

Income accrues on completion of services; ITAT accepts Completion Contract Method for revenue recognition

Summary – The Pune ITAT in a recent case of Vinay V. Kulkarni, (the Assessee) held that where work related to installation and erection of equipment had been completed in subsequent years, accrual of income happened only in subsequent years when assessee gets an enforceable right to receive same even if in accounts assessee had shown it as income and TDS had been claimed by him.

Facts

- The assessee was an individual and a proprietor carrying on the business activity in the name and style of 'Servicool' which comprises of trading of air-conditioning of the accessories and equipments, consulting engineers in airconditioning and commission agent/dealers for Daikin Air-Conditioning India Pvt. Ltd.
- During the assessment proceedings, the Assessing Officer observed that in the balance sheet under current liabilities there was certain amount under heading 'contingent income'. The Assessing Officer sought the explanation with respect to the taxability of the aforesaid amount.
- The assessee furnished explanation that revenue was recognized on raising of the invoice as against receipt of money as mercantile system of accounting was being followed and, therefore, the commission credited by deducting TDS was not considered as income but treated as 'contingent income'.
- The Assessing Officer, however, did not accept the explanation furnished by the assessee as credit for the TDS for the said income had been claimed, and treated the said amount as income for the current assessment year 2009-10.
- On appeal, the Commissioner (Appeals) deleted the same.
- On appeal:

Held

- The assessee's main activity is that of commission agent/dealer for Daikin air-conditioning India Pvt. Ltd. The steps taken for effecting the commission by Daikin to the assessee indicates that as soon as order is booked by Daikin, credit for commission is given to the assessee irrespective of the supply of material and delivery of goods which ensures expenses for Daikin but not necessarily income to the assessee. The assessee starts the work of installation only after the receipt of equipment from Daikin. After the installation is done and collection of money against the goods is completed the principal *i.e.* Daikin advises the assessee to raise an invoice. On its advice the assessee *i.e.* dealer raises the invoice along with service tax. The principal, thereafter, makes the payment by way of cheque adjusting the commission against his account for supply of goods. The Assessing Officer has observed that the TDS made on the amount which has been shown as contingent income and its claim being made during the year under consideration though the receipts not offered for taxation.

Mere tax deduction at source is not a test for determining income for the reason that the responsibility of deducting the TDS is on the person making the payment, *i.e.* Daikin, at the time of booking of expense or making payment whichever is earlier. The assessee offers the income received by way of commission for taxation as and when the transaction is completed. The Commissioner (Appeals) observed that the details filed by the assessee of the various transactions entered into clearly reveals that the commission earned from Daikin have been offered for taxation on the basis of completion of the service and installation contract in the respective year and this method has been consistently followed year to year by assessee. This method is also seen in consonance with the accounting method AS-9 in respect of service contract and installation fee which states that revenue be recognised only when equipment is installed and accepted by customer.

- The regular method of accounting determines only the mode of computing the taxable income and the point of time at which the tax liability arises. It could not determine the range of taxable income or the ambit of taxation. In the case, there is no income, it could not be said that income has accrued merely on the ground that the assessee had followed the mercantile system of accounting. Even if the assessee makes a debit entry to that effect no income could be said to have accrued to the assessee. In the case no income has accrued there can be no liability to tax on a hypothetical income. What is to be considered is whether the income has really accrued to the assessee. The question whether real income has materialized has to be examined in the context of commercial and business realities of the situation in which the assessee is placed and not with reference to system of accounting. The accrual of income does not depend on the accounts of assessee. Whatever the position of accounts, income would have to be referred back to the chargeable accounting period during which such profits or gains actually arose or accrued and the assessee would be liable to tax in respect of the same during the correct and proper chargeable accounting year.
- The mercantile accounting system has some set rules. Since there is often more than one ways of understanding a commercial transactions for accounting purposes, since the income for income-tax is computed under ordinary principles of commercial accounting. There is a fall out in tax accounting, which are the concept of matching principles is not always acceptable, since taxable income is understood as a legal concept as ordained under the income-tax law. Since the accounting is kept on the basis of matching principles, there can be difference between the taxable income and income as per accounts, so as to require adjustment to the income as per books to arrive at taxable income for purposes of income-tax under mercantile system of accounting. The income accrues only when there is right to receive such income, whether it is actually received or not, what matters is legal right to claim the same. Schedule VI of the Companies Act would require income 'accrued but had not' become due as part of profits, though for income tax purposes, concept of income 'accrued but not due' is a contradiction in terms, since what was not due could not have accrued. What is not due cannot be subject to legal action to enforce recovery, so that income in a legal sense could not

be treated as accrued, so as to require inclusion in taxable income. Matching principle in accounting does not make legal sense in every case.

- In the case, work relate to the installation and erection of the equipment has been completed in subsequent years as the time taken varies between 1 month to 21 months. Therefore, the accrual of income earned happened only in subsequent years and not in the impugned Financial Year 2008-09 relevant to Assessment year 2009-10 as held by the Assessing Officer. Therefore, the assessee was justified to content that income accrues only in subsequent year when the assessee gets an enforceable right to receive the same. In view of above factual and legal discussion, the addition made by Assessing Officer was rightly deleted by Commissioner (Appeals). This reasoned finding of Commissioner (Appeals) needs no interference.
- In the result, appeal filed by the revenue is dismissed.