

Money retained by ONGC to ensure successful completion of contract to be taxed in year of actual receipt

Summary – The Mumbai ITAT in a recent case of Commtel Networks (P.) Ltd., (the Assessee) held that where assessee entered into contract for providing telecommunication services and in terms of contract certain amount was withheld by contractee towards retention money for satisfactory execution of contract by assessee, retention money was to be taxed in assessment year in which it was actually paid to assessee

Facts

- The assessee was primarily engaged in the business of design, engineering, integrated testing, supply, installation and commissioning of state of the art telecommunication systems. The assessee entered into a contract with one of its customer, ONGC for supply, engineering, integrated testing, installation and commissioning of high end telecommunication systems and related technology solutions. As per terms of contract, 10 per cent of total contract value was retained by contractee, ONGC for satisfactory completion of work. The assessee had shown retention money in the books of account.
- The Assessing Officer had added such retention money available in the accounts on the ground that retention money would be accruing to the assessee and it had to be assessed during relevant assessment year in which it was shown by assessee.
- On appeal, the Commissioner (Appeals) deleted the additions made by the Assessing Officer.
- On appeal to Tribunal:

Held

- Only issue for consideration is as to year in which retention money to be taxed in the year of completion of contract or when the performance guarantee period is over and the contractee releases the payment.
- The terms of contracts executed by the assessee with contractee, ONGC shows that the right to receive the retention money of the respective projects, did not accrue to, or vest in, the assessee during the previous year ended 31-3-2012, because the same in terms of time fell beyond that year. Therefore, the retention moneys did not accrue to the assessee during that year, notwithstanding the accounting as revenue in the books of account on completion of work of the respective projects. Accordingly, considering the terms of the contract, unless the assessee satisfied the customers as to the performance of the work, during the pre-fixed period after completion of the contract, the assessee has no right to receive retention money. However, the Assessing Officer has failed to appreciate the legal position and erroneously comparing this legal obligation in a manner to post

sale warranty obligations. In the post sale warranty obligations the suppliers right to receive the sale consideration is never at stake because he fully collects the same at the time of completion of sale; nor does he give any performance bank guarantee to the customer. His only obligation is to provide after-sales service, and in case he falls therein, the only recourse to the customer is to sue him for the damages; there is absolutely no impact whatsoever on the accrual of sale consideration. But in the assessee's case the client either physically retains the retention money or gets PBG in lieu thereof, which he can unilaterally invoke even without recourse to the assessee and recover the retention money directly from the bank. The conditions of the PBG would clearly show the assessee's precarious position vis-à-vis the customer in this matter. The assessee had submitted relevant terms and conditions of PBG issued by bank to assessee's customer. Accordingly, even though retention money is physically released against the PEG, the risk does not abate until the PEG expires or is cancelled by the customer. Therefore, during this period the assessee does not have right to receive the retention money, therefore, there was no accrual qua the retention money in the previous year relevant to the assessment year 2012-13.

- The accounting treatment given by the assessee in its books of account cannot decide the accrual of income in law. It is now well settled that accounting entries are not determinative of taxability of income or deductibility of any expenditure. A mere book keeping entry cannot be income unless income has actually resulted. If income does not result at all, there cannot be a tax, even though in book keeping an entry is made about a hypothetical income. Furthermore, income is to be computed as per the provisions of law, and it is not necessary that law should follow the footsteps of accountancy. Income-tax law does not march step by step in the divergent footprint of the accountancy profession.
- In view of the above, merely because retention money was accounted for in the books of account that same cannot be brought in the tax net without income having been accrued to the assessee. Furthermore, the assessee is consistently following the above practice for the retention moneys year after year since the assessment year 2003-04 and onwards. In the assessment year 2004-05, the then Assessing Officer after examining the claim in detail and on consideration of detailed submissions, accepted the same. For the first time in assessment year 2010-11 this claim was rejected. It is true that the principles of *res judicata* do not apply to tax assessments, yet there ought to be uniformity of treatment and consistency when facts and circumstances are identical.
- After comparing the early return income of the assessee *vis-à-vis* rate of tax, even after exclusion of retention money does not confer on the assessee any permanent tax benefit, but it is only a deferment of tax liability. There is no issue that it is taxable/income; the only crucial question is whether it is taxable in the year in which (the relevant work is completed, or in the year in which it accrues to the assessee as per the law when the right to receive vest in it. In other words, this issue is whether the sum is taxable in one or the other year. Such an issue, really speaking, is not material in case of a company, where the income is always taxed at a flat rate.

- While deciding the issue, the Commissioner (Appeals) has relied on the decision of Bombay High Court in case of *CIT v. Associated Cables (P.) Ltd.* [\[2006\] 286 ITR 596](#), wherein also assessee was engaged in the very similar activity and retention money was held to be taxable only in the year of receipt and not in the year when the project is completed. In this case, Bombay High Court held that right to receive retention money accrued only after the conditions under the contract are fulfilled, it will not accrue till that conditions are fulfilled. This income will be assessed as assessee's income only when contractee fulfils all the conditions of the contract and pays the amount.
- One is also in agreement with the contention of revenue that principle of consistency is required to be followed unless facts are different in subsequent years. In the *present case*, it is found that from the assessment year 2003-04 to the assessment year 2009-10, assessee's method was accepted by the Department, moreover, in the assessment year 2004-05, there was scrutiny assessment wherein after having a detailed discussion, the Commissioner (Appeals) accepted assessee's contention regarding retention money. Even for each assessment year being separate unit, what is decided in one year may not apply in the following year, but where a fundamental aspect permeating through the different Assessment Years has been found as a fact one way or the other and parties have allowed that position to be sustained by not challenging the order, it would not at all be appropriate to allow the position to be changed in a subsequent year.
- Retention money accrues only when the performance period has been successfully completed and the Bank guarantees have been released. The facts of the assessee's case is identical to that of the case of the *Associated Cables (P.) Ltd. (supra)*. Associated Cables were also doing manufacturing Cables as per specifications of the contractee. The assessee is involved in design, engineering, integration, testing, supply, installation and commissioning state of the art telecommunication system as per customers' specific requirements. Every fact is identical to the facts of the case of *Associated Cables (P.) Ltd. (supra)* is identical to the facts in respect of assessee's case.
- Furthermore, the assessee is in the 30 per cent bracket in all the years under consideration. Earlier years retention money is taxed in this year and this year's retention is taxed in the subsequent years. Hence there is no loss of revenue. Therefore, the treatment adopted by the assessee should not be declined. Furthermore, the accounting treatment given by the assessee in its books of account cannot decide the accrual of income in law. It is now well settled that accounting entries are not determinative of taxability of income or deductibility of any expenditure. A mere book keeping entry cannot be income unless income has actually resulted. If income does not result at all, there cannot be a tax, even though in book keeping an entry is made about a 'hypothetical income.'
- In view of the above, merely because retention money is accounted for in the books of account, that by itself does not make it taxable in assessment year 2010-11 when in law the same cannot be said to have accrued in that year as discussed above.
- In view of the above discussion, there is no infirmity in the order of Commissioner (Appeals) for directing the Assessing Officer to tax the retention money is to be taxed the year of actual receipt and not in the year of completion of contract.