

Chemical Construction Vs. Chemical Construction

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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Jul-15-1997

Appellant : Chemical Construction

Respondent : Chemical Construction

Judgement :

1. These cross-appeals one by the assessee and the other by the Revenue are directed against the order passed by the CIT(A) on 13th September, 1996, for asst. yr. 1993-94.

2. The assessee is engaged in the business of designing, supply, installation and erection of solvent extraction plant on a turnkey basis. During the year under consideration, the assessee completed few projects of supply of plants to different customers, most of whom are limited companies. The various other projects were also in progress.

The AO examined the profits shown by the assessee in various projects completed during the year as well as the projects which were in progress at the end of the close of the year. The AO in view of the elaborate reasons mentioned in the assessment order made an aggregate addition of Rs. 2,87,35,776 in the income declared from contract for turnkey project of supplying solvent extraction plant to some of the customers. The AO has given detailed reasons in support of making such addition.

2.1 The CIT(A) observed that the AO has not discussed in detail the method of accounting followed by the assessee in respect of the turnkey projects, the period of execution of which normally overlap two or three accounting years. He further observed that the completed contract method is a recognised method of accounting of the profits of long drawn projects which extend over periods longer than one accounting year. In other words, the expenditure of each year relating to each project are accumulated and are carried forward as work-in-progress and are finally adjusted against the total receipts that are due from the projects in the year of substantial completion of the contracts. The CIT(A) further observed that there may be a continuous flow of advance amounts from the clients which, generally are commensurate with the extent of work done or sometimes even slightly more than the work done, the excess being in the nature of work advance. The CIT(A) observed that the assessee has treated most of the expenditure in accordance with the completed contract method but the value of supply of certain bought out items which are fairly independent items of machinery have been booked as sales and profit have been worked out accordingly. The CIT(A) further observed that the AO was incorrect in his assessment that the entire receipts from the clients would constitute sales made during the year. Thereafter, the CIT(A) reexamined the whole matter in this light and examined the addition made in relation to various projects. The position of addition made by the AO and relief granted by the CIT(A) in respect of various projects has been summarised by him in para 4.11 of the order passed by him. The chart showing relevant details of addition made by the AO, addition confirmed by the CIT(A) and the relief granted by him is as under :-

Name of the Added by the AO		Confirmed by	Relief granted by client	CIT(A)	CIT(A)	Rs.	Rs.	
Rs.		Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	
Atul Food Products		26,42,000	20,47,269	5,94,731	Atul Agro Oils	48,56,800	20,45,770	28,11,100
Malwa Vanaspati		64,54,326	4,69,809	59,84,517	Goetz (India)	50,00,000	50,00,000	
Nil/Other items				97,82,650		14,13,137		83,69,513
				Total		2,87,35,776		1,09,75,985
1,77,59,791								

"1. The A/A authority grossly erred in arriving at profit on factually incorrect figures of value of contracts and on principles of accounting which are based on conjunctures.

2. The A/A authority erred in treating the entire receipts of know-how fee of Rs. 50 lacs from Goetz (India) Ltd. as income without considering the expense relating to this receipt as well as the fact that the know-how fee was part of the total contract receipts, therefore, treatment of know-how fee in isolation to the exclusion of total contract receipt is against facts of the case.

3. The method of arriving of figures of profit by A/A in case of completed contracts and incompleting contracts is against the accepted accounting principles.

4. It is prayed that the return version be accepted and relief as above be given to the assessee." "On the facts and in the circumstances of the case the learned CIT(A) erred both on facts and in law in computing the profits on complete contract method rather than mercantile system of accounting regularly followed by the assessee." 5. The learned counsel for the assessee submitted that the assessee has consistently maintained its accounts on the basis of similar method of accounting, which has been accepted in the past as well as in the future years. He drew our attention towards the directions given by the Addl. CIT, New Delhi, under s. 144A of the Act for asst. yr. 1984-85.

In the said directions, the Addl. CIT in asst. yr. 1984-85 has accepted the completed contract method of accounting followed by the assessee.

The learned counsel submitted that the Revenue's ground would fail in view of the directions given by the Addl. CIT under s. 144A for asst.

yr. 1994-95.

5.1 The learned counsel for the assessee further submitted that the additions confirmed by the CIT(A) in relation to the various aforesaid projects is patently wrong. He pointed out that the CIT(A) has erred in confirming the addition of Rs. 20,47,269, in respect of turnkey project executed with Atul Food Products. It was pointed out by him that the CIT(A) has sustained the aforesaid addition as per the details mentioned below :Gross receipts from the client 30,42,000(-) Purchases and other direct costs 9,56,166Balance gross Profit 20,85,834(-) Profits already accounted 38,565 ----- The learned counsel submitted that the gross receipts

was only Rs. 30 lacs and not Rs. 30,42,000. Out of Rs. 30 lacs received from the aforesaid client, a sum of Rs. 8 lacs were wrongly credited in the accounts of two other parties. He pointed out that a reconciliation of receipts from Atul Food Products was submitted before the CIT(A) which has not been taken into consideration by him while sustaining the aforesaid addition. The reconciliation statement submitted before the CIT(A) was as under :the assessment order 30,42,000Less : Amounts wrongly credited by the Alwar Agro (Ch. No. 237992) 4,00,000 8,00,000 ----- advice was received 42,000 -----per assessee's books - Rs. 22,00,000 22,00,000 ----- The learned counsel submitted that the receipt of Rs. 8 lacs credited in the account of Atul Agro Oils and Alwar Agro has resulted in double addition, as income from contracts executed with these two other parties have been separately taxed as income. He, therefore, urged that the income declared by the assessee in respect of the project of Atul Food Products ought to have been accepted by the CIT(A).

6. The learned counsel further submitted that the CIT(A) has similarly erred in confirming the addition of Rs. 20,45,770 in relation to the project of Atul Agro Oils. The said addition has been confirmed by the CIT(A) as per the details mentioned below : Total contract price 1,30,00,000Less : Purchases and direct costs March, 1992 1,04,04,357 ----- Balance profit 25,95,643 Profit already accounted for 5,49,873 ----- to the returned 20,45,770 ----- The learned counsel drew our attention towards the revised agreement executed with the said party which shows the total contract price of the project of this party was only Rs. 106 lakhs. Copy of page No. 3 of the revised agreement has been submitted at p. 50 of the compilation.

However, the complete copy of the revised contract has not been placed in the record. The learned counsel submitted that the CIT(A) ought to have taken the total contract receipt only at Rs. 1,06,00,000 instead of Rs. 1,30,00,000 adopted by him.

6.1 The learned counsel also submitted that the CIT(A) has erred in confirming the addition of Rs. 50 lakhs in relation to project of M/s.

Goetz (India) Ltd. This income was shown by the assessee in asst. yr.

1994-95. Inclusion of the same income in the year under consideration has resulted in double taxation of the same income.

6.2 The learned counsel made the submissions with regard to the additions confirmed in relation to the various projects discussed in the order of the CIT(A). He, strongly urged that the addition sustained by the CIT(A) should be cancelled.

7. The learned Departmental Representative submitted that the assessee has not maintained any regular or recognised method of accounting. He drew our attention towards a chart submitted at p. 81 of the paper-book which shows that the assessee has booked sales in relation to various projects in the year under consideration, which is claimed to have been booked on the basis of value of certain bought out items supplied to the clients in the year under consideration. The learned Departmental Representative submitted that the figures of sales booked in the year under consideration with regard to various projects are in round sums.

They cannot represent the value of supply of certain bought out items for the respective contracts. The assessee has booked the sales in the year under consideration without any definite basis. The assessee has been trying to defer the income in the various projects to subsequent years by following such a method of accounting which can neither be described as a completed contract method nor the method so adopted by the assessee is a recognised method of accounting. The learned Departmental Representative also pointed out that the CIT(A) has erred in granting relief to the assessee by determining the income on the basis of so-called completed contract method. He submitted that the AO has given adequate and convincing reasons in support of the various additions made by him. The CIT(A) ought to have confirmed the entire addition made by the AO.⁸ We have carefully considered the submissions made by the learned representatives of the parties and have also perused the orders of the learned Departmental authorities as well as various other documents submitted in the compilation to which our attention was drawn during the course of hearing.

9. The assessee contended that the receipts to the extent of Rs. 8 lacs were wrongly credited to from Atul Agro Oils and Alwar Agro and the income to that

extent has been taxed twice. Such a contention raised on behalf of the learned counsel does not appear to be correct. In order to properly consider the submissions made on behalf of the assessee, it will be worthwhile to reproduce the copy of trading account for work done for Atul Food Products as well as the copy of trading account of the project for Atul Agro Oils.

TRADING ACCOUNT FOR WORK DONE FOR ATUL FOOD PRODUCTS Year ended 31ST MARCH, 1993 Dr.

Cr. Opening W.I.P. Nil Sales 4,00,000 Purchases 7,73,601 Closing W.I.P. 4,12,166 Other direct cost Nil Opening W.I.P. 4,12,166 Project receipts 10,14,335 Purchases Nil Sales value 7,69,615 Direct cost 1,82,565 Closing W.I.P. Nil Gross profit 11,89,219 TRADING ACCOUNT OF THE PROJECT FOR ATUL AGRO OIL LTD. Year ended 31st March, 1992 Dr.

Cr. Purchase 17,88,443 Closing work in progress 17,88,443 (Year ended 31st March, 1993) Opening W.I.P. 17,88,443 Sales value 55,80,000 Purchase 74,84,810 Closing W.I.P. 53,74,230 Direct Costs 11,31,104 ----- 1,09,54,230 1,09,54,230 ----- (Year ended 31st March, 1994) Opening W.I.P. 53,74,230 Project receipts 52,98,930 Purchase Nil Gross loss 75,300 Direct cost Nil ----- 53,74,230 53,74,230 ----- It is an undisputed fact that the assessee has received Rs. 30 lacs upto the end of the relevant accounting year ended on 31st March, 1993.

The receipts in Atul Food Product have been admittedly understated by Rs. 8 lacs which has been wrongly credited in the accounts of the aforesaid two parties. The income of Atul Oil Ltd. Project for asst.

yr. 1993-94 has been disclosed at Rs. 5,49,873 only. In this year, the project for Atul Agro Oil Ltd. had not been completed as is evident from the copy of their trading account for the year ended on 31st March, 1994 also. Hence the income of Atul Agro Oil Ltd. for the year ended on 31st March, 1993 has been disclosed with reference to the sales value of Rs. 55,80,000 which is said to be the sale value of certain bought out items supplied to the clients in that year. The question of including the income of Rs. 4 lacs representing the wrong credit entry in their

account instead of the same in the account of Atul Food Products does not arise. Likewise, the wrong credit of Rs. 4 lacs made in the account of Alwar Agro has also not resulted in disclosure of income by the assessee in asst. yr. 1993-94, as is evident from the chart at p. 81 of the paper-book which shows that the total sales booked by the assessee in respect of that project in asst.

yr. 1993-94 was only Rs. 2,50,000 on which the gross profit of Rs. 3,05,790 was shown. It is, therefore, clear that income with reference to the total wrong credits of Rs. 4 lacs each in the account of Atul Agro Oil Ltd. and Alwar Agro has not been shown as income by the assessee in asst. yr. 1983-84.

9.1 Likewise, the assessee has not been able to substantiate the correctness of income declared in relation to project of Atul Agro Oil Ltd. It is not known as to how the assessee has bifurcated the sale value in two years ended on 31st March, 1993 and 31st March, 1994. The exact date of completion of the turnkey project with Atul Agro Oil Ltd. has also not been communicated by the assessee to the Departmental authorities.

9.2 The AO and the CIT(A) also required the assessee to communicate the exact date of completion of the project of Atul Food Products. The assessee produced a copy of letter dt. 29th June, 1993, addressed by the said client to the assessee requesting them for deputing a person for repairing the plant. The learned counsel was requested to supply a copy of the said letter which was not available with him. The contents of the said letter as reproduced in the order of the CIT(A) indicates that the client required the assessee to repair the plant vide letter dt. 29th June, 1993. It necessarily implies that the turnkey project of the said client had already been completed prior to the said date, when the client asked the assessee to carry out certain repairs in the said plant. Ordinarily, it should not be difficult for the assessee to give the exact date, when the erection of the plant of Atul Food Products was finally completed. This information can be correctly ascertained by examining the records of Atul Food Products. Their production register can clearly reveal the exact date when production from the said plant supplied by the assessee had commenced. Such precise detail was not furnished by the assessee. The exact date of the completion of the project may be perhaps

necessary for proper determination of income from the said project.

10. The CIT(A) has confirmed the addition of Rs. 50 lacs in relation to the project for Goetz (India) Ltd. The copy of trading account of the project for Goetz India Ltd. is reproduced as hereunder : TRADING ACCOUNT OF THE PROJECT FOR GOETZ (INDIA) LTD. YEAR ENDED 31ST MARCH, 1993 Dr.

Cr. Opening W.I.P.	Nil	Closing W.I.P.	94,74,451	Purchases	93,58,867	-----
-----	94,74,451	94,74,451	-----	-----	Year ended 31st March, 1994	
Opening W.I.P.	94,74,451	Project receipts	50,00,000	Purchases	1,35,36,476	
Closing W.I.P.	2,40,94,391	Direct cost	10,83,464	-----	-----	2,90,94,391
2,90,94,391	-----	-----	-----	-----	-----	-----

The CIT(A) has observed that two different contracts were executed with the said client. The first contract signed on 4th June, 1992, was for the purpose of designing and supply of drawings for a fully automatic solvent extraction plant. The total contract price was Rs. 50 lacs payable as 33 per cent. against the acceptance of the contract and receipt of certain drawings, another 33 per cent. payable on site layout and the balance 34 per cent. on order of placement of bought out items. The aforesaid payment of Rs. 50 lacs was received by the assessee as under : Another agreement with the same client was expected on the same date, i.e., on 4th June, 1992. This agreement was for supply of material and equipments, erection and commissioning of the same plant. The price agreed upon was Rs. 271.50 lakhs payable according to certain schedule in different instalments. The time-limit of supply of equipments was 30th November, 1992, so that the plant can be commissioned and guarantee runs completed by 28th February, 1993.

10.1 The CIT(A) has confirmed the addition of Rs. 50 lakhs in the year under consideration on the ground that there was no valid basis for postponing the income of Rs. 50 lakhs accrued and actually received in the year under consideration. The learned counsel, however, submitted that expenses incurred against the said sum of Rs. 50 lakhs are included in the expenses shown in the trading account for the year ended on 31st March, 1993. Proportionate expenses incurred towards the supply of designs and drawings have not at all been allowed by the CIT(A). There is a considerable force in the submission made on behalf of

the assessee in this respect.

11. The aforesaid facts and discussions clearly reveal that the matter has not been properly examined by the CIT(A) as well as by the AO. The CIT(A) has given a finding that income has to be determined on the basis of completed contract method without examining as to what type of method of accounting was really followed by the assessee. The CIT(A) nor the AO have examined the method of accounting followed by the assessee in a proper manner. It was necessary on the part of the CIT(A) to first deeply examine the method of accounting followed by the assessee and then decide whether such a method followed by the assessee is one of the recognised methods of accounting and whether income can be properly deduced therefrom.

12. After giving a deep and thoughtful consideration to the entire and relevant facts and the circumstances of the present case, we are of the view that it would be necessary to set aside the order of the CIT(A) as well as that of the AO and restore the matter back to the AO for passing a fresh order after conducting necessary enquiries and investigations and after thoroughly examining the books of accounts maintained by the assessee in relation to its income from various projects. The AO will inter alia examine the following aspects.

12.1 First of all the AO should carefully examine as to which method of accounting has been followed by the assessee in relation to its income from carrying out of the various projects. The very fact that the assessee has shown income from the various turnkey projects carried out for its various clients in two or more years indicates that the method of accounting followed by the assessee cannot perhaps be termed as completed contract method. The correctness of the method of accounting followed by the assessee of booking of the sales and income thereon in respect of value of supply of certain bought out items in the year in which the items are supplied, is also required to be thoroughly investigated by the AO. For this purpose, the AO will have to take into consideration the terms of contract executed with the various customers. It will have to be found out whether the title over the various bought out items used in the execution of turnkey projects passed in the favour of the clients at the time when the material were supplied or at the

time when the entire work of erection and installation of the plant was completed. The figures of sales booked in the prior years prior to the completion of the contract on account of value of supply of certain bought out items will also have to be verified with reference to the invoices issued by the assessee at the time of supply of such material. The AO will have to examine whether any scientific basis has been adopted by the assessee for booking the sales in the interim year of the currency of contract work or it has been booked in an arbitrary manner to suit the convenience of the assessee. In case, where no written contracts have been executed, it may be necessary to examine the terms of contract by recording the statement of the senior executive of the buyer companies or by examining the entries in the books of accounts of the buyer concerns.

The AO should deeply examine the method of accounting followed by the assessee. He should then examine the various types of recognised method of accounting in relation to such turnkey projects. For this purpose, he may refer to various accounting standards issued by the Institute of Chartered Accountants in this regard or he may refer the well-known books of the Principles of Accountancy.

12.2 If the AO arrives at the conclusion that the method of accounting adopted by the assessee is not a recognised method of accounting, he should give a specific finding as to whether the proviso to s. 145(1) or s. 145(2) is applicable on the facts of the present case.

12.3 Thereafter the AO should adopt a fair and proper method for estimation of income of the assessee in relation to each project carried out by the assessee in the year under consideration.

12.4 The AO may also make a useful reference to the various decisions in relation to the determination of income in the turnkey projects. He may inter alia refer the following judgments : 13. The AO will be entitled to conduct further probe and deep investigation, as may be considered proper by him for determination of true and correct income from the various contracts carried out by the assessee.

13.1 The assessee will also be entitled to produce all such material as may be considered proper by him to support the correctness of the method of accounting

and he may also submit his submissions as to how the income from turnkey projects should be properly determined on the facts and circumstances of the present case.

13.2 The AO will pass fresh order in accordance with the provisions of law and after providing reasonable opportunity to the assessee.

14. In the result, both the appeals are treated as allowed for statistical purposes.

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