



## Retention money cannot be regarded as income till the contractual obligation is fulfilled. Therefore, it cannot be regarded as income for computing MAT

### Background

Recently, the Kolkata Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Mcnally Bharat Engg. Co. Ltd.<sup>1</sup> (the taxpayer) observed that retention money is not in the nature of income till such time the contractual obligations are fully performed to the satisfaction of the customer by the taxpayer. On the date when the bills were submitted, having regard to the nature of the contract, no enforceable liability accrued or arose, and it could not be said that the taxpayer had any right to receive the entire amount on the completion of the work or upon submission of the bills. Therefore, retention money cannot be regarded as income for computing Minimum Alternate Tax (MAT) under Section 115JB of the Income-tax Act, 1961 (the Act).

### Facts of the case

- The taxpayer is engaged in the business of manufacture and sale of metallurgical machinery, materials handling and conveying plant/machinery/spares and coal washing plant on a turnkey contract basis.
- During the year under consideration, the taxpayer executed turnkey contracts. Under the terms of contract, a certain percentage of the value of the contract is retained by the persons for whom the taxpayer executes the contract.

This is referred to as retention money and will be given to the taxpayer only on a successful trial run of the final acceptance by the customer. During Assessment Year (AY) 2006-07, the taxpayer credited retention money to the profit and loss account.

- The taxpayer claimed that retention money credited to the profit and loss account cannot be considered as income both under the normal provision of the Act as well as while computing the book profit under Section 115JB of the Act.
- The Assessing Officer (AO) held that retention money shall be included while computing book profit under the provisions of Section 115JB of the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)] was of the view that in the mercantile system of accounting, the income cannot be said to have resulted even though the entry might have been made in the books of accounts. MAT cannot be levied on notional income, which has not accrued to the taxpayer. It can be levied only on real book profits, which have been earned by the company. If the notional income has been credited to profit and loss account, and the said income has not accrued during the year, the same cannot be considered as to disclose the result of working of the company during the financial year as provided under Part-I and Part-II of Schedule VI to the Companies Act, 1956. Accordingly, the CIT(A) held the decision in favour of the taxpayer.

<sup>1</sup> DCIT v. Mcnally Bharat Engg.Co.Ltd (ITA No. 100/Kol/2011) – Taxsutra.com

Note – The Kolkata Tribunal in this decision has dealt with several other issues. However, we have prepared flash news on the issue of taxability of retention money while computing MAT

## Tribunal's decision

- As far as the question with regard to excluding the retention money while computing the total income under the normal provisions of the Act is concerned, the sum in question is in the nature of retention money. Relying on the decision of the Calcutta High Court in the case of Simplex Concrete (Piles) India Pvt. Ltd.<sup>2</sup> it has been held that the retention money cannot be regarded as income of the taxpayer.
- The Calcutta High Court in the case of Simplex Concrete (Piles) India Pvt. Ltd. observed as follows:
  - Only after the taxpayer fulfilled the obligations under the contract, the retention money would be released, and the taxpayer would acquire the right to receive such retention money.
  - On the date when the bills were submitted, having regard to the nature of the contract, no enforceable liability accrued or arose and, accordingly, it could not be said that the taxpayer had any right to receive the entire amount on the completion of the work or on the submission of bills.
  - The taxpayer had no right to claim any part of the retention money till the verification of satisfactory execution of the contract. Therefore, the Tribunal was right in holding that the retention money in respect of the jobs completed by the taxpayer during the relevant previous year should not be taken into account in computing the profits of the taxpayer for the assessment year in question.
- The Kolkata Tribunal in the case of Binani Industries Ltd.<sup>3</sup> observed that where a receipt is not in the nature of income at all, it cannot be included in book profits though it is credited to the profit and loss account.
- The admitted factual and legal position in the present case is that retention money is not in the nature of income till such time the

contractual obligations are fully performed to the satisfaction of the customer by the taxpayer. Therefore, the retention money cannot be regarded as income even for the purpose of book profits under Section 115JB of the Act though credited in the profit and loss account, and have to be excluded for arriving at the book profits under Section 115JB of the Act.

## Our comments

Post globalisation, many companies have entered into various types of turnkey projects in India. Where payment terms differ from contract to contract, one common feature generally found in most of the contracts is that a certain portion of the contract amount is retained by the principal as retention money, which is to be finally paid after completion of the contract or in certain cases upon satisfactory performance of the work, or after lapse of warranty period. Thus, the retention money may be paid to the company several years after the completion of the contract. The issue for consideration is whether the retention money is to be treated as income on completion of the contract, or the same is to be treated as income only when the monies are actually received by the company.

In the case of Ilgnifluid Boilers (I) Ltd<sup>4</sup>. and East India Constructions & Ind Ltd<sup>5</sup>, the issue raised was whether the monies retained by the contractee is to be treated as income only when the money is actually received by the contractor, even though the contractor is following a mercantile system of accounting. The Madras High Court observed that the retention money accrues to the taxpayer only after satisfactory completion of the contract. On the date of the bills, no enforceable liability had accrued or arisen. When the taxpayer had no right to receive the same by virtue of the contract between the parties, and the taxpayer also had no right to enforce payment, it could not be said that the right to receive payments of the remaining 10 per cent of the value of job done accrue as soon as it was completed. The High Court also considered the decision of the Supreme Court in the case of Shoorji Vallabhdas<sup>6</sup> wherein it was held that income-tax is a levy on income. No doubt the Act takes into account two points of time at which the liability to tax was attracted, viz., the accrual of the income or its receipt; but the substance of the matter was the income.

<sup>2</sup> CIT v. Simplex Concrete (Piles) India Pvt. Ltd. [1989] 179 ITR 8 (Cal)

<sup>3</sup> DCIT v. Binani Industries Ltd. [2016] 178 TTJ 0658 (Kol)

<sup>4</sup> CIT v. Ilgnifluid Boilers (I) Ltd. [2006] 283 ITR 295 (Mad)

<sup>5</sup> CIT v. East India Constructions & Ind Ltd [2006] 283 ITR 297 (Mad)

<sup>6</sup> CIT v. Shoorji Vallabhdas [1962] 46 ITR 144 (SC)

The Kolkata Tribunal in the present case has held that the retention money cannot be regarded as income of the taxpayer for computing MAT since under the contract the retention money would be released only on fulfillment of the obligations and thereafter, the taxpayer would acquire the right to receive such retention money. It was observed that the retention money is not in the nature of income till such time the contractual obligations are fully performed to the satisfaction of the customer by the taxpayer.

It is pertinent to note that ICDS III dealing with Construction Contracts provides for recognition of retention money as a part of contract revenue. The Supreme Court in the case of *E. D. Sassoon & Co. Ltd.*<sup>7</sup> held that if the taxpayer acquires a right to receive the income, the income can be said to have been accrued to him though it may be received later, on its being ascertained. The basic conception is that the contractor must have acquired a right to receive the income. What is sought to be taxed must be contractor's income and that cannot be taxed unless it has arrived at a stage where it can be called 'income'. The Supreme Court in the case of *Shoorji Vallabhdas & Co.*<sup>8</sup> held that 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', which does not materialise.

It would be interesting to see how the applicability of ICDS III dealing with the treatment of retention money vis-à-vis the above-referred Supreme Court decisions would impact the taxpayer.



---

<sup>7</sup> *E. D. Sassoon & Co. Ltd.* [1954] 26 ITR 27 (SC)

<sup>8</sup> *CIT v. Shoorji Vallabhdas & Co.* [1962] 46 ITR 144 (SC)

**Ahmedabad**

Commerce House V, 9th Floor,  
902 & 903, Near Vodafone House,  
Corporate Road,  
Prahlad Nagar,  
Ahmedabad – 380 051  
Tel: +91 79 4040 2200  
Fax: +91 79 4040 2244

**Bengaluru**

Maruthi Info-Tech Centre  
11-12/1, Inner Ring Road  
Koramangala, Bangalore 560 071  
Tel: +91 80 3980 6000  
Fax: +91 80 3980 6999

**Chandigarh**

SCO 22-23 (1st Floor)  
Sector 8C, Madhya Marg  
Chandigarh 160 009  
Tel: +91 172 393 5777/781  
Fax: +91 172 393 5780

**Chennai**

No.10, Mahatma Gandhi Road  
Nungambakkam  
Chennai 600 034  
Tel: +91 44 3914 5000  
Fax: +91 44 3914 5999

**Delhi**

Building No.10, 8th Floor  
DLF Cyber City, Phase II  
Gurgaon, Haryana 122 002  
Tel: +91 124 307 4000  
Fax: +91 124 254 9101

**Hyderabad**

8-2-618/2  
Reliance Humsafar, 4th Floor  
Road No.11, Banjara Hills  
Hyderabad 500 034  
Tel: +91 40 3046 5000  
Fax: +91 40 3046 5299

**Kochi**

Syama Business Center  
3rd Floor, NH By Pass Road,  
Vytilla, Kochi – 682019  
Tel: +91 484 302 7000  
Fax: +91 484 302 7001

**Kolkata**

Unit No. 603 – 604,  
6th Floor, Tower – 1,  
Godrej Waterside,  
Sector – V, Salt Lake,  
Kolkata 700 091  
Tel: +91 33 44034000  
Fax: +91 33 44034199

**Mumbai**

Lodha Excelus, Apollo Mills  
N. M. Joshi Marg  
Mahalaxmi, Mumbai 400 011  
Tel: +91 22 3989 6000  
Fax: +91 22 3983 6000

**Noida**

6th Floor, Tower A  
Advant Navis Business Park  
Plot No. 07, Sector 142  
Noida Express Way  
Noida 201 305  
Tel: +91 0120 386 8000  
Fax: +91 0120 386 8999

**Pune**

703, Godrej Castlemaine  
Bund Garden  
Pune 411 001  
Tel: +91 20 3050 4000  
Fax: +91 20 3050 4010

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2017 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.