

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 13.08.2018

CORAM

THE HONOURABLE MR.JUSTICE T.S.SIVAGNANAM
and
THE HONOURABLE MRS.JUSTICE V.BHAVANI SUBBAROYAN

Tax Case (Appeal) Nos.170 & 171 of 2004
and
501 & 502 and 1450 & 1451 of 2007

T.C. (A) No.170 of 2004:-

M/s.FFE Minerals India Private Limited,
27, G.N.Chetty Road,
T.Nagar, Chennai-600 017.

..Appellant/Respondent
in Tc.501/07 & 502/07
and 1450 and 1451/07

-vs-

The Joint Commissioner of Income-tax,
Special Range VI, Chennai.

..Respondent/Appellante
in TC.501/07 and 502/07
and 1450 and 145/07

Tax Case (Appeal) filed under Section 260-A of the Income Tax Act, 1961 against the order of the Income-tax Appellate Tribunal, "A" Bench, Chennai dated 12.12.2002 in I.T.A.No.2022/Mds/2000 for the assessment year 1997-98.

Tax case No.171 of 2004 in

'A' Bench dated 12.12.2002 ITA.No.973 of 2002 Assessment year 1998-99.

Tax Case No.501/07 in

'C' Bench dated 21.7.2004 in MP.No.283/mds/2003 in ITA Nos.2002/mds/2000 dated 12.12.2002 Assessment year(s) 1997-1998.

Tax Case No.502 of 2007 in

'C' Bench dated 21.07.2004 in MP.No.283/mds/2003 in ITA.Nos.973/mds/2000 dated 12.12.2002 Assessment year (s) 1998-1999.

Tax Case No.1450 of 2007 in

'A' Bench, dated 29th March 2007 in ITA.NO.966/mds/2003
Assessment year 1999-2000.

Tax Case No.1451 of 2007:

'A' Bench dated 29th March 2007 in ITA No.734/Mds/2003
Assessment year 2000-2001.

For Appellant : Mr.G.Baskar
(in all Appeals)

For Respondent : Mr.Karthik Ranganathan,
(in all Appeals) Standing Counsel

COMMON JUDGMENT

[Delivered by T.S.Sivagnanam, J.]

In these batch of cases, the issue arises out of the common order of the Tribunal in the assessee's own case for the assessment years 1997-98 and 1998-99.

2.After hearing the learned counsels appearing for the parties, we found that T.C.(A) Nos.170 and 171 of 2004 are the substantive appeals. This is so because, the assessee has filed these appeals challenging the common order passed by the Tribunal, confirming the order passed by the Commissioner of Income Tax (Appeals) on the ground that the liquidated damages, as claimed by the assessee for the impugned two assessment years remained only as provisional damages or unliquidated damages on the close of the respective previous years and therefore, the assessee is not entitled to assert for the deduction of these amounts as if they are liquidated damages. The other four appeals arose out of the following situation.

3.The assessee filed miscellaneous petition before the Tribunal to revise the order dated 12.12.2002, which is impugned in T.C.(A) Nos.170 and 171 of 2007. The said petition was dismissed by order dated 24.09.2003. The assessee filed second miscellaneous petition to revise and to sustain their claim for deduction. This miscellaneous petition was allowed by order dated 21.07.2004, accepting the claim made by the assessee for deduction of those amounts as liquidated damages. Therefore, the assessee withdrew T.C.(A) Nos.170 and 171 of 2004.

4.The Revenue challenged the common order passed by the Tribunal on the second miscellaneous petition vide order dated 21.07.2004 in T.C.(A) Nos.501 and 502 of 2007. For the assessment years 1999-2000 and 2000-01, the Tribunal followed the order in the second miscellaneous petition dated 21.07.2004. Therefore, the Revenue has filed T.C.(A) Nos.1450 and 1451 of 2007. By our order dated 25.07.2018, we have restored T.C.(A) Nos.170 and 171 of 2004. Those appeals were dismissed as infructuous in the light of the order passed by the Tribunal dated 21.07.2004.

5.We opined that since the said order dated 21.07.2004 was put to challenge by the Revenue in T.C.(A) Nos.501 and 502 of 2007, the appeals have not become infructuous and therefore, the restoration petitions have been allowed and that being the substantive appeals, we have heard the arguments of the learned counsels for the parties.

6.The above referred appeals had been admitted on the following substantial questions of law:-

"T.C(A) Nos.170 and 171 of 2004 :

Whether on the facts and circumstance of the case and in view of the admitted delay in execution the Tribunal was right in coming to the conclusion that the claim of Liquidated damages in respect of delay in delivery has not arisen during the current year under appeal?"

T.C.(A) Nos.501 and 502 of 2007 :

(a) Whether on the facts and in the circumstances of the case, the Tribunal is empowered to entertain a second application for rectification of its order having rejected an identical application earlier?

(b) Whether the facts and circumstances of the case warranted a rectification of its earlier order by the Tribunal?

(c) Whether the Tribunal as in the guise of rectifying its order dated 12.12.2002 has in effect reviewed the said order which it is not empowered to do?

T.C.(A) Nos.1450 and 1451 of 2007 :

(a) Whether on the facts and in the circumstances of the case, the Tribunal was right in dismissing the Revenue's appeal against the order of the CIT(A) granting relief in a miscellaneous application when the issue was still debatable?

(b) Whether on the facts and in the circumstances of the case the Tribunal was right in holding that the assessee is entitled to deduction of the provisions made for damages for delayed supply, even prior to finalizing the same?"

7.Mr.G.Baskar and Mr.M.P.Senthil Kumar, learned counsels for the assessee submitted that the Tribunal was well justified in passing the order dated 21.07.2004 thereby substituting paragraph 11 of its earlier order dated 12.12.2002.

8.By referring to the terms and conditions of the agreement, it is submitted that the liability is an ascertained liability, as the conditions clearly stipulate the percentage of liquidated damages which the assessee has to incur in case of breach of the covenants of the contract. It is submitted that the assessee is engaged in the business of turnker projects, in which, time is the essence of contract, and one of the conditions enumerated in the contract was delivery of equipment in time, which if not done within the stipulated time, leads to liquidated damages. It is further submitted that the said provision is an ascertained liability and not contingent liability.

9.It is further submitted that as when there is a delay in delivery of the machinery, liability to pay damages accrues and it is an ascertained liability and in case of purchase, where there has been delay in delivery, the purchasers have withheld the amount of liquidated damages and the assessee has also not denied the liability.

10.The learned counsels have drawn the attention of this Court to the order passed by the CIT(A) dated 09.10.2000, in which the quantum of liquidated damages payable on account of failure to meet the performance of guarantees have been stipulated. It is submitted that individual liquidated damages on account of failure to meet the performance guarantees shall be maximum of 2.5% of the contract value and shall be applicable for dewatering capacity of the Lime Sludge Filter, production capacity of the Kiln, quality of Burnt Lime, LSHS Oil Consumption per tonne of lime etc.

11.Further it is submitted that the total of the above liquidated damages on account of failure to meet such performance guarantees shall be limited to a maximum of 7.5% of the total contract price and the liquidated damages for delay in delivery of equipment and spares is 0.5% per week subject to the maximum of 5% on contract price. Further, the total liquidated damages on account of failure to meet performance guarantees and

late delivery shall be limited to 10% of total contract price. Thus, it is submitted that the liability to pay liquidated damages arises immediately on occurrence of the delay. Hence, the liability accrued is an accrued liability and the assessee has accepted the delay in each of the contract as on 31.03.1997 and 31.07.1998 and have computed liquidated damages as per the respective contracts. The above contention though not initially accepted by the Tribunal, on the second miscellaneous petition having been filed, the Tribunal accepted the case of the assessee and held as follows:-

".....The claims in the books are based on the terms of the contract between the parties. Since the liability has arisen and is crystallized as a result of binding contract between the parties the same is allowable as held by the Hon'ble Supreme Court reported in 37 ITR 1 and 245 ITR 248 as well as the decision of the Special Bench reported in 35 ITD 18 and 43 ITD 527 and as conceded by the department before the jurisdictional High Court in 130 Taxman 400 (supra). We further hold that allowability of the claim need not be postponed till the plea for waiver is considered or rejected by the customer. We also hold that in view of the decisions of the Hon'ble Supreme Court reported in 37 ITR 1, 245 ITR 24, 261 ITR 275 and 240 ITR 355 extracted above, the decisions of the Kerala High Court reported in 226 ITR 142 and 182 ITR 175 are not relevant in deciding the issue....."

12. Thus, it is submitted that the Tribunal was well justified in passing the order dated 21.07.2004, in the second miscellaneous petition, which lies upon the correct legal position and hence, the order dated 12.12.2002 impugned in TCA Nos.170 and 171 of 2004 calls for interference.

13. The learned counsels for the assessee referred to the decision of the Hon'ble Supreme Court in Calcutta Co. Limited vs. CIT reported in (1959) 37 ITR 1. By referring to the said decision, it is submitted that liability already accrued on the date when the contract was entered into and though that liability was to be discharged on a future date, it is an accrued liability and the estimated expenditure, which would be incurred in discharging the same could very well be deducted from the profits and gains of the business.

14. Reliance was placed on the decision of the Hon'ble Supreme Court Rotork Controls India (P) Ltd. vs. Commissioner of Income Tax reported in (2009) 314 ITR 0062 wherein the provision for warranty claims on the basis of past experience was held to be an allowable as deduction under Section 37 of the Income Tax Act, 1961 (hereinafter referred to as "the Act").

15. Reliance was also placed on the decision of the Hon'ble Supreme Court in the case of Bharat Earth Movers vs. Commissioner of Income Tax reported in (2000) 245 ITR 0428. By referring to the said decision, it is submitted that the provision for meeting the liability for encashment of earned leave by the employees was held to be admissible deduction.

16. T(A) as well as the Tribunal in its order dated 12.12.2002 negatived the case of the assessee by placing reliance on the decision of the High Court of Kerala in N. Sundareswaran vs. CIT reported in (1997) 226 ITR 142.

17. The learned Standing Counsel distinguishing the said decision submitted that in the said case, the assessee had made provision on the ground that the foreign buyer had initiated arbitration proceedings and immediately without awaiting for the outcome of the arbitration proceedings, a provision in the accounts was made for the claim of damages. Therefore, it is submitted that in the said case, the Court held that the amount was unascertained and contingent. It is submitted that the said decision can have no application to the facts of the present case, as the liability has been fixed under the agreement and the assessee has accepted the delay and the payments have been effected to the assessee after deducting the amount towards damages as fixed under the contract. With the above submissions, the learned counsels prayed for allowing TC(A) Nos. 170 and 170 of 2004 filed by the assessee and dismissing TC(A) Nos. 501 and 502 and 1450 and 1451 of 2007 filed by the Revenue.

18. Mr. Karthik Ranganathan, learned Standing Counsel appearing for the Revenue sought to sustain the order passed by the Tribunal by contending that to be entitled for deduction on the provision made, the assessee has to satisfy the three tests laid down by the Hon'ble Supreme Court in Rotork Controls India (P) Ltd. vs. Commissioner of Income Tax reported in (2009) 314 ITR 0062.

19. By referring to the decision in the case of Commissioner of Income-tax vs. Forbes Campbell Finance Ltd. reported in (2013) 352 ITR 602, it is submitted that the Hon'ble Court has held that unless the three conditions recognising the liability are satisfied, the claim could not be automatically allowed as a provision made on a historical trend.

20. Reliance was also placed on the decision of the Hon'ble Division Bench of this Court in the case of Renowned Auto Projects Mfrs. Ltd. vs. Income-tax Officer [(2013) 40 taxmann.com 13 (Madras)], wherein the Court took into consideration the decisions in Rotork Controls India (P) Ltd.

(supra) as well as in the case of Forbes Campbell Finance Ltd. (supra) and held that the assessee, having not proved the provision of warranty expenditure based on any scientific method, cannot place reliance on the decision of the Hon'ble Supreme Court in Rotork Controls India (P) Ltd. (supra).

21. The learned counsel also referred to the decision of the High Court of Calcutta in Commissioner of Income-tax vs. Burlop Commercial (P.) Ltd. [(1993) 200 ITR 605].

22. After we have elaborately heard the learned counsels for the parties, we are required to consider the aspect as to whether the assessee is entitled for deduction under Section 37 (1) of the Act in respect of provision made towards damages that the assessee is liable to pay to the organisation for whom they have already done turnkey projects, which has been provided by them in their books of accounts. We may note that Section 37 of the Act uses the word "any expenditure". Therefore, an expenditure, which is referred to therein, viz., Section 37(1), would be entitled for being claimed as a deduction. Thus, the test to be satisfied by the assessee to claim a provision to be an expenditure in terms of Section 37(1) of the Act, the onus is heavily on the assessee and the assessee has to necessarily discharge the obligations, which have been laid down by the Hon'ble Supreme Court in Rotork Controls India (P) Ltd. (supra), which has been popularly known as "triple test". The Hon'ble Supreme Court in the said decision, explained as to what is a provision? in the following terms:-

"10. What is a provision? This is the question which needs to be answered. A provision is a liability which can be measured only by using a substantial degree of estimation. A provision is recognized when: (a) an enterprise has a present obligation as a result of a past event; (b) it is probable that an outflow of resources will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision can be recognized.

12. A past event that leads to a present obligation is called as an obligating event. The obligating event is an event that creates an obligation which results in an outflow of resources. It is only those obligations arising from past events existing independently of the future conduct of the business of the enterprise that is recognized as provision. For a liability to qualify for recognition there must be not only present obligation but also the probability of an outflow of resources to settle that obligation."

23. Thus, the three tests being that (a) an enterprise has an obligation as a result of a past event; (b) it is probable that an outflow of resources will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation. The Revenue cannot dispute the fact that the assessee in the instant case satisfied test Nos. (a) and (c).

24. To be entitled to a deduction as claimed by the assessee, the assessee has to cumulatively satisfy all the three tests. Therefore, it has to be seen as to whether it is probable that an outflow of resources will be required to settle the obligation.

25. Mr. G. Baskar, learned counsel for the assessee submitted that in the instant case, it is not a probability at all but definite mathematical position, as the contract itself stipulates the percentage of liquidated damages, which is payable based on the length of delay. In this regard, documents were referred to, to show that there is an admitted delay on the part of the assessee and therefore, the third party for whom, turn key projects have been implemented, are bound to deduct the same and therefore, there is a certainty in the outflow. In this regard, various contracts entered into with the contracting parties were referred to.

26. The Hon'ble Supreme Court while laying down the three tests, has used the expression "probable" in the second test. The 'Black's Law Dictionary' defines "probable consequences" to mean an effect or result that is more likely to follow its supposed cause than not to follow it. "Possibility" has been defined as an event that may or may not happen. Thus, degree of proof required to show that there is a probability of outflow of resource is higher, as the effect is which is more likely to happen than not to happen as to where possibility is an event, which may or may not happen. Therefore, the assessee has to definitely show that there is every probability that an outflow of resources will be required to settle.

27. The documents placed before the Court will clearly show that there has been negotiations, discussions before the liquidated damages was arrived at, which was much after the subject assessment years. These documents are in fact strengthening the case of the Revenue and the findings rendered by the CIT(A) as well as the Tribunal, which had held that there is no ascertained liability.

28. As pointed out by the Hon'ble Supreme Court, a past event that leads to a present obligation is called an obligating event and the obligating event is an event that creates an

obligation, which results in an outflow of resources. Thus, only those obligations arisen for past event existing independently on the future contract of the enterprise is recognised provision. Admittedly, in the instant case, no such past events have been placed before the Assessing Officer to show that there is every probability that the expenditure will be incurred. At best, the assessee can pitch their case as a case of possibility but, not a case of probability. Thus, the assessee having failed to fulfil the triple test prescribed in Rotork Controls India (P) Ltd. (supra), is not entitled to the deduction as claimed by them.

29. The learned counsel for the assessee submitted that the assessee should be entitled to claim the same in the year when the damages had been recovered. Needless to state that it is for the assessee to disclose the same in the return of income to the relevant year, which will obviously be considered by the Assessing Officer in accordance with law. Accordingly, the second substantial question of law framed in these appeals is answered in favour of the Revenue and against the assessee.

30. In the light of the decisions referred above, we have taken the second question of law and decided the case in favour of the Revenue and against the assessee.

31. The first substantial question of law, which has been framed for consideration as to whether on the facts and in the circumstances of the case, the Tribunal was right in dismissing the Revenue's appeal against the order of the CIT(A) granting relief in a miscellaneous application when the issue was still debatable, has become academic. Therefore, we leave open that question for consideration.

32. Mr. D. Prabhu Mukunth Arunkumar, learned Standing Counsel submitted that the Hon'ble Full Bench of the High Court of Delhi in Lachman Dass Bhatia vs. Assistant Commissioner of Income-tax [ITA No. 724/2010 dated 06.08.2010] held that an order passed under Section 254(2) of the Act recalling an order in entirety would not be amenable to appeal under Section 260A of the Act. Further, it has been held that an order rejecting the application under Section 254(2) is not appealable and if an order is passed under Section 254(2) amending the order passed in appeal, the same can be assailed in further appeal on substantial question of law.

33. The learned counsel for the assessee submitted that there are decisions of this Court, where writ petitions were filed challenging such orders and were converted into tax cases and have been decided.

34. In our considered view, as observed earlier, the first substantial question of law, which has been framed for consideration, has become academic in the instant case and therefore, we refrain from expressing any opinion on the said question and leave it open.

35. Accordingly, the appeals filed by the Revenue are allowed and the appeals filed by the assessee are dismissed on question no.2. No costs.

Sd/-

Assistant Registrar (CS-V)

//True Copy//

Sub Assistant Registrar

abr

To

1. The Joint Commissioner of Income-tax,
Special Range VI, Chennai.
 2. The Income-tax Appellate Tribunal, "A" Bench, Chennai.
- + 1 cc to Mr. Karthik Rnganathan, Advocate Sr.56026
+ 2 ccs to M/s. N. Muthukumar, Advocate SR.55839
+ 2 ccs to M/s. N. Muthukumar, Advocate Sr.53838
+ 2 ccs to M/s. N. Muthukumar, Advocate Sr.55837

Tax Case (Appeal) Nos.170 & 171 of 2004
and 501 & 502 and 1450 & 1451 of 2007

सत्यमेव जयते

PP (CO)
EU (20/09/2018)

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