

Exp. incurred on abandoned projects is allowable under sec. 37(1)

Summary – The High Court of Karnataka in a recent case of Asia Power Projects (P.) Ltd., (the Assessee) held that where assessee incurs a liability under a contract which is terminated and therefore no amount under contract or in pursuance of a claim is receivable, assessee is entitled to claim said amount incurred as expenditure in implementing contract

Facts

- The assessee-company was awarded a contract by Madhya Pradesh Electricity Board (for short 'MPEB') for rehabilitation job for the 'A' Thermal Power Station.
- An amount of Rs. 9.29 crore was paid as advance. The assessee gave a bank guarantee for the said amount. The assessee commenced the work and incurred expenditure on the project. The total amount of expenditure incurred on the project was Rs. 6.64 crore. The case of the assessee was that the MPEB arbitrarily terminated the contract and invoked the bank guarantee.
- The assessee invoked the arbitration clause and put forth a claim. The amount of Rs. 6.64 crore included money spent on raw materials like tubes and pressure parts, consumables, freight and carriage and also bank charges, professional charges etc., in addition to the expenses on personnel, transport and communication and administrative expenses.
- The assessee debited the said amount being the cost of abandoned project towards the profit and loss account.
- The Assessing Authority was of the view that the assessee had been following mercantile method of accounting. As and when any expenditure was incurred on a contract, it should either result in corresponding receipts from the contract or it should be represented as work-in-progress. The assessee had neither received any amount from MPEB nor was showing any work-in-progress. The expenditure on a particular project could not be merely allowed as an expenditure unless there was a corresponding credit in the form of contract receipt or work-in-progress.
- The Commissioner (Appeals) as well as the Tribunal confirmed said disallowance.
- On appeal:

Held

- For the years 1999-2000, 2000-01 the amount spent towards expenditure is shown as 'work-in-progress' in the books of account. It is only for the previous year 2001-02 the expenditure incurred is not shown as work-in-progress. The reason is, the contract was terminated. The bank guarantees had been invoked. No doubt the claim was put forth before the arbitrator. But in the near future there was no chance of getting any amount in that particular previous year and the amount paid had been taken away.

- Therefore, the assessee in that previous year has shown the entire amount incurred as expenditure and sought for writing off as business expenditure. This aspect has been missed by the first Appellate Authority. It is only in the relevant year the assessee has not shown the amount spent towards expenditure as work-in-progress. It is during that year the contract was terminated and he put forth the present claim. He could not have shown it as work-in-progress. Therefore, the finding that he is not entitled to the benefit is ex-facie illegal and cannot be sustained.
- Therefore, if the assessee incurs a liability and when the contract under which that liability was incurred was terminated and when no amounts under the contract or in pursuance of a claim is receivable, he is entitled to claim the said amount incurred as expenditure in implementing the contract as a set off under section 37(1) read with section 28.
- In view of the aforesaid provision, though the assessee has incurred expenditure during the assessment years 2000-01, 2001-02 and 2002-03 during which period he has not received any amount as against the expenditure, if and when he receives the money in pursuance of the award which is already passed, if it is upheld by the High Court, the said amount is chargeable to income tax as the income of that previous year in which he receives the said amount whether the business in respect of which the deduction has been made is in existence in that year or not. Therefore, the interest of the revenue is fully protected.
- All the three authorities have not applied their mind to the factual aspects of the case and have not kept in mind the statutory provisions and thus committed a serious illegality in passing the impugned orders. The orders are not sustainable.
- The Appeal is allowed. The impugned orders passed by the three authorities are hereby set aside.