



The foreseeable loss determined in respect of incomplete contract as per the Accounting Standard – 7 is an allowable expenditure

Recently, the Mumbai Income-tax Appellate Tribunal (the Tribunal) in the case of Jacobs Engineering India Pvt.Ltd.¹ allowed the foreseeable loss determined in respect of incomplete contract as per Accounting Standard (AS) – 7 issued by the Institute of Chartered Accountants of India (ICAI).

Facts of the case

- The taxpayer was a company engaged in the business of consulting engineers in the field of chemicals, petrochemicals, fertilisers, cement, etc.
- The taxpayer was following a percentage completion method as prescribed under AS-7 issued by ICAI for the purpose of accounting of revenues and expenditure. The taxpayer charged foreseeable loss in respect of an incomplete contract in accordance with AS-7.
- The Assessing Officer (AO) disallowed the provision made by the taxpayer in respect of foreseeable loss on the basis that the provision does not represent actual loss and the taxpayer was entitled for the actual liability and not for the future expected liability. The AO relied on the decision of Supreme Court in the case of Tuticorin Alkali Chemicals & Fertilizers Ltd.² to hold its contention.
- The Commissioner of Income-tax (Appeals) validated the order of AO and held that the anticipated losses can not be allowed while computing the tax payable.

¹ Jacobs Engineering India Pvt.Ltd v. ACIT (AIT-2009-285-ITAT)

² Tuticorin Alkali Chemicals & Fertilizers Ltd v. CIT [1997] 227 ITR 172 (SC)

Issue before the Tribunal

- Whether the foreseeable loss determined as per the AS-7 was allowed while determining the taxable income?

Tax department's contentions

- The department contended that only those AS that have been notified by the Government of India under the Act was allowed to be followed by the taxpayer. However, AS-7 was not notified under section 145(2) of the Income-tax Act, 1961 (the Act).
- The department also contended that the foreseeable loss was not actual loss and under the mercantile system of accounting only the existing liability was deductible and not the anticipated or future liability.
- Though the matching concept was essential for determination of income as well as expenditure, it was violated by the taxpayer.

Taxpayer's contentions

- The taxpayer contended that as per AS-7, when the current estimates of total contract cost and revenue indicate a loss, provision was required to be made by the taxpayer for the entire loss on the contract irrespective of the amount of work done and the method of accounting followed.
- The taxpayer also contended that the Tribunal in its own case for the earlier assessment year approved the method of accounting followed and also allowed the provision made for the foreseeable loss, claimed by the taxpayer.
- The taxpayer also placed reliance on the following rulings:
 - Mazagaon Dock Ltd³: The Mumbai Tribunal in this case held that the foreseeable losses under AS-7 were allowable under the Act. The Tribunal also held that the matching concept was not much of significance if the loss had been properly estimated in the year, in which the contract had been entered into.
 - Woodward Governor India (P) Ltd⁴: The Delhi High Court held that for the purpose of determining whether there has been an accrual of liability or income, the AS prescribed by the ICAI, had to be followed and applied.
 - Metal Box Company of India Ltd⁵: The Supreme Court in this case held that the provision is a charge against profits for anticipated losses and contingencies and therefore, they should

³ Mazagaon Dock Ltd. v. JCIT [2009] 29 SOT 356 (Mum)

⁴ CIT v. Woodward Governor India (P) Ltd. [2007] 294 SOT 356 (Delhi)

⁵ Metal Box Company of India Ltd. v. Their Workmen [1968] 73 ITR 53 (SC)

be taken into account against the gross receipts in the Profit and Loss account and Balance Sheet.

Tribunal's Ruling

- The Tribunal after discussing the above referred decisions held that the foreseeable loss determined in respect of incomplete contract as per AS – 7, was an allowable expenditure.

Our comment

This ruling has reiterated the significance of the ASs and method of accounting followed by the taxpayer consistently while determining the deductibility of losses. This ruling also discusses an important aspect that even though a particular AS (AS – 7) is not notified under section 145(2) of the Act, it cannot be a base to disallow the foreseeable losses.

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