

## **Deputy Commissioner Of Income-Tax, ... vs Deccan Mechanical And Chemical ... on 29 June, 2005**

**Equivalent citations: [2006]102ITD171(PUNE), [2006]287ITR65(PUNE), (2006)104TTJ(PUNE)840**

ORDER

K.G. Bansal, Accountant Member

1. These appeals of the revenue involve common grounds and, therefore, they were argued in a consolidated manner. Consequently, a consolidated order is passed. For this purpose, we shall discuss the facts and the grounds of appeal for assessment year 1991-92 by way of illustration. Four grounds of appeal had been taken up for the aforesaid year. Ground Nos. 1 and 2 challenge the finding of the learned CIT(A), in which addition of Rs. 74,42,520, made by the Assessing Officer in the assessment, was deleted. It is inter alia, mentioned that the impugned amount, representing retention money, was income, which accrued to the assessee in the relevant previous year in view of mercantile method of accounting followed by it, and that liability to pay tax arises the moment income accrues to the assessee even if its actual receipt is postponed. Therefore, in ground No. 3, it was urged that the order of the learned CIT(A) may be vacated. Ground No. 4 is residuary in nature.

2. The issue has been dealt with by the learned CIT(A) in paragraphs 2 to 4 on pages 1 to 10 of his appellate order. In this order, it is mentioned that the assessee has been executing its contract with Maharashtra Slate Electricity Board (Contractee) for installation of "Ash Handling Plant" (AHP) at Chandrapur Thermal Power Station on turnkey basis. Its responsibility starts from designing of the plant to testing and handing over the plant to the contractee. Its responsibility also extends to any repair or replacement in the warranty period. Under the agreement 10 per cent of the billed amount is payable by the contractee after taking over the plant and after satisfactory completion of contractual work, which includes performance test and final acceptance. The aforesaid part of the contracted price, termed as retention money, amounting to Rs. 74,42,520 was not included by the assessee in its income on the ground that this amount did not accrue to it as income in the relevant previous year. Note 16 of "Notes on Accounts" mentioned that during the year, in pursuance of accounting standard No. 7, and accounting standard No. 9, issued by the Institute of Chartered Accountants of India (ICAI), retention money of the contract withheld by the customers, has not been recognised as income, since the right to receive this amount does not exist. As a result of this change in the basis of accounting, the profits of the company are lower by about Rs. 74.42 lakhs. It is further mentioned by the learned CIT(A) that the Assessing Officer considered the facts and circumstances of the case and held that this change in the method of accounting was not acceptable. He was of the view that accrual of income cannot be based on a different method than the method of accounting followed by the assessee. Under mercantile method of accounting, both the income and expenditure are to be recognized on the basis of accrual. He was also of the view that where sale price has been fixed between the parties, and purchases and sales are quantified and, therefore, the income had to be taxed after considering the entire contract value. The contractee had paid sales tax

on full invoice price and, therefore, the same should be considered for arriving at the income of the assessee. The assessee had also not given any credit note to the contractee on account of retention money. This implied that the entire money was payable by the contractee to the assessee. Accordingly, the Assessing Officer held that the retention money was liable to be included in the income of this year. It is also mentioned that the case of the assessee was that as on 31-3-1991, being the last date of the relevant previous year, the assessee had right to receive only 90 per cent of the billed amount and there was no right to receive the remaining 10 per cent of the amount. The right to receive the balance amount was contingent upon a number of factors enumerated in the agreement between the assessee and the contractee. The right to receive this amount will accrue only when the contract is fully completed by not only erecting the plant but on its acceptance by the contractee after its rigorous testing. The learned CIT(A) considered these facts and various cases quoted by both the sides on the issue of accrual of income. He came to the conclusion that the right to receive the retention money would arise only when the assessee had fulfilled its part of the contract i.e., on final acceptance of the plant by the contractee. He also referred to accounting standard Nos. 7 and 9, in which, it was pointed out that the retention money is not to be recognized as income. He also dealt with the Assessing Officer's argument regarding the impugned change amounting to change in method of accounting, and held that there was no such change inasmuch as the assessee continued to follow the mercantile method of accounting. On the basis of this method, he concluded, that right to receive the impugned amount of Rs. 74,42,520 did not accrue to the assessee in this year. Accordingly, he deleted the impugned addition.

3. The learned DR referred to the "Notes on Accounts" and argued that the change made by the assessee amounted to change in method of accounting, which was rejected by the Assessing Officer as not bona fide. He further referred to the finding of the Assessing Officer on page 7 to the effect that as per the agreement, aggregate sum of the contractors' price, broken down, shall be equal to the lump-sum contract price, which shows that price adjustment for various activities has to be done within the limits of total contract price which could not be reduced by any party to the contract. He also referred to the findings of the Assessing Officer in paragraph 4 of his order, which dealt with clause 32 of the agreement, regarding passing of the property to the contractee. According to this clause, the property was to pass when, - (i) the plant is delivered in pursuance of the contract, (ii) the contractor is paid any sum to which he may be entitled to in accordance with the terms of payment and, (iii) the plant is otherwise taken over by the contractee, whichever is earlier. The case of the learned DR was that since the property in plant had passed to the contractee, the whole of the amount receivable under the contract had accrued to the assessee as income in this year. The learned DR also referred to page 9 of the order of the Assessing Officer, which deals with clause 13 of the agreement. It provides that the plant shall be considered as commissioned after successful completion of performance test, which was to continue for a period of 24 hours. If the assessee failed to establish the guaranteed power consumption as envisaged in the contract, it will rectify the defects within a period of three months. If no successful performance is made in these three months, the contractee will have the right to rectify the defect at the cost of the assessee. On the basis of this clause, the case of the learned DR was that the retention money was not to be withheld permanently but was to be paid after successful completion of performance test and in case of excess consumption of power, the contractee could rectify the fault at the cost of the assessee. This showed that there could be some liability by way of damages or penalty, but that does not mean that

contacted price did not accrue to the assessee as income. The learned DR also pointed out that the assessee could receive the retention money by substituting it with a bank guarantee. This showed that the money had accrued as income to the assessee but only its payment was postponed and that the postponement could also be avoided by furnishing a bank guarantee. Thus, the retention money had accrued as income to the assessee. The learned DR greatly emphasized on the fact that the expenditure relating to commissioning of the plant had been fully accounted for by the assessee. Therefore, if the retention money is not brought to tax as accrued income in this year, there will be a complete mismatch between the receipts and expenditure, leading to a distorted picture of profits of this and Ors.years. Accordingly, he urged that the Assessing Officer had rightly included the retention money in the income of the assessee for this year.

4. The Learned Counsel of the assessee pointed out that the assessee was installing AHP for the contractee, at their Chandrapur Thermal Power Station. The assessee was entitled to receive 90 per cent of the billed amount and the balance 10 per cent was retained by the contractee, which was to be received after guarantee period. Since the money was not immediately receivable by the assessee on raising the bill, it was argued by him that the assessee did not have the right to receive the retention money. It was further pointed out that the assessee had been following mercantile method of accounting and there was no change in this method in this year also. It was also pointed out that the assessee had been wrongly declaring retention money as income in earlier years though the right to receive the money had not accrued. This wrong was rectified this year. However, as and when the right to receive the money came into existence from this year onward, the money was shown as income accrued notwithstanding the fact that there was no actual receipt which may be due to some delays in working of the contractee. It was also pointed out that the payment of tax on accelerated basis in earlier years, in showing full amount as income accrued, cannot and should not come in the way of deciding the matter on correct judicial principles in the assessment in this year. Since the right to receive retention money had not arisen, the income had not accrued to the assessee in respect of retention money. In the course of hearing of the appeal, the Learned Counsel was questioned whether any provision was made in the books of account for future warranty liabilities and it was stated by him on the bar that no such provision has been made. The order proceeds with the assumption that this statement is true. The Learned Counsel was also questioned whether in subsequent year, the retention money was offered for tax on receipt basis or mercantile basis and it was specifically stated that the amount was offered for tax not on receipt basis but on accrual basis as soon as the right to receive arose. The order proceeds with the assumption that this statement is also true. The Learned Counsel of the assessee relied on a number of cases, which are discussed in succeeding sub-paragraphs:

5.1 The Learned Counsel, for the purpose of accrual of income, relied on the decision of Hon'ble Allahabad High Court in the case of CIT v. Govind Prasad Prabhu Nath . The facts of the case are that the assessee, a firm dealing in fertilizers maintained its books of account of mercantile method. The ITO noticed that the assessee had deposited Rs. 1,07,957 in a post office savings bank account, which was pledged to the District Magistrate, Sultanpur. It was explained that the selling price of fertilizer was raised by the Government of India with effect from 1-6-1974. Later on, U.P. Government also issued an ordinance that the stock held on 31-5-1974 will have to be sold at the old rates. The order was unsuccessfully challenged before the High Court and, therefore, the appeal was

filed to the Supreme Court. In the case of the assessee, the Supreme Court passed an order that the fertilizer may be sold at the new rate but the excess price over the price at old rate may be deposited with the District Magistrate. The question was whether such deposit made with the District Magistrate represented income accrued to the assessee. After considering a number of decisions in the matter, including that of Hon'ble Supreme Court in the case of State Bank of Travancore v.CIT , the Hon'ble Court came to the conclusion that basic concept of accrual income is that the assessee must have acquired a right to receive income. Therefore, there must be debt owed to him by somebody. Unless and until there is created in favour of the assessee a debt due by somebody, it cannot be said that he has acquired a right to receive income or that the income has accrued to him.

5.2 The Learned Counsel relied on the decision of Hon'ble Supreme Court in the case of CIT v. Hindustan Housing and Land Development Trust Ltd. . The facts of the case are that certain lands belonging to the assessee were compulsorily acquired by the State Government. The Land Acquisition Officer awarded a sum of Rs. 24,97,249 as compensation. On appeal, the compensation was enhanced to Rs. 30,10,873, on which interest at the rate of 5 per cent was also ordered to be paid from the date of acquisition. The State Government filed an appeal to the High Court. Pending decision in appeal, the Government deposited a sum of Rs. 7,36,691, the additional amount payable, with the Court on 25-4-1956. The assessee was allowed to withdraw this amount on 9-5-1956 after furnishing a security bond for refunding the amount in case the Government's appeal was allowed. The assessee credited this amount in suspense account. The question was whether the amount received by the assessee could be taxed as income for assessment year 1956-57 as income received in pursuance of the enhancement of compensation. The Tribunal decided the matter against the department. The decision was affirmed by the High Court in its order, in which it was pointed out that the compensation was enhanced on 29-7-1955. The enhanced amount was disputed in appeal. The assessee was allowed to withdraw the amount only on furnishing a security bond. Therefore, there was no absolute right vested in the assessee to receive the amount till that stage. Thus, the extra compensation did not accrue as income of the assessee in the previous year relevant to assessment year 1956-57.

5.3 The learned Counsel of the assessee relied on the decision of Hon'ble Allahabad High Court in the case of New Victoria Mills Co. Ltd. v. CIT [1966] 61 ITR 395. The assessee was maintaining its books of account on mercantile method. It made a provision of Rs. 4.5 lakhs in the books, representing bonus payable for the previous year and claimed the amount as deduction from its income, even though the bonus was actually paid in the succeeding year. The Hon'ble Court pointed out that when provision for bonus was made because of an amicable settlement or by an industrial adjudication, the liability was incurred by the employer on mercantile method of accounting notwithstanding the fact that it was paid in the subsequent year. It was explained that under the aforesaid method all credit items are brought in as income immediately when they become legally due, whether received or not, and all expenditure are brought into the debit for which a legal liability has been incurred, whether or not the liability has been disbursed. It will be clear from the judgment that once a legal right gets vested in the assessee to receive a sum, the income accrues notwithstanding the fact whether the corresponding amount is received or not. However, if no such legal right gets vested in the assessee, no income can be said to accrue to him.

5.4 The learned Counsel relied on the decision of Hon'ble Kerala High Court in the case of CIT v. Kerala State Drugs and Pharmaceuticals Ltd. . The facts of the case were that the assessee was engaged in manufacture and sale of pharmaceutical products, and sales were made entirely to the Government of Kerala. The agreement between the assessee and the State Government provided that if the price fixed by the State Government was lower than the price fixed by the assessee, the excess payment would be adjusted against the future supplies. However, if the price fixed was higher, the assessee could prefer a claim to receive balance amount. In the previous year relevant to assessment year 1978-79, the assessee made a claim for Rs. 41,86,349. The claim was not accepted by the Government. The amount had been shown in the profit and loss account as amount receivable. During the pendency of proceedings under Section 144B, the assessee filed a revised return, excluding the impugned amount. By this time, the State Government had negated the claim of the assessee. The claim of the assessee regarding the exclusion of aforesaid amount from the income was not accepted by the Assessing Officer. However, the Tribunal accepted the assessee's claim. The Hon'ble Court pointed out that the price entered in the books was merely a tentative price, which did not represent the income accrued or income received. Therefore, the said amount could not be treated as income. The Hon'ble Court pointed out, on review of various cases, that in order to tax an amount as income, we have to see whether it is real income and whether income has materialized. The amount could not be some kind of hypothetical income but it has to be real income. When income has not resulted at all, there is neither accrual nor receipt of income even though entries were made to the effect in the books of account. Accordingly, on the facts of this case, the Tribunal was right in holding that expectation to receive income cannot be taken as income.

5.5 The learned Counsel relied on the decision of Hon'ble Allahabad High Court rendered in case of CIT v. Purshotam Das Govind Das . The facts of this case and the ratio deklendi are identical with the facts of the case of Govind Prasad Prabhu Nath (supra). Therefore, this case is not discussed in detail here.

5.6 The learned Counsel relied on the decision of Hon'ble Patna High Court in the case of CIT v. Chanchani Bros. Contractors (P.) Ltd. . The assessee carried on the contract work for the irrigation department of Government of Bihar. The ITO found that the assessee had not included a sum of Rs. 1,64,428 in the bills for assessment year 1970-71, which was shown as bills receivable. It was explained to him that the irrigation department has withheld the bill for verification of satisfactory completion of work. The ITO also added a sum of Rs. 23,06,079, which was in respect of amount claimed by the assessee for the work done beyond the contract. The assessee claimed deduction for the expenditure incurred in the extra work, which was disallowed. The AAC allowed a relief of Rs. 84,243 from the total sum of Rs. 1,64,428. He also deleted the addition of Rs. 23,06,06,079. The Tribunal upheld the order of AAC. The Hon'ble High Court pointed out that the irrigation department had kept the bill pending for verification of the work and this position had been accepted by the Assessing Officer. The assessee had no right to claim this amount and, accordingly, it was not includible in the income of assessment year 1970-71. In respect of extra work, the Tribunal found as a matter of fact that the claims were not based on a prior undertaking or agreement. The final decision about the claim had not even been made before the closure of the accounting period. Therefore, this amount also could not be included in the income. The Hon'ble Court observed that it cannot be doubted that in mercantile method of accounting, business

expenses are allowable as and when the expenses are incurred. An allowance cannot be postponed as a contract work is one whole work and so the expenses incurred in a particular year have to be allowed on mercantile method of accounting. The learned Counsel laid special emphasis on this part of the judgment to canvass his case that receipts and expenditure cannot be linked, as has been argued by the learned DR. The receipts have to be taxed when right to receive amount has income into existence. The expenses are to be allowed as and when incurred because the contract work is one whole work.

5.7 The learned Counsel relied on the decision of Hon'ble Calcutta High Court in the case of CIT v. Simplex Concrete Piles (India) (P.) Ltd. . The facts of the case were that the assessee carried on the business of concrete piling for buildings. For and upto assessment year 1964-65, 100 per cent of the job value was credited to profit and loss account. However, in the previous year relevant to assessment year 1965-66, it credited 90 per cent of the amount to the profit and loss account deducting the retention money, which resulted into the reduction of income. The ITO treated this action of the assessee as change in method of accounting, which was not bona fide according to him. Therefore, the change was not accepted. This led to addition of Rs. 20,77,161 in the assessment for assessment year 1965-66. The AAC deleted the addition on the ground that retention money did not accrue as income of the assessee in the year in which job was executed. It accrued in a later year depending upon the completion of the contract work and its certification by the engineer to the effect that the work had been satisfactorily completed. The Tribunal upheld the decision of the AAC and in doing so, it pointed out that under mercantile method of accounting what could be brought to tax is the amount which has accrued as income to the assessee. Prima facie, it appeared that retention money did not accrue as income of the assessee, which will accrue as income as per terms of the contract. The Tribunal remanded the matter to the Assessing Officer to examine the contract regarding accrual of retention money as income. The Hon'ble Court upheld the decision of the Tribunal. While doing so, it was pointed out that the retention money did not become legally due to the assessee on completion of work. This money becomes legally due to the assessee on fulfilment of obligations and only thereafter the money would be realized by the assessee. Till that date, the assessee had no right to claim any part of the retention money, till the verification of the satisfactorily execution of the contract. The facts of the case are very similar to the facts of our case and, therefore, it is clear that it will have to be seen when the right to receive retention money arose in this case with reference to its agreement with the contractee.

5.8 The learned Counsel relied on the decision of ITAT, Bombay 'B' Bench, Third Member, in the case of Associated Cables (P.) Ltd. v. Dy. CIT [1994] 48 ITD 141. The assessee was engaged in the business of manufacturing cables as per specifications of the customers. According to the contract, 10 per cent of the price was to be paid on signing the contract, 80 per cent on presentation of dispatch documents and balance 10 per cent on receipt and acceptance of the goods, subject to performance and workmanship guarantee. The Assessing Officer noted that the bank guarantee was furnished by the assessee and this balance amount was also realized by the assessee. Accordingly, he held that this amount has accrued as income to assessee. The CIT(A) pointed out that the assessee has changed its method of accounting in this year on this issue and such change would not reflect proper computation of income. Therefore, he upheld the decision of the Assessing Officer. Judicial Member held that the character of this amount of 10 per cent did not change merely because it was

receivable on furnishing bank guarantee. However, the Accountant Member held that since the assessee could raise a bill for 10 per cent only after guarantee period, this amount did not constitute the sale proceeds. The Hon'ble Third Member held that the principle of recognition of income in mercantile method of accounting was that as long as enforceable right did not arise in respect of an amount, the amount could not be recognized as income. Coming to the facts of the case, agreeing with the Accountant Member, it was held that as long as performance guarantee remained and was enforceable without notice to the assessee, the income from retention money could not be recognized and, therefore, retention money had to be excluded from the income till the guarantee period was over. The facts of our case are similar to the fact of that case except that in that case, the assessee could raise the bill for 10 per cent amount only after guarantee period was over. In our case, the bill for the whole amount was raised but 10 per cent of the bill amount was withheld till successful setting up of the plant.

5.9 The learned Counsel relied on the decision of Hon'ble Gujarat High Court in the case of Anup Engineering Ltd. v. CIT [2001] 247 ITR 457 114 Taxman 584. The facts of the case are that the assessee was manufacturing vessels used by chemical industries. It entered contract with "G" for supply and erection of spray drying plant for synthetic detergent plant for a consideration of Rs. 40 lakhs. The contract provided for retention of 10 per cent of amount of each invoice, which was payable to the assessee after finding out that the plant was handed over in perfect condition and in satisfying "G" regarding its performance in all respects. The question was whether the right to receive this amount accrued to the assessee before satisfaction of the condition and on raising the invoice. The Hon'ble Court held that entries in the books of account of the assessee were not conclusive of the matter and the said amount could not be treated as income at all. In coming to this conclusion, the Hon'ble Court pointed out that it is crystal clear that the amount of Rs. 3 lakhs deducted from sales account was rightly claimed by the assessee by way of deduction, as this income had not accrued at all to the assessee. In the alternative, the Court pointed out that if the amount was taken as income, the assessee's liability with regard to the repairs of the plant as per the terms of contract had also arisen in the same previous year. Therefore, the said liability ought to have been deducted while computing the income.

5.10 The learned Counsel relied on the decision of Hon'ble Punjab and Haryana High Court in the case of CIT v. Punjab Tractors Cooperative Multi-Purpose Society Ltd. . In this case, the assessee engaged in the business of purchase and sale of tractors, motor cycles and their parts. In the assessment year 1978-79, the assessee made provision of Rs. 2,01,236 for "post warranty service advances". It was explained that the assessee was liable to provide free service in the warranty period of one year, The Hon'ble Court held that the assessee did not become owner of the amount and could not appropriate till the service was rendered in lieu of which the advance was received. The assessee could legally claim the amount after rendering the services. Part of the amount could be treated as income in the year under assessment on the basis of right to appropriate the money. However, as the receipt was relatable to a particular period in future, it would fructify and mature into income in the period and not in the earlier period.

5.11 The learned Counsel relied on the decision of ITAT, Pune Bench in the case of G.H. Ajwani Construction (P.) Ltd. v. Jt. CIT [IT Appeal No. 581 (Pune) of 1999, dated 31-10-2001]. The Hon'ble

Tribunal, in the light of the facts of the case, held that the assessee had no right to claim any part of retention money till the verification of satisfactory execution of contracts. The learned Counsel also relied on the decision of ITAT, Mumbai "D" Bench in the case of Corrosion Control Services (Bombay) (P.) Ltd. v. Dy. CIT [1999] 70 ITD 109. The Hon'ble Tribunal pointed out that the accrual of income has to be determined with reference to contract between the parties. On the particular facts of that case, it was pointed out that there was no dispute raised by the revenue about terms and conditions of agreement between the parties. In terms of the contract, it was held that retention money did not accrue as income and this amount could not be assessed merely on the view which the assessee had taken inadvertently or otherwise. The learned Counsel also relied on the decision of ITAT, Ahmedabad "C" Bench in the case of Kevin Enterprise v. Joint CIT [2001] 79 ITD 196. In this case, 10 per cent of the sale amount for which bank guarantee had been furnished was excluded from sale receipts by the assessee on the ground that the amount had not become due to the assessee as there was no entitlement to it until after satisfactory performance of supply of material under the contract. This was in conformity with the accounting standard 9 formulated by the ICAI. The Assessing Officer taxed this amount, but the ITAT pointed out that furnishing bank guarantee was subject to significant risks and uncertainties as the guarantee could be enforced without reference to the assessee. Therefore, it was held that the retention money was not liable to be taxed even though it had been received on furnishing of the bank guarantee.

6. On combined reading of these orders, the following propositions of law emerge regarding mercantile method of accounting:

- (i) the accrual of income takes place when right to receive income arises [Paragraphs 5.1, 5.2, and 5.3],
- (ii) in a contract, under mercantile method of accounting, the accrual of income takes place when the assessee gets unconditional legal right to receive money under the agreement [Paragraphs 5.4, 5.7, 5.8 and 5.11],
- (iii) receipt of money by itself does not lead to accrual of income, especially when the assessee has not rendered corresponding service [Paragraph 5.10],
- (iv) the principle of matching of income and corresponding expenditure may be an accountant's view, but under the law the expenditure and income can be treated differently, depending upon whether one or both had accrued or not on the basis of method of accounting followed by the assessee. [Paragraph 5.5]; and,
- (v) receipt of retention money by furnishing unconditional bank guarantee may or may not amount the accrual of income which will have to be considered on the basis of terms and conditions of the contract. However, furnishing of unconditional bank guarantee is attendant with significant risks, and where the agreement provides for acceptance test for satisfactory performance in lieu of which certain money was retained by the contractee, that amount will accrue as income only on satisfactory performance of the test and acceptance by the contractee [Paragraph 5.9].



7.1 We may now consider the facts of the instant case in the light of various case laws and their ratios discussed in the preceding paragraphs. Various terms and conditions of the contract had been narrated by the Assessing Officer in his order from page 6 onward. The assessee agreed to deliver the AHP and all other accessories in all respects for a contract price of Rs. 12,59,06,940. As per the clause 24, all payments during the currency of the contract will be "on account payments" only and the final payment shall be made on completion of guarantee period or earlier fulfilment by the assessee of all his liabilities under the contract. Clause 32 of the contract provides that property in all materials, equipment and Ors.supplies shall vest in and become the property of the contractee from the date of receipt of the material. Clause 13 provides that plant shall be considered as commission after successful completion of the performance test to be carried out for 24 hours. If the assessee fails to establish the guaranteed power consumption envisaged, it will undertake to rectify the plant within a period of three months. However, if that is not done, the contractee will have the right to rectify the defect on its own and the cost of rectification will be collected from the contractor. The payments were to be made as under:

- (i) 15 per cent of the price to be given as advance on signing the contract,
- (ii) further 75 per cent to be paid on production of invoice and satisfactory evidence of dispatch by the assessee,
- (iii) further 5 per cent of the price to be paid against the taking over of the plant by the contractee, and
- (iv) final 5 per cent of the price is to be paid prior to completion of guarantee period but after satisfactory completion of all contractual works including performance test and final acceptance.

7.2 The case of the learned Assessing Officer was that when on supply of material, payment upto 90 per cent of the supplies were made by the contractee, it meant that the full payment was quantified and accepted by the contractee. This is so because without quantification of the full amount, 90 per cent thereof cannot be worked out and paid. Therefore, when the whole price was quantified, the amount receivable was also quantified and, therefore, whole of the amount accrued as income to the assessee. The retention of 10 per cent of the money was in respect of material already\* supplied and accepted, and the retention was merely for safeguarding the interest of the contractee. The acceptance of the full liability by the contractee amounts to accrual of income in the hands of the assessee. This view was not upheld by the learned CIT(A).

7.3 We have already considered various case laws which point out that if receipt of retention money is conditional upon performance of a part of contract, this money will accrue as income only when that part of the contract has also been performed. We have also seen that the expenditure incurred in supply of the whole material was for the purpose of business and it constituted a deductible expenditure. Its deduction does not depend upon the corresponding receipt. In other words, the principle of matching of expenditure with receipt does not represent correct legal approach, though it may be an accountant's view. However, that is also not the case here, as accounting standard No.

9, issued by ICAI, lays down that if receipt of retention money is hedged upon future contingencies, it should not be recognized as income. Thus, the expenditure and the corresponding receipt may have to be treated differently, depending upon the terms of the contract. The contract provides that property in goods shall pass to the contractee as soon as those are supplied to it. Therefore, on supply of goods, the expenditure has been incurred because the assessee is no more owner of the goods. Insofar as, retention money is concerned, it will accrue as income in two equal instalments on, - (i) taking over the plant by the contractee, and (ii) completion of performance test and its acceptance by the contractee. The contract provides for rectification of the defaults by the assessee within three months and in case of his failure to do so by the contractee on its own at the cost of the assessee. Therefore, there are significant risks associated with the accrual of retention money as income. Insofar as retention money is concerned, furnishing of bank guarantee by the assessee to the contractee and receipt of retention money in lieu thereof does not obliterate the risks associated with this money. Therefore, even if the assessee is entitled to receive the money by furnishing unconditional bank guarantee, the risks do not abate. There is a significant risk that the money may be recovered from the bank guarantee without reference to the assessee in case performance test is not performed satisfactorily. This risk is not covered by making any provision in books for the warranty as stated by the Learned Counsel.

7.4 It was also the case of the learned DR that the assessee had changed its method of accounting in respect of accounting of retention money. The case of the learned Counsel was that the assessee has been consistently following mercantile method of accounting and there was no change in this regard. Earlier, the assessee had been showing retention money as income on the mistaken belief that the income had accrued to it. However, if correct principles of law are applied, it will be seen that income will accrue only when performance test is satisfactorily undertaken and accepted by the contractee. As pointed out earlier, he has also stated that, - (i) no provision is made for liability in case performance test fails and some expenditure may have to be incurred in the warranty period, and (ii) retention money has been offered for taxation the moment the performance test has been undertaken successfully and accepted by the contractee. Therefore, his case was that he has been following mercantile method of accounting, his past mistaken belief of law cannot be held out against him in this year, and it also cannot be concluded that he has changed method of accounting when he followed the correct legal principles regarding accrual of income while filing the return of income for this year. Looking to the aforesaid discussion we are of the view that there was no change in method of accounting, which continued to be mercantile method of accounting. We are also of the view that the retention money does not accrue as income merely on raising the bill. It accrues as income as per paragraph 7.3 (supra) of this order. The Assessing Officer and the CIT(A) have dealt with the retention money as one item. But, in fact, it accrues as income on happening of two distinct events. The Assessing Officer may examine whether any part of retention money accrues as income in this year on aforesaid basis. If he is of the view that some portion accrues as income this year, he may hear the assessee and tax that part portion accordingly.

8.1 In view of the aforesaid discussion, various grounds of appeal for assessment year 1991-92 are decided as under:

Ground Nos. 1, 2 and 3 are taken as dismissed. 4th Ground of appeal of the assessee does not require any decision from us as it is residuary ground of appeal. The appeal of the revenue is treated as dismissed.

8.2 Grounds for assessment year 1992-93 are identical with the grounds of appeal for assessment year 1991-92 except for the amount of retention money. In view of our finding for assessment year 1991-92, this appeal is also treated as dismissed.

8.3 The grounds of appeal for assessment year 1993-94 are also identical with the grounds of appeal for assessment year 1991-92 except for the amount of retention money. In view of our discussion in respect of grounds for assessment year 1991-92, this appeal is also treated as dismissed.