ITO, ITA No. 9302/Bom/92, Mkb (Asia) (P) Ltd. vs. CIT, 294 ITR 655 (Gau) and CIT vs. Woodward Governor India (P) Ltd., Metal Box Co. of India Ltd. v. Their Workmen, 73 ITR 53(SC) and Gopal Purohit vs. DCIT20 DTR 99. The Id. A.R also filed a chart showing percentage completion on the expired contracts for the A.Y 2002-03 and 2003-04, wherein percentage completion ranges from 39.49 to 97.86% and 33.80 to 97.96% respectively.

7. The Id. 'D.R' drawn attention of the Bench to the provisions of section 145(2) of the Income-tax Act, 1961 and contended that accounting standards are required to be notified by the Central Government and the same are notified vide notification No. SC(69E) dated 25/1/1996. It was also contended that these notified accounting standards are relevant for all assesseees following mercantile system of accounting and Accounting Standard - 7 has not been notified. The Id. 'D.R' discussed at length the said notified accounting standards, including the considerations governing the selection and application of accounting policies, such prudence, substance over form and materiality. The Id. D.R' also stressed the concept of matching principle essential for income and expenditure. The Id. 'D.R' also quoted certain case laws on such matching principle reported in 75 ITR 191, 82 ITR 363, 97 ITR 615 and 116 ITR



8. The Id. 'A.R' as a rejoinder, cited decisions on the issue of Accounting Standard -7, in the case of Metal Box Co. of India Ltd. vs. Their Workmen, 73 ITR 53 (SC) and the decision in the case of Mazagoan Dock Ltd. vs. Jt.CIT, Spl. Rng. II, Mumbai (2009) 29 SOT 356 (Mum).

9. We have carefully perused and considered the rival submissions, facts of the case, relevant record and the case laws relied upon by both the parties. The contention of the Id. 'A.R' on the issue of allowability of foreseeable losses the Id. 'A.R' placed reliance on the decision in the case of Metal Box Co. India Ltd. (supra), wherein the Hon'ble Court held as under:-

"Business expenditure – Bonus – Liability stated in profit and loss account- Such liability to be presumed to be genuine in the absence of challenge by workmen or to the effect that liability cannot be estimated fairly.

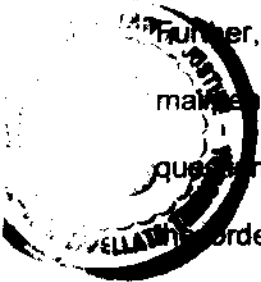
Words & phrases – "Provision" and "reserve" – Distinction – Provisions are charges against profits for anticipated losses and contingencies and, therefore, to be taken into account against gross receipts in P&L a/c. and the balance sheet – Reserves are appropriation of profits, the assets by which they are represented being retained to form part of the capital employed in the business"

The Id. 'A.R' contended that in the case of Mazgaon Dock Ltd. (supra) A.S – has been duly considered and supports the case of the assessee. The relevant part of the decision is reproduced hereunder:-

" The question that came up for consideration was as to whether the anticipated loss on the valuation of fixed price contract, in view of the mandatory requirements of the AS-7, was to be allowed in the year in which the contract had been entered into or it was to be spread over a period of contract, as was done by the assessee in earlier years. As far as the change in the method of valuation of work-in-progress was concerned, it could not be disputed that in view of mandatory requirement of the AS-7, it was a bona fide change in the method of valuation of work-in-progress, particularly in view of the qualification made in this regard by statutory auditors as well as by the Comptroller & Auditor General of India. Therefore, the observation of the Commissioner (Appeals) that the assessee had booked bogus loss was not correct. As far as the basis of estimation was concerned, the same was done on technical estimation basis and, therefore, merely because there were some variations in the figures furnished by the assessee at different stages, it could not be said that the estimated loss was not allowable. It was not



disputed that the department in earlier years had allowed the loss on estimated basis having regard to the expenditure actually incurred in various years. Therefore, in principle, it was not disputed that the estimated loss under the present circumstances was an allowable deduction. However, merely because the change in method of accounting was bona fide, it could not lead to the inference that the income was also deductible properly under the Act. This aspect is very evident from the first proviso to section 145 as it stood prior to the amendment by the Finance Act, 1995 with effect from 1/4/1997. It could not be disputed that from the method adopted by the assessee, the assessee's income could not be deducted properly in the year in which the loss had been anticipated. As a matter of fact this aspect was not disputed by the Assessing Officer also. He had swayed more by the revenue loss than by the correct principle to be applied. The matching principle of accounting was not of much significance in the present context because if the loss had been properly estimated in the year in which the contract had been entered into, then it had to be allowed in that very year and could not be spread over the period of contract. The matching principle is of relevance where income and expenditure, both are to be considered together. However, in the instant case the effect of valuation of WIP would automatically affect the profit of subsequent years accordingly. Therefore, there was no reason for not accepting in principle the assessee's claim as being allowable. However, in view of discrepancies pointed out by the Commissioner (Appeals) for correct estimation of loss, the matter was to be restored to the file of the Assessing Officer to examine the correctness of amount claimed."



Further, the Id. 'A.R' also cited the case of Gopal Purohit (supra) to stress his point of maintenance of consistency and uniformity in according treatment to the issue in question, as the similar loss was allowed in the A.Y 1997-98. The relevant part of the order of the Id. CIT(A), dated 26/9/2000, for the A.Y. 97-98, is reproduced hereunder:-

"15. I have carefully considered the submissions of the appellant. I find that the assessee has been consistently following the method accounting which has the due approval of the accounting policy laid down by the institute of the C.As. This methodology has also been approved by the C.B.D.T. It is also to be taken into account that more than 90% of the contract was complete during the year, and therefore, as per the accounting policy there was nothing wrong in considering the anticipated losses. Considering the facts and circumstances, and taking into account that the appellant had consistently followed this method of accounting, the addition of Rs. 75,218/- is deleted."

11. Having regard to the above legal and factual discussions, and following the decision of the ITAT in the case of Mazgaon Dock Ltd.(supra) and Metal Box Co. of India Ltd. (supra) and decision of the Hon'ble Delhi High Court in the case of CIT vs. Woodward Governor India Pvt. Ltd.,(2007) 294 ITR 451 (Del), the contention of the assessee regarding allowability of foreseeable loss is accepted in principle, However, the issue is restored to the file of A.O., for the purpose of quantification and calculation of the said loss in terms of Accounting Standard - 7, as the same has not been done. The A.O. is, further, directed to afford reasonable and proper opportunity to the assessee for the purpose of calculation and quantification of the said foreseeable losses. It is, further, made clear that the similar ground has been raised by the assessee for the A.Y 2003-04, vide ground No.2. As the issue is identical expect the assessment year and the amount of foreseeable losses at Rs. 5,83,038/-, the findings given in respect of A.Y 2002-03 is also applicable for the A.Y 2003-04. Therefore, ground No.1 of A.Y 2002-03, and Ground No.2 of A.Y 2003-04 of the assessee are allowed.


12. In ground No.2, of A.Y. 2002-03 and ground No.1 of A.Y. 2003-04, the assessee contended that the Id. CIT(A) has erred in partially confirming the disallowance on account of expenditure on computer software to the extent of Rs. 47,404/-, for A.Y. 2002-03 and Rs. 31,16,486/-, for A.Y. 2003-04.

13. For the Assessment year 2002-03, the A.O. disallowed the claim of the assessee for purchase of computer software and maintenance of computers. The assessee has expended Rs. 1,40,44,387/-, on purchase of computer software and maintenance of computers. This amount is inclusive of Rs. 93,20,213/- expended on purchase of computer software. This claim of the assessee cannot be



entertained as the payment is made for outright purchase of computer software. As the acquisition of software and its repeated usage in the business of the assessee involves the creation of an asset of an enduring nature, the expenditure on the acquisition of the software is to be treated as capital expenditure as held in the case of Arawali Construction Co. Pvt. Ltd. reported in 124 Taxman 146 (Raj). Reliance is also placed on the decision in the case of CIT v. Elecon Engineering Co. Ltd. (1987) (SC) wherein it was held that acquisition of drawing and patterns for the manufacture of work reduction gear units and conveyor idlers were to be treated as plant or machinery eligible for depreciation. In the modern era, computer software replaces the drawings and patterns in the manufacture / software development. However, depreciation @ 25% amounting to Rs. 23,30,053/- is allowed to the assessee u/s. 32 of the I.T. Act being intangible asset.

14. For the assessment year 2003-04 also the A.O. disallowed the claim of the assessee for purchase of computer software and maintenance of computers. However, the Id. CIT(A) partially confirmed the disallowance.



15. In the course of present appellate proceedings, the Id. 'A.R' contended that it would be in the interest of justice to restore the issue to the file of A.O. for fresh adjudication in terms of the decisions on the identical issue in the case of Amway India Enterprise (2008) 111 ITD 112 (Del) (SB). The Id. D.R. on the other hand, contended that the Id. CIT(A) has passed detailed order and the same may if at all required be restored to the file of Id. CIT(A) for fresh adjudication in terms of the decision of Amway India Enterprises (supra)

16. We have carefully considered the relevant facts of the case and rival submissions. Having regard to the fact situation of the case, it is evident that the lower authorities did not have the benefit of the Special Bench decision, in the case of Amway India Enterprises vs. DCIT, Cir.1(1), New Delhi (2008) 111 ITD 112 (Del) (SB) at the time of passing their respective orders. Therefore, the issue is set aside to the file of the A.O., for fresh adjudication, in the light of the Special Bench decision in the case of Amway India Enterprises (supra), after affording proper and reasonable opportunity to the assessee. Consequently, the finding of the Id. CIT(A) on this ground are set aside for both the assessment years and restored to the file of the A.O., for fresh adjudication as mentioned earlier in the light of the decision of the Special Bench (supra).

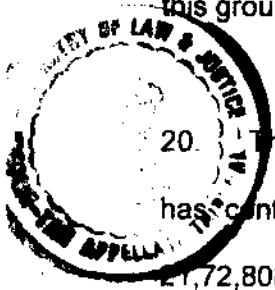
17. In ground No.3, raised in A.Y 2003-04, the assessee contended that the learned CIT(A), has erred in confirming the action of A.O., in reducing unabsorbed depreciation of earlier years while computing 'profits from the business' when granting deduction under section 80 HHE of the Income-tax Act. (the Act)



In the course of present appellate proceedings, the Id. 'A.R' did not pursue ground of appeal seriously. The Id. D.R. on the other vehemently defended the order of the A.O. and the first appellate authority. The Id. CIT(A), confirmed the finding of the A.O., on the issue that the brought forward unabsorbed depreciation is to be treated as the current depreciation u/s. 32(2) of the Act, and has to be set off against business income for allowing deduction u/s. 80 HHE of the Act. The Id. CIT(A), placed reliance on the decision of the Mumbai Tribunal in the case of Vithal Health Care Pvt. Ltd. vs. ITO in ITA No.1754/M/04 for A.Y 01-02 , wherein the decision of the Jurisdictional High Court in the case of Shirke Construction 246 ITR

429 has been discussed. *M/s. Cambay Electric Supply & Industrial Co. Ltd. Vs. CIT*, 113 ITR 84(SC). The findings of the Id. CIT(A) on the issue in question are contained from page 5 to 8 of the impugned appellate order.

19. It is now well settled that deduction under Chapter VI A are to be allowed only on net income and not on gross income. The net income is to be computed after giving full effect to the provisions of sections 80AB, 32, 70, 71 & 72 of the Act. Therefore, the assessee is entitled to claim deduction under Chapter VIA of the Act after determination of eligible profit, as contemplated u/s. 28 to 44 and after giving effect to the provision of section 32, 70, 71 & 72 of the Act. In view of this, the assessee, in the present case, can claim deduction u/s. 80 HHE of the Act, after considering brought forward depreciation and brought forward loss. Thus, the assessee is eligible for deduction u/s. 80 HHE of the Act, only on net income. Thus, this ground of appeal is decided in favour of the revenue and against the assessee.



20. The revenue, in its solitary ground of appeal, for both the assessment years has contended that Id. CIT(A), has erred in directing the A.O., to treat Rs. 1,72,808/- and Rs. 1,34,28,461/- respectively for A.Y 2002-03 & 2003-04, spent on purchase of computer software as revenue expenditure.

21. This issue has been decided by in assessee's Ground No.2 for A.Y 2002-03 & Ground No.1 in A.Y. 2003-04, in assessee' appeal and the issue has been set aside to the file of A.O., for fresh adjudication of the matter, in accordance with the Special Bench decision, in the case of *Amway India Enterprises vs. DCIT*, Cir.1(1), New Delhi (2008) 111 ITD 112 (Del) (SB). Therefore, these grounds of the revenue,

for both the assessment years are also set aside, to the file of A.O., for fresh adjudication in the light of the Special Bench decision (supra), after providing reasonable and proper opportunity to the assessee. Therefore, these grounds of appeal for A.Y. 2002-03 & Y.Y. 2003-04 are allowed for statistical purposes.

22. We summarise the result as under:

- (1) Assessee's appeals are partly allowed.
- (2) Revenues appeals are allowed for statistical purposes.

Order pronounced on 26th May.2009.

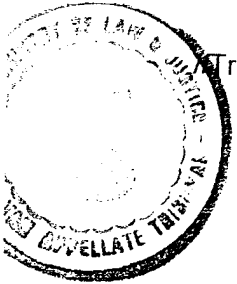
Sd/-

(N.V.VASUDEVAN)
JUDICIAL MEMBER

Mumbai: Dated 26th May.2009

Copy to:

1. The Appellant
2. The Respondent
3. The CIT (A)II, Mumbai VIII
4. The CIT,III, Mumbai VIII
5. The DR 'C' Bench



True copy//

VM

Sd/-

(MEHAR SINGH)
ACCOUNTANT MEMBER

BY ORDER


ASST.
REGISTRAR
ITAT,
MUMBAI