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Court : Gujarat

Decided On : Jul-06-2000

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Appeal No. : IT Ref. No. 300 of 1984 6 July 2000 A.Y. 1977-78

Appellant : Anup Engineering Ltd.

Respondent : Commissioner of Income Tax

Advocate for Pet/Ap. : J.P. Shah, *for the Assessee* Akil Qureshi for M.R. Bhatt, *for the Revenue*

Judgement :

A.R. Dave, J.

The Appellate Tribunal, Ahmedabad Bench 'A', has referred to this court, under the provisions of section 256(1) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') the following question of law arising out of its order No. ITA No. 731/Ahd/1982 for consideration of this court :

'Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in disallowing the claim of Rs. 3,00,000?'

2. The facts and circumstances in which the reference has arisen, in a nutshell, are as under :

2.1. The applicant, assessee-company, is in business of manufacturing vessels used by chemical industries. It entered into a contract with Godrej Soaps (P) Ltd. (hereinafter referred to as 'Godrej'), for supply and erection of a spray drying plant for synthetic detergent plant for a consideration of Rs. 40 lakhs. During the relevant assessment year 1977-78, the plant was erected and the assessee was paid a sum of Rs. 34.49 lakhs against bills issued by the assessee- company to Godrej.

2.2. The assessee-company had shown in its books of account that a sum of Rs. 40 lakhs was to be received from Godrej, but during the calendar year 1976, which was previous year for the relevant assessment year, it had debited a sum of Rs. 3 lakhs from its sales account by crediting the same to warranty account as some dispute had arisen with regard to quality of the vessel supplied by the assessee to Godrej and the assessee apprehended that due to the clause of warranty incorporated in the contract, the assessee might not receive the said amount.

2.3. In the course of the assessment, the assessing officer disallowed the debited sum of Rs. 3 lakhs on the ground that the claim was still in dispute and till the claim was settled, the same could not have been allowed as a deduction. Thus, the claim made by the assessee with regard to Rs. 3 lakhs was not allowed.

2.4. Being aggrieved by the said decision of the assessing officer, the assessee had filed an appeal before the Commissioner (Appeals). It was contended by the assessee that the assessee had undertaken the liability to supply spare parts along with the plant, which had not been supplied and as there was a dispute with regard to quality of the vessel supplied to Godrej, the above referred amount was debited from the sales account by crediting the same to warranty account. The appeal was allowed by the Commissioner (Appeals) and the claim of the assessee was accepted.

2.5 Being aggrieved by the order passed in appeal, the revenue had filed an appeal before the Tribunal. The Tribunal allowed the appeal and restored the assessment made by the assessing officer so far as the said amount of Rs. 3 lakhs was concerned.

3. This court has now to examine whether, on the facts and in the circumstances of the case, the Tribunal was right in law in disallowing the claim of Rs. 3 lakhs, which was made by the assessee.

4. Before answering the question, let us see what is included in 'income' of an assessee. In order to examine the scope of 'total income', one has to look at the provisions of section 5 of the Act. Relevant portion of the said section reads as under:

'5. (1) Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which :

(a) is received or is deemed to be received in India in such year by or on behalf of such persons; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year; or

(c) accrues or arises to him outside India during such year'

5. Thus, income is taxable when it accrues, arises or is received or when, by fiction of law, it is deemed to accrue, arise or is deemed to be received. Upon perusal of section 5(1)(b), it is clear that all income from whatever source derived, which accrues, arises or is deemed to accrue or arise to the assessee becomes income for the relevant previous year and it becomes subject to charge of income-tax under the provisions of section 4 of the Act. It is not necessary that a person should have actually received the income. The words 'accrue' and 'arise' have not been defined in the Act but, the Hon'ble Supreme Court, in CIT v. Ashokbhai Chimanbhai : [1965]56ITR42(SC) has observed that the words 'accrue' and 'arise' are used to contra- distinguish the word 'receive'. Income is said to have been received, when it reaches the assessee. When the right to receive the income becomes vested in the assessee, income is said to have been accrued or arisen. Thus, income becomes taxable on the footing of accrual only when right to receive the income becomes vested in the assessee.

6. A similar principle was propounded by the Hon'ble Supreme Court in *E.D. Sassoon & Co. Ltd. & Ors. v. CIT* : [1954]26ITR27(SC) . It has been held in the said case that if the assessee acquires a right to receive the income, the income is said to have accrued to him, though, it may be received later on. The basic conception is that he must have acquired a right to receive the income. In other words, there must be a debt owed to him by somebody. Unless and until, a debt is created in favour of the assessee by somebody, it cannot be said that the assessee has acquired a right to receive the income or the income has accrued to him.

7. Looking to the legal position referred to hereinabove, one has to see whether a right had been created in favour of the assessee to receive a sum of Rs. 3 lakhs, which was claimed by way of deduction by the assessee in the relevant previous year. It is not in dispute that the assessee had shown in his books of account that he had to receive a sum of Rs. 40 lakhs from Godrej in pursuance of the contract with regard to supply of spray drying plant for synthetic detergent plant. Relevant entries reflecting the above transaction, were made by the assessee in its books of account. Subsequently, on account of certain dispute, which had arisen during the same previous year between the assessee and Godrej due to unsatisfactory quality of the plant, the assessee was of the view that the assessee would not receive the entire amount of Rs. 40 lakhs and as per the terms and conditions on which the plant was to be supplied to Godrej, the assessee might receive something less on account of the warranty which had been given to Godrej, especially in view of the fact that even Godrej had a right to retain certain amount with it and the amount to be retained was to be paid only when the plant was handed over to it in a perfect condition and when Godrej was satisfied with regard to performance of the plant in all respects.

8. It appears that, on account of the book entries made by the assessee, the revenue has finally decided to assess, the assessee for the entire amount which was shown as receivable by the assessee at an initial point of time. As stated hereinabove, and as observed by the Hon'ble Supreme Court in different cases, income accrues only when the assessee gets a right to receive the same and if the right to receive is not established, no income would accrue or arise to the

assessee.

9. To ascertain whether Rs. 40 lakhs was income of the assessee, one has also to look at the contract in pursuance of which the amount was to be received by the assessee from Godrej. One has to look at the nature of the transaction and the terms and conditions on which the plant was supplied by the assessee to Godrej. Only when the right of the assessee to receive Rs. 40 lakhs is established, the income would accrue or arise and not otherwise. It is pertinent to note that the accounting entries are not made in abstract. Entries reflect the transactions which have taken place. So, one has to look at the nature of the transaction and the terms and conditions of the contract under which the revenue believed that the entire income had accrued to the assessee during the previous year in question.

10. In the circumstances, it would be worthwhile to look at the terms and conditions on which the plant was to be supplied by the assessee to Godrej. Relevant terms forming part of the contract, which was executed between the assessee and Godrej in Feb., 1975, and which is forming part of the paper book, is reproduced hereinbelow .

'1. Prices :

(A) Plant and Machinery;

Charges for the supply of Plant and Machinery as per Annexure 1 enclosed herewith

Rs. 38,00,000

The above-mentioned price includes cost of packing, forwarding, freight, including insurance and is for free delivery at our factory at Vikhroli.

(b) Erection and start-up :

Charges for the erection and starting-up of the plant and machinery to be supplied by you as above

Rs. 2,00,000'

'8. Workmanship guarantee:

Since, the entire plant will be supplied, erected and commissioned by you, the workmanship guarantee period will be 12 months from the date of commissioning, or 24 months after the supply of plant item of equipment, whichever is later.

It shall be your entire responsibility to replace, repair such defective equipment or part(s) thereof to our complete satisfaction, free of cost to us.

'14. Payment Terms :

For supply of plant and machinery.

10 per cent along with order.

90 per cent against progressive deliveries, under IDBI Scheme.

Without prejudice to the above, in order to help you with working capital, in the initial stages, we have agreed, as a special case, and further with a view to help indigenous industry, to advance you an additional 15 per cent of the value of the contract. This 15 per cent will be adjusted pro rata against invoice as for deliveries made during the first twelve months. The balance outstanding at the end of twelve months, is to be returned to us promptly and without any reservation whatsoever.

Accordingly, we forward herewith our cheque for Rs. 9,50,000 (Rs. nine lakhs and fifty thousand only) being the 25 per cent payment.

Retention :

An amount equal to 10 per cent of your invoices will be recovered from each invoice as retention money. This 10 per cent of contract price will be paid to you after the plant is handed over to us in a perfect condition and satisfying us regarding its performance in all respects.

For erection and start-up :

90 per cent against progressive monthly bills payable within 15 days of submission of bills, and rest 10 per cent retention to be released 30 days after the plant is

handed over to our entire satisfaction. '

The assessee had supplied the plant to Godrej and was to receive the consideration in pursuance of the terms referred to hereinabove. It is an admitted position that Godrej was not satisfied with the quality of the plant supplied by the assessee. During the relevant previous year itself, there was correspondence between the assessee and Godrej. Even, the assessee was of the view that the plant supplied was not satisfactory. Looking to clause 14, the terms on which the payment was to be made, which has been reproduced hereinabove, it is very clear that Godrej had a right to retain 10 per cent of the total consideration and the said amount was to be released 30 days after the plant is handed over to Godrej and if the plant was to the entire satisfaction of Godrej.

11. In view of the said clause 14 and in view of the fact that the plant, which was supplied by the assessee to Godrej, was not to the satisfaction of Godrej and as certain spare parts were also not supplied to Godrej by the assessee, Godrej had a right to retain a sum of Rs. 4 lakhs, being 10 per cent of Rs. 40 lakhs, as per clause 14. If Godrej had a right to retain the said amount, the assessee had no right to receive the said amount, till the plant was handed over to Godrej in perfect condition and up to the satisfaction of Godrej.

12. As stated hereinabove, it is not in dispute that the plant was not up to the mark and was not to the satisfaction of Godrej and, therefore, the assessee had no immediate right to receive Rs. 4 lakhs, which could have been retained, and which was in fact retained, by Godrej. During the relevant previous year, only a sum of Rs. 34.49 lakhs was paid to the assessee by Godrej and the remaining amount was not paid. Of course, the amount which could have been retained was only Rs. 4 lakhs, but the other amount was not paid as some spare parts were not supplied by the assessee to Godrej. Be that as it may, we are not concerned with the remaining amount, but we are concerned only with a sum of Rs. 3 lakhs in respect of which deduction was claimed by the assessee from the entire amount of consideration which was to be received by the assessee from Godrej and which was reflected in the books of account as receivable from Godrej at an initial point of time.

13. Looking to the terms of payment referred to in clause 14 hereinabove, it is clear that the assessee did not get any right to receive Rs. 4 lakhs, the amount which could have been retained and which was in fact retained by Godrej. Merely because the assessee made an entry at an initial point of time recording in its books of account that it had to receive Rs. 40 lakhs from Godrej, the said amount cannot be treated as income of the assessee. If income does not result at all, there cannot be any tax, even though in book-keeping an entry is made about a hypothetical income which does not materialise. It has been observed by the Hon'ble Supreme Court in CIT v. Shoorji Vallabhdas & Co. : [1962]46ITR144(SC) that where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. But, when the income cannot be said to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account.

14. For the purpose of ascertaining whether income had, in fact, accrued, one has also to see whether there is a real income. It has been also observed by the Hon'ble Supreme Court in CIT v. Bokaro Steel Ltd. : [1999]236ITR315(SC) , that no matter by adopting what method the assessee maintains his accounts, it may be either the cash system where entries are made on the basis of actual receipts and actual outgoings or disbursements, or it may be the mercantile system where entries are made on accrual basis, that is to say, accrual of the right to receive payment and the accrual of the liability to disburse or pay. However, in both cases, unless there is real income, there cannot be any income-tax. In the instant case also, there is no real income so far as Rs. 3 lakhs are concerned because no debt has been created in favour of the assessee by virtue of clause 14 of the contract and as the assessee did not get any right to receive the said amount during the previous year in question, it cannot be said that income in respect of the amount in question had been accrued to the assessee during the previous year in question.

15. Looking to the facts of the present case and in the light of the law laid down by the Hon'ble Supreme Court in the cases referred to hereinabove, it is very clear that unless and until, a debt is created in favour of the assessee, which is due by

somebody, it cannot be said that the assessee has acquired a right to receive the income or that the income has accrued to him. A debt must have come into existence and the assessee must have acquired a right to receive the payment. In the instant case, the assessee did not get any right to receive a sum of Rs. 4 lakhs which could have been retained by Godrej in pursuance of clause 14 of the contract. One has to look at the contract and not at the entries made in the books of account. If, upon construction of the contract, one comes to a conclusion that the assessee could not have received Rs. 4 lakhs from Godrej, by no stretch of imagination it can be said that the said amount had accrued by way of income to the assessee in the previous year in question. As the plant was not up to the satisfaction of Godrej, Godrej had a right to retain Rs. 4 lakhs. It is not in dispute that during the previous year in question the dispute as to quality of the plant had arisen and the assessee had also felt that quality of the plant was not up to the mark and, therefore, believing that Godrej might ultimately retain Rs. 3 lakhs or under the warranty clause the assessee might have to pay Rs. 3 lakhs, the assessee made a provision for Rs. 3 lakhs by deducting the said amount from the sales account. In fact, in the previous year in question, the assessee had no vested right to receive Rs. 4 lakhs and, therefore, it cannot be said that income to that extent had accrued to the assessee. We can test the above conclusion in a different manner too. Whether Godrej was liable to pay Rs. 4 lakhs to the assessee in spite of the fact that quality of the plant was admittedly not up to the mark? Did the assessee get a vested right to get the said amount Answer to these questions would be in negative and, therefore, as observed hereinabove, it cannot be said that income had accrued to the assessee.

16. A similar question had arisen in case of CIT v. Simplex Concrete Piles (India) (P) Ltd. : [1989]179ITR8(Cal) . Having regard to the facts and circumstances of the case, it was held in that case that, when there is a clause with regard to retention money, the assessee gets no right to claim any part of the retention money till the verification of satisfactory execution of the contract is concluded and, therefore, if there is no immediate right to receive the retention money, the said amount cannot be said to have accrued to the assessee. Even in the instant case, so far as retention money is concerned, the assessee had not to receive the same and, therefore, it cannot be said that the amount of Rs. 3 lakhs had accrued to the

assessee.

17. Learned advocate Shri Akil Qureshi appearing for the revenue has submitted that the question with regard to interpretation of the terms of payment had not been referred to this court and, therefore, that being a new point, it could not have been considered by this court. In support of his submission, he has relied upon the judgment delivered in case of CIT v. Sirpur Paper Mills Ltd. AIR 1978 SC 509. We do not agree with the said submission for the reason that, for the purpose of ascertaining whether income had accrued to the assessee, one has to find out whether the assessee had a vested right to receive the income and for the purpose of knowing whether a right to receive income had arisen, one has to look at the terms and conditions of the contract in pursuance of which the assessee was to receive the amount. As stated hereinabove, one has to look at the contract and not at the book entries because book entries only reflect the transactions which had taken place and by virtue of entries a person neither earns nor spends. For the purpose of knowing whether an income has accrued, one has to know whether the assessee had a vested right to receive the amount from Godrej. In our opinion, by looking at the terms of the contract, we are not considering something which is not subject-matter of the reference.

18. Looking to the law discussed hereinabove and the facts and circumstances of the case, it is crystal clear that Rs. 3 lakhs, which was deducted from the sales account by the assessee was rightly claimed by the assessee by way of deduction as the said amount had never become income of the assessee. As the income had not accrued in respect of the said amount, it was not proper on the part of the revenue to treat the same as income accrued to the assessee. Even for the sake of argument, it is assumed that the income had accrued to the assessee, the assessee's liability with regard to repairs of the plant as per the terms of the contract had also arisen in the same previous year. If the liability had also arisen in the same previous year in which the income had accrued, the said amount of liability ought to have been deducted from the amount of income accrued. The said view taken by the Commissioner (Appeals) while allowing the deduction claimed by the assessee, would be correct in that event. Therefore, in any view of the matter, the assessee would be entitled to claim Rs. 3 lakhs by way of

deduction and, therefore, the revenue ought not to have disallowed the said claim.

19. In view of what has been stated hereinabove, we answer the question in negative, that is, in favour of the assessee and against the revenue. The reference stands disposed of accordingly with no order as to costs.

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