

R.M. AMBERKAR
(Private Secretary)

**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
O.O.C.J.**

WRIT PETITION NO. 294 OF 2019

CMI FPE Limited

.. Petitioner

Versus

The Union of India & Anr.

.. Respondents

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- Mr. Prakash Shah a/w Mr. Jas Sanghvi, Ms. Sherry Goyal and Ms. Divyasha Mathur i/by PDS Legal for the Petitioner
 - Mr. A.R. Malhotra for the Respondents
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**CORAM : AKIL KURESHI &
M.S. SANKLECHA, JJ.**

DATE : MARCH 8, 2019.

P.C.:

1. Heard learned counsel for the parties for final disposal of the petition.

2. The petitioner has challenged a notice of reassessment dated 23.3.2018 issued by respondent No. 2 - Assessing Officer for the assessment year 2011-12. Brief facts are as under:-

2.1 The petitioner is engaged in manufacturing and installation of cold rolling mills, galvanizing lines, colour coating lines etc for ferrous and non-ferrous industries. For

the assessment year 2011-12, the petitioner had filed return of income on 29.11.2011 declaring total income of Rs. 55.94 crores under the normal provisions of the Income Tax Act, 1961 ("the Act" for short) and at Rs. 71.08 crores under Section 115JB of the Act. Such return was taken in scrutiny by the Assessing Officer who passed the order of assessment under Section 143(3) of the Act on 26.2.2014 and assessed the assessee's total income at Rs. 63.55 crores under the normal provisions. To reopen such assessment, the Assessing Officer issued the impugned notice. In order to so, he had recorded following reasons:-

"1. The return of income has been filed electronically on 29.11.2011 declaring total income of Rs. 55,49,31,710/- under normal provision and Book Profit of Rs. 71,08,52,520/- under Section 115JB of the Act. Assessment under section 143(3) of the Act was completed on 26.02.2014 determining income at Rs. 63,55,78,600/- under normal provision of the Act and Rs. 62,35,14,920/- under section 115JB.

2. **Disallowance of prior period expenditure amounting to Rs. 11,34,234/-**

2.1 Assessee claimed an amount of Rs. 11,34,234/- being the prior period expense under the head miscellaneous expenses. This being the expenditure in the nature of prior period expense is not allowable in the year under consideration and the same is required to be disallowed. In the computation filed as well as in the concluded assessment, this amount has not been disallowed resulting in under

assessment of Rs. 11,34,234/-.

2.2 In view of above, it is concluded that the income of Rs. 11,34,234/ related to incorrect claim of 'prior period expenditure' has escaped the assessment

3. **Amount due to customers on construction not offered for taxation:-**

3.1 The assessee has shown in the balance sheet under the head 'current liabilities and provisions' as 'due to customers on construction contract' of Rs. 4188.90 Lakhs. This amount is nothing but the difference in bills raised by the assessee & sales booked by the assessee in its books of accounts. It is not understood how when the bill is already raised why this income will not accrue to the assessee. After all, the assessee can raise bill only when it is entitled to do so as as per the terms of the contract on reaching certain milestone.

3.2 The cost incurred by the assessee in respect of the above projects till reaching of milestone was actually debited by the assessee in the profit and loss account.

3.3 The assessee has explained in note (J) of Schedule J - notes on accounts that as per accounting standards, it has booked sales based on percentage completion method which is reflected by actual cost incurred by it and not based on bills raised which was based on various mile stones reached in the project.

3.4 It is to be noted that the Accounting Standard AS 7 is not recognized under section 145(2). Even otherwise the method followed by the assessee is not acceptable as considered below.

3.5 It is held by various courts that the mode of book entries cannot change the nature of receipt. If a receipt is a trading receipt

the fact it is not so shown in the account books of an assessee does not prevent the assessing authority from treating it as a trading receipt (Chowringee Sales Bureau P. Ltd. Vs CIT (1973) 87 ITR 542, 548-9(SC). In other words a trading receipt does not cease to be so by being written up in the books in a particular manner (Purjab Distilling Industries Ltd. Vs CIT 1959, 35 ITR 519, 523(SC). The entries in the account books cannot alter or affect the nature quality and character of a transaction (CIT Vs Provisional Farmers Pr. Ltd. 1977, 108 ITR 219(Cal). It is the true nature and quality of the receipt and into the head under which it is entered in the account books which would prove decisive if a receipt is a trading receipt the fact that it is not so shown in the account books of the assessee would not prevent the assessing authority from treating it as a trading receipt (CIT Vs Bazpur Cooperative Sugar Factory Ltd. 1988 172 ITR 321, 329(SC), Khattar Kiln Co. Vs CIT 1983 140 ITR 425, 428 Punj). The matter of taxability cannot be decided on the basis of the entries which the assessee may choose to make in his accounts but has to be decided in accordance with the provisions of law (CIT Vs Mogul Line Ltd. 1962, 46 ITR 590 600 (Bom).

3.6 If the true income from profits and gains cannot properly be ascertained on the basis of the assessee's method, the income must be computed upon such basis and in such manner as the AO may determine (CIT Vs. McMillan & Co. (1958) 33 ITR 182, 187(SC), CIT Vs. British Paints India Ltd (1991) 188 ITR 44 (SC).

3.7 Therefore, the income of the assessee's under assessment by sum of Rs. 4188.90 lakh which reflects the amount which has already become due to the assessee in terms of the contracts but is not accounted in the profit and loss account.

3.8 In the balance sheet under head current assets, the assessee has shown amount recoverable from customers at Rs. 11910.99 Lakh. This amount represents excess of aggregate sale proceeds

recognized over the progress billings as on the reporting date. This amount cannot be reduced since if work done exceeds aggregate bills raised, the same will represent the work in progress and should be accounted as such by crediting income account. Thus this possible plea is not acceptable.

3.9 In view of above, it is concluded that the income of 4188.90 Lakh "due to customers on construction contract" has escaped the assessment.

4. **Warrant Provision :**

4.1 In respect of the warranty provision debited at Rs. 408.11 lacs, the assessee has submitted an explanation on 26/12/2013 explaining the year end provision at Rs. 895.69 Lakh. These figures are not reconciled and no movement statement was obtained showing the net provision for the year and the utilization from earlier balance. Further, the AO has not examined the past history of actual expenses with reference to provision made to conclude that the provisioning is scientifically done,

5. As there is a failure on part of assessee to disclose fully and truly all material facts necessary for its assessment during the year under consideration and considering the facts that the assessee has claimed incorrect deduction as well as has not offered his entire income for tax, I have reasons to believe that income of more than Rs. 1 Lakh chargeable to tax has escaped assessment for this assessment year i.e. A.Y. 2011-12, coming within the meaning of Section 147 of the Income Tax Act, 1961.

6. In view of the same, notice u/s. 148 is issued after approval of CIT-LTU, Mumbai vide letter No. CIT(LTU)/CMIFPE/147/2017-18 dated 22.3.2018".

2.2 Upon being supplied the reasons, the petitioner raised objections to the notice of reopening of assessment under communication dated 31.7.2018. Such objections were rejected by the Assessing Officer by order dated 18.9.2018 upon which this petition is filed.

3. Appearing for the petitioner, learned counsel Mr. Shah raised following contentions:-

- (i). The impugned notice has been issued beyond the period of four years from the end of relevant assessment year. There was no failure on the part of the assessee to disclose truly and fully all material facts;
- (ii) Out of three grounds on which the Assessing Officer relied for issuing the impugned notice, two were subjects in the scrutiny during the original scrutiny assessment and on the third ground, the Assessing Officer in case of this very assessee for the preceding assessment year 2010-11, having reopened the assessment, had passed the order of re-assessment on 29.5.2017 in which no additions under this head was made. Thus,

clearly, the Assessing Officer agreed in law that no addition was sustainable.

4. On the other hand, learned counsel Mr. Malhotra appearing for the department opposed the petition contending that the Assessing Officer has recorded proper reasons for issuing notice. The ground on which the notice of reopening is issued cannot be said to have been examined during the original scrutiny assessment. The petitioner had failed to disclose truly and fully all material facts.

5. Having thus heard the learned counsel for the parties and having perused the documents on record, we may recall that the impugned notice has been issued beyond the period of four years from the end of relevant assessment year. The question of failure on the part of the assessee to disclose truly and fully all material facts, therefore, becomes relevant. We may, therefore, bear this aspect in mind while examining the material on record. Further as per settled law, if a certain claim had already been examined by the Assessing Officer in the original assessment proceedings, in absence of any new or additional material not forming part of the record,

any attempt on his part to reopen the assessment on such ground would be based on change of opinion.

6. With this background, we may revert to the documents on record. The analysis of reasons recorded by the Assessing Officer would show that he had pressed in service three grounds of escapement of income chargeable to tax which are as under:-

- i. A sum of Rs. 11.34 lacs (rounded off) being prior period expenses had to be disallowed;
- ii. An amount of Rs. 41.88 crores (rounded off) which is a difference between the total of bills raised by the assessee to the clients and the sale booked in the account. According to the Assessing Officer, when the bills are already raised, the amount has accrued to the assessee and therefore, had to offer to tax which the assessee had not done;
- iii. An amount of Rs. 4.08 crore which was claimed by way of warranty provision was not allowable looking to the past history of actual expenses in relation to such warranty.

7. In the context of prior period expenses, the Assessing Officer had during the original assessment under a letter dated 11.11.2013 called upon the assessee to provide the

following details:-

"4. Details of miscellaneous expenses."

8. In response to such query, the assessee under a letter dated 26.12.2013 had provided said details of miscellaneous expenses at Annexure 1 which included details of prior period expenses.

9. Likewise with respect to the warranty provision, the Assessing Officer under the same letter dated 11.11.2013 had asked the petitioner to explain as under:-

"5. Please explain why the provision for warranty should not be disallowed and added back to the income under normal provision and under book profit u/s 115JB as it is contingent in nature?"

10. In response to such query, under letter dated 16.12.2013, the assessee had answered as under:-

"3. The explanation regarding allowability of provision for warranty under normal provision of Tax is enclosed herewith at Annexure : 2. During the year the Company has paid tax under normal provision and not under MAT u/s 115JB. So even if provision for warranty is added back to Book Profit will not increase tax liability."

Along with this letter, the assessee had annexed a detail explanation regarding the claim of warranty which

reads as under:-

"Explanation on provision for warranty of Rs. 408.11 lac

The assessee has charged the above sum in the Profit & Loss account. In the instant case, it appears that the provision for performance warranties made by the Company is on the basis of technical assessment by the management considering the possible defects or performance failures with the likely costs for correcting such defects or failures. Considering the global policy and based on the detailed technical assessment, the Company have made a provision of 1% of sales value for such likely expenditure.

In respect of allowability of the provisions for warranty the decision of Supreme Court in the case Rotork Controls India (P) Ltd. v. CIT (2009) 314 ITR 62 may be referred where it has been held that the warranty provision is in the nature of ascertained liability and therefore an allowable deduction under the Income Tax Act. The said decision is discussed hereunder in brief:

" The assessee company was engaged in the business of valve actuators. At the time of sale, the assessee provides a standard warranty whereby in the event of any Beacon Rotork Actuator or part thereof becoming defective, the assessee company undertakes to rectify or replace the defective part free of charge. Warranty was an integral part of the sale price of valve actuators.

The Supreme Court observed that a "provision" is a liability which can be measured only by using a substantial degree of estimation. A provision is recognized when (i) an enterprise has a present obligation as a result of a past event, (ii) it is probable that an outflow of resources will be required to settle the obligation, and (iii) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision can be recognized.

The Court further stated that there was enough statistical data

to indicate that every year some of the value actuators manufactured by the assessee company were found to be defective and no customer was prepared to buy such products without a warranty. Thus, the warranty stood attached to the sale price of the product.

The Supreme Court based on the facts and circumstances held that provision for warrant is rightly made by the assessee company. Accordingly, the Supreme Court concluded that the assessee company was eligible for a deduction in respect of its provision for warrant claims when computing its taxable business income under the Income Tax Act."

Various other courts including Tribunals has relied on above Supreme Court's decision.

Based on the above discussion and various judicial precedents available till date, provision of warrant made by the Company in its books of accounts may be allowed as deduction while computing its taxable income under Income Tax Act."

11. In clear terms, thus, both these grounds contained in the reasons recorded by the Assessing Officer namely the prior period expenses as well as the provision for warranty became subject matter of the scrutiny during the original assessment. Thus, on both grounds namely no failure on the part of the assessee to disclose truly and fully all material facts as well as scrutinized grounds, the impugned notice based on these grounds cannot be sustained.

12. Coming to the sole surviving ground of difference between the bill amount and the income reflected in the accounts of the assessee, we may notice that in the books of accounts, the assessee had made full disclosure with respect to the same which also provided the ground for such treatment given by the assessee to the receipts. In the schedule forming part of the accounts ending on 31.3.2011, the assessee had in this respect made following disclosures:-

"(J) Revenue Recognition:-

Sales, other than long term contracts are recognized on dispatch of goods. Sales are not of Value Added Tax. The Excise Duty recovered is presented as a reduction from gross sales.

Revenues from long term contracts are recognized on the percentage of completion method, in proportion that the contract cost incurred for the work performed up to the reporting date bear to the estimated total contract costs.

Construction contracts are accounted for in accordance with the Accounting Standard 7 on Accounting for Construction contracts. When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract are recognized as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date, (the percentage of completion method).

At each reporting date, the contracts in progress (Progress work) is valued and carried in the Balance Sheet under Current Assets. Advance and progress payments received from customers during the

course to completion are carried under Current Liabilities. Based on overall Gross margin estimated for outstanding contracts, revenues for contracts in progress are recognized in the Profit and Loss account based on the stage of completion of contract at the Balance Sheet date. Stage of completion of a contract is determined based on the proportion that contract cost incurred for work performed upto the reporting date bear to the estimated total contract costs.

The Cenvat Credit is accounted by crediting the amount to cost of purchases on receipt of goods and is used on clearance of finished goods by debiting Excise duty account.

Contract revenue accrued in excess of billing amounting to Rs. 11,910.99 lacs (2009-2010: Rs. 6,289.40 lacs) has been reflected as "due from customers on construction contracts" under the head "Currents assets, Loans and Advances". While billing in excess of Contract revenue accrued amounting to 4,188.90 lacs (2009-2010: Rs. 3,533.43 lacs) has been reflected as "due to customers on construction contracts" under the head "Current Liabilities and Provisions"

Provision for estimated losses, if any, on uncompleted contracts are recorded in the period in which such losses become probable based on the current estimates.

Income from services is recognized as and when the services are rendered.

Interest Revenue is recognized on time proportion basis taking into account the amount outstanding and the rate applicable.

Dividend income is recognized when the right to receive dividend is established.

Eligible export benefits, if any, are recognized in the Profit and Loss Account when the right to receive credit as per the terms of the

entitlement and reasonable certainty of collection / utilization is established in respect of exports made / to be made."

13. Under these circumstances, clearly there was no failure on the part of the assessee to disclose truly and fully all material facts necessary for assessment. Reference to first explanation to Section 147 of the Act in this respect, would not aid the revenue. Further, we also find that on this very ground, besides others, the Assessing Officer had reopened the assessment of the petitioner assessee for assessment year 2010-11. The order of reassessment that he passed on 29.12.2017 i.e before issuing the impugned notice on 23.3.2018, he had made no addition on this ground. This ground has been taken by the assessee in the petition. However, the order of reassessment dated 29.12.2017 was not produced earlier which he has now tendered which is taken on record. Perusal of this order would show that the notice of reassessment in the said case was, besides others, was based on following grounds:-

" 2. Amount due to customers on construction contracts not offered for taxation:

2.1 The assessee has shown in the balance sheet under the head 'current liabilities and provisions' as 'due to customers' at Rs. 35.33

crores. This amount is nothing but the difference in bills raised by the assessee and sales booked by the assessee in its books of accounts. It is seen that the bill has already raised but this income was not offered by assessee. It is seen that assessee can raise bill only when it is entitled to do so as per the terms of contract on reaching certain milestone.

2.2 The cost incurred by the assessee in respect of the above projects till reaching of certain stages was actually debited by the assessee in the profit and loss account. The assessee has explained in note (J) of schedule K-notes on accounts that as per accounting standards it has booked sales based on percentage completion method which is reflected by actual cost incurred by it and not based on bills raised which was based on various stages reached in the project.

2.3 It is a settled position that the mode of book entries cannot change the nature of receipt. If a receipt is trading receipt, it must be treated as such, irrespective of the manner, it has been recorded in the books of account.

2.4 Therefore, the income of the assessee is under-assessed by sum of Rs. 35.33 crores which reflects the amount which has already become due to the assessee in terms of the contracts but is not accounted in the profit and loss account. The tax effect for the underassessment works out to Rs. 12.0 Cr.

In the balance sheet under head current assets, the assessee has shown amount recoverable from customers at Rs. 62.89 Cr. This amount represents excess of aggregate sale proceeds recognized over the progress billings as on the reporting date. Prima facie, it appears that this amount cannot be reduced since if work done exceeds aggregate bills raised, the same will represent the work in progress and should be accounted as such by crediting income

account."

14. In the order of assessment, however, there was no addition made on this ground. Clearly, therefore, the Assessing Officer through scrutiny assessment agreed that the assessee on the accounting treatment given by the assessee to such billed amount and on that ground also, the Assessing Officer now cannot press the ground in service to sustain the impugned notice of reassessment.

15. Under these circumstances, the impugned notice is quashed. Petition is allowed and disposed of.

[M.S. SANKLECHA, J.]

[AKIL KURESHI, J]