

आयकर अपीलीय अधिकरण, मुंबई न्यायपीठ 'एल', मुंबई ।

IN THE INCOME TAX APPELLATE TRIBUNAL "L", BENCH MUMBAI

सर्वश्री आर.सी.शर्मा, लेखा सदस्य एवं श्री संजय गर्ग, न्यायिक सदस्य

BEFORE SHRI R.C.SHARMA, AM

&

SHRI SANJAY GARG, JM

आयकर अपील सं./ITA No.39/Mum/2007

(निर्धारण वर्ष / Assessment Year :2002-2003)

Bechtel International Inc., C/o KPMG, 1 st Floor, Apollo Mills Compound, N.M.Joshi Marg, Mahalaxmi, Mumbai-400011	Vs.	The DDIT, International Taxation-3(2), Mumbai
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : AAACB 6149 A		
(अपीलार्थी /Appellant)	..	(प्रत्यर्थी / Respondent)

आयकर अपील सं./ITA No.650/Mum/2007

(निर्धारण वर्ष / Assessment Year :2002-2003)

The ADIT, International Taxation-3(2), Mumbai	Vs.	Bechtel International Inc., C/o KPMG, 1 st Floor, Apollo Mills Compound, N.M.Joshi Marg, Mahalaxmi, Mumbai-400011
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : AAACB 6149 A		
(अपीलार्थी /Appellant)	..	(प्रत्यर्थी / Respondent)

Cross Objection No.122/Mum/2007

(Arising out of ITA No.650/Mum/2007)

(निर्धारण वर्ष / Assessment Year :2002-2003)

Bechtel International Inc., C/o KPMG, 1 st Floor, Apollo Mills Compound, N.M.Joshi Marg, Mahalaxmi, Mumbai-400011	Vs.	The ACIT, International Taxation-3(2), Mumbai
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : AAACB 6149 A		
(अपीलार्थी /Appellant)	..	(प्रत्यर्थी / Respondent)

निर्धारिती की ओर से /Assessee by

:

Shri Sunil M. Lala

& Sh. Varun Sankhesara

राजस्व की ओर से /Revenue by

:

Ms. Vandana Sagar

सुनवाई की तारीख / **Date of Hearing** : **09/07/2015**
घोषणा की तारीख/**Date of Pronouncement** **30/10/2015**

आदेश / O R D E R

PER R.C.SHARMA (A.M):

These are the appeals filed by the assessee and revenue as well as the cross objection by the assessee against the order of CIT(A), Mumbai, for the assessment year 2002-03.

2. Rival contentions have been heard and record perused. Facts in brief are that the assessee is a closely held company incorporated in USA. In India, assessee has entered into contracts with Dabhol Power Company (DPC) and Haldia Petrochemicals Ltd. (HPL). The contract with DPC was in respect of construction of power project in District Ratnagiri, Maharashtra. Contract was in two phases. Contract-I was entered on 09.05.1994 for first phase which was completed in May, 1999. Contract-II was entered into on 30.11.1998 for construction of 1444MW gas turbine power plant. Contract-II consisted of two contracts, namely, Construction Contract and Service Contract. The Onshore Construction Contract entered into between DPC and the assessee on 30.11.1998 did not run its full course. This contract was terminated by the assessee on 17.06.2001 on account of non-payment of bills by the DPC. Pursuant to termination of contract with DPC, the assessee raised a claim of USD 17.73 million (Rs. 85.99 crores) which comprises of following:

Sr.No.	Particulars	Amount (in Rs)
1	For the contractual work performed till date of termination i.e. June 2001	26,47,94,234
2	For demobilization in winding up of site operations post termination of the contract	59,51,15,766
	Total	85,99,10,000

Above bill amount was not credited to its profit and loss account for the year ending on 31-3-2002, on the plea that the ultimate collection of the said amount was not certain while raising the bill. The assessee also gave a note to the Computation of Income that the claim raised for various amount due from DPC for the contractual work performed till date of termination and for demobilization in winding up of site operations post termination of the contract, has not been offered as income for the year.

3. During the course of scrutiny assessment the AO made addition on account of receivables amounting to Rs.26.47 crores and for demobilization in winding up of site operation of Rs.59.51 crores.

4. By the impugned order the CIT(A) confirmed the action of the AO for adding amount of Rs.26.47 crores in respect of contractual work till date of termination i.e. June 2001, however, he deleted the addition of Rs.59.51 crores made by the AO on account of mobilization in winding up of site operation on the plea that invoice in this respect was never accepted by the DPC consequently same amount never accrued to the assessee. Against the above order of CIT(A) both the assessee and revenue are in appeal each before us. The assessee has also filed cross objection.

5. It was contended by Id. AR that a sum of Rs.26.47 crores did not accrue during the year on account of uncertainty of its ultimate collection. He further submitted that sympathizing with the plight of all the asses sees affected by ENRON bankruptcy, the Government of India came out with the Deed of Release dated 12 July 2005. In accordance with this deed, no claims / demands for taxes or tax assessments relating to the DPC in excess of USD 3 million including amounts already paid, can be made upon any assessee. As per Id. AR in line with the Deed of Release issued by the Government of India, the demand raised by the AO is contrary to the Deed of Release issued by Government of India. It was the contention of Id. AR that even though the right to receive is important pre-requisite for taxing particular income, the same is not enough to decide whether the said income has accrued or not during the year. As per Id. AR it cannot be said that income has accrued merely on the ground that the assessee had been following mercantile system. It has to be considered whether there has been real income to the assessee taking into consideration the commercial and business realities of the case, for e.g. precarious financial condition, suits/disputes between parties. No real income can be said to have accrued during the pendency of suit/dispute. For this Purpose reliance was placed on the following cases :-

Sr. No.	Case Laws	Citation
1	CIT v. Motor Credit Co. P. Ltd.	[1981] (127 ITR 572) (Mad)
2	SLP by the Department against the decision of Madras High Court in the case of CIT v. Motor Credit Co. P. Ltd reported in 127 ITR 572 (Mad) dismissed	[1983] (144 ITR (St) 50)
3	CIT v. Ferozpur Finance (P) Ltd.	[1980] (124 ITR 619) (P&H)
4	SLP by the Department against the decision of P&H High Court in the case of CIT v. Ferozpur Finance (P) Ltd reported in 124 ITR 619 (P&H) dismissed	[1983] (144 ITR (St) 50)
5	CIT v. Vasisth Chay Vyapar	[2011] (330 ITR 440) (Del.)
6	D.R.D Tata v. ITO	[1986] (17 ITD 0642)

		(Bom.)
7	Malbros Investment Ltd. v. DCIT	[2008] (11 DTR 314) (Del.)
8	ITO v. Dyestuffs & Chemicals (P) Ltd.	[1983] (6 ITD 513) (Bom.)
9	FGP Ltd. v. CIT (applying Supreme Court judgment in case of Godhara Electricity 225 ITR 746)	[2010] (326 ITR 444) (Bom)
10	CIT v. Orissa State Financial Corporation	[1993] (201 ITR 595) (Ori.)
11	UCO Bank vs. CIT	[2014] (43 taxmann.com 294) (Cal HC)
12	Maruti Securities Ltd. vs. ACIT	ITA No. 468/Hyd/2009
13	CIT vs. Excel Industries Ltd.	[2013] (358 ITR 295) (SC)

6. With regard to amount of Rs.59.51 crores on account of mobilization and winding up of site operation bill, the contention of Id. AR was that the bills raised were never accepted by the DPC, therefore, the amount did not accrue nor any right to receive was in favour of the assessee.

7. On the other hand, it was contended by Id. DR that the contract is continuing from 1998 till 17-6-2001. The method of accounting followed by assessee is mercantile under which the accounting the receipts or raising the invoices for the work done had been uniformly followed by assessee and honoured by DPC as per the terms of the contract. Thus, as per the accepted practice between assessee and DPC, the right to receive accrues when the assessee performs the work, though the bills are raised in time bound manner as per the agreement after certification of work done and actual payment may be made at later date i.e. within 30 days of the certification of the work.. Reliance was placed on the decision of Hon'ble Bombay High Court in the case of Navin Kamani, 185 ITR 408, wherein it was observed that the concept of real income cannot be employed so as to defeat the provisions of the Act. She further contended that the assessee showed payments in earlier years on accrual basis. Since work continued in the first two months of the relevant financial year, there was no reason not to disclose the same on accrual basis this year. As per Id. DR by giving up an amount after accrual and before receipt, the assessee cannot escape taxability Postponement of the date of payment of bills does not affect the accrual of income mentioned in the bills if they are as per the terms of contract and the work/services have been rendered as per the contract. The fact that the income is not subsequently received would also not detract from or efface the accrual of income, although when the factum of non receipt is established, then in appropriate cases the assessee may be entitled to claim deduction as bad

debts on satisfaction of requisite conditions. She further contended that assessee had a legally enforceable right as it has already rendered the services before termination of contract and pendency of litigation does not efface the accrual/right to receive.

8. We have considered rival contentions, carefully gone through the orders of the authorities below and deliberated on the judicial pronouncements referred by lower authorities in their respective order as well as cited by Id. AR and DR during the course of hearing before us. From the record we found that the assessee was awarded two contracts by DPC. The DPC contract was in two phases. Contract-I was completed on May 1999 whereas Contract - II, comprising of Construction and Service Contract did not run in its full course and was terminated by the assessee on 17 June 2001 on account of non-payment of bills by DPC. DPC was a company based in India, formed to manage and- operate Dabhol Power Plant. Enron was the major shareholders of DPC. Enron had entered into Memorandum of Understanding ('MOU') with the government of the state of Maharashtra for the project which was followed by execution of Power purchase agreement ('PPA') for 20 years with Maharashtra State Electricity Board ('MSEB'). The terms of PPA included guarantee by MSEB to buy 90% of electricity produced, annual payment of USD 220 million to DPC. Subsequently Enron, the major shareholder went bankrupt and filed for bankruptcy in December 2001. Further due to ongoing dispute with MSEB, the MSEB stopped making any payment to DPC. This has resulted in precarious financial position of DPC resulting in

continuous payment defaults to contractor parties including the assessee. Due to continuous default in payment by DPC, after giving its intention to terminate the contract, vide letter dated 17 April 2001 (i.e. in the beginning of the previous year), the assessee eventually terminated its contract on 17 June 2001. The assessee is one of the victims of the Enron debacle which occurred in India almost about 15 years back. As a consequence, the assessee incurred huge losses due to non-receipt of Rs. 85.99 crs from Dabhol Power Company ('DPC'), an Enron company which had entered into a contract with the assessee with regard to construction of power plant in Ratnagiri, Maharashtra. Out of the said claim of Rs. 85.99 crs, the assessee realized only Rs 7.30 cr i.e. 8.58 percent of the total claim and that was after four years of legal fight and this fact has been duly accepted by the AO. The case of the department is that the assessee should pay tax on the aforesaid amount of Rs. 85.99 crs in AY 2002-03 which admittedly has not been realized by the assessee. From the record we found that because of non-payment of earlier dues by DPC, the assessee terminated contract on 17-6-2001. Thereafter two bills were raised. The AO held that since the assessee is following mercantile system of accounting and since the bills were raised, income accrues to the assessee, therefore, both amounts of bills were added by the AO in the assessee's income. The CIT(A) deleted the addition of Rs.59.51 crores on the plea that bills were not accepted by the DPC and there is no liability to make payment to the assessee, therefore, right to receive never accrues to the assessee. From the record we found that bill of Rs.59.51

crores was raised in November, 2001, which is five months after the termination of contract. The fact of non-acceptance of the invoices by DPC has not been disputed by the department. Accordingly, we do not find any infirmity in the order of CIT(A) for deleting the addition in respect of claim of assessee which was not accepted by the DPC.

9. The assessee rightly following the Accounting Standard-9 i.e. the Revenue recognition, has not credited abovementioned amount to its profit and loss account for year ending on 31 March, 2002, since the ultimate collection of the said amount was not certain while raising the claim. Precarious financial position of DPC resulted in continuous defaults in payments to assessee. The assessee terminated the contract due to non payment of claims and on a realistic/prudent basis did not make any entry for the improbable contract revenue in its profit and loss account. As regards claim of Rs. 59.51 crores the invoices in respect of the same were raised in November 2001 which is 5 months after the termination of contract. The said invoices was in respect of sub-clause (ii) and iii) of Clause 44.2 of the agreement which refers to the amount of expenditure which the assessee incurs in expectation of the performance of contract or in consequence of termination of Contract and loss of anticipated profit on account of termination of contract. The CIT(A) has held that the invoices in relation to the same were never accepted by DPC and that consequently the said amount never accrued to the assessee. The fact of non-acceptance of the invoices has not been disputed by the department. In the given circumstance CIT(A) has rightly held that since the assessee

had no right to receive the said amount, the said amount had not accrued to the assessee. In light of findings given by CIT(A) on page no 17-21, there is no reason to accept the contention of Id. DR that income had accrued to assessee even though invoice was not accepted by DPC. It cannot be said that income has accrued merely on the ground that the assessee had been following mercantile system. It has to be considered whether there has been real income to the assessee taking into consideration the commercial and business realities of the case, for e.g. precarious financial condition, suits/disputes between parties. No real income can be said to have accrued during the pendency of suit/dispute.

10. Hon'ble Supreme Court in the case of CIT Vs. Excel industries Ltd. 358 ITR 295, had laid down three tests to determine when income can be said to have accrued. :

- (a) Whether the income is real or hypothetical;
- (b) Whether there is a corresponding liability of the other party to pay the amount to the assessee;
- (c) the probability or improbability of realisation of the income by the assessee has to be considered from a realistic and practical point of view.

Thus, probability or improbability of realization of the income has to be considered from practical point of view.

11. The Hon'ble Delhi High Court in the case of CIT Vs. Eicher Ltd., 320 ITR 410, held that where claim of Rs.617 lakhs was settled at Rs.480 lakhs after four years of dispute, even in this scenario, it was held by the Hon'ble High Court that only sum of Rs.480 lakhs can be taxed and that too in the year in which it was received.

12. There is no dispute to the fact that there was termination of contract and full uncertainty was there with respect to recoverability of the amount invoiced. In fact, the assessee has rightly followed the accounting principle by not recording the said impugned amount in the books of account. As per Accounting Standard ('AS') - 9 i.e. Revenue recognition, if there is uncertainty with regard to the collection of amount then recognition of said amount should be deferred in the books of account. The assessee being company has to follow these accounting standards while maintaining its books of accounts Further, the CBDT has recently issued a Notification dated 31st March 2015 notifying the Income Computation and Disclosure Standards (,ICDS,) to be followed by all income-tax assessee following the mercantile system of accounting for the purposes of computation of income chargeable to tax under the heads "Profit and gains of business or profession" or "Income from other sources". As per ICDS - III (revenue recognition in the case of construction contracts) and IV (revenue recognition in other case) also ultimate recovery of amount is important criteria for the amount to be held as accrued during the year. Thus, revenue itself has now recognized ultimate recovery as important principal for accrual of income.

13. The fact that the Assessee never recorded the impugned amount in its book of accounts shows that the Assessee never considered the said amount as accrued income. The raising of invoice is initial process of recovery after which the assessee realized that there is uncertainty with respect to receipt of impugned amount and terminated the contract. If

assessee had given up its claim then it would not have received even Rs.7,30 crores, which is merely 8.58 percent of total claim after a long legal fight. The fact that (i) the Assessee recovered only 8.58% of the total claim, and that too after a period of 4 years and that (ii) the addition confirmed by CIT(A) in this year had been allowed as a deduction by the AO in AY 2006-07 clearly shows that the said amount could not be said to have accrued in favour of assessee in the relevant assessment year under consideration. However, the AO is directed to bring to tax net the amount received in future in the year of actual receipt. We direct accordingly.

14. In the result, appeal of the revenue is dismissed, whereas appeal of the assessee is allowed in part, in terms indicated hereinabove. The cross objection become infructuous, therefore, the same is dismissed.

Order pronounced in the open court on this 30/10/2015.

Sd/-
(संजय गर्ग)

(SANJAY GARG)

न्यायिक सदस्य / JUDICIAL MEMBER

मुंबई Mumbai; दिनांक Dated 30/10/2015

प्र.कु.मि/pkm, नि.स/ 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), Mumbai.
4. आयकर आयुक्त / CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file.

सत्यापित प्रति //True Copy//

Sd/-
(आर.सी.शर्मा)

(R.C.SHARMA)

लेखा सदस्य / ACCOUNTANT MEMBER

आदेशानुसार/ BY
ORDER,

उप/सहायक पंजीकार

(Asstt. Registrar)

आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai