



BOM HC: A Definite Business Liability Incurred In Praesenti But Quantified And Discharged In Future Is Allowable U/S 37 (1) If It Can Be Reliably Estimated

Facts in brief:

ECA Infrastructure India Pvt Ltd. (the assessee) was a special purpose vehicle (SPV) engaged in the business of road construction on Build, Operate and Transfer (BOT) basis and of collection of Toll.

In the assessment for AY 2015-16, the AO passed an assessment order u/s 143(3) of the Act disallowing Rs. 7,47,00,000/- being provision towards liability incurred by it for major road repairs to be made in future, as per the contractual terms.

In the appeal thereagainst, the Assessee sought to justify the allowability of the said provision on time proportion basis by contending as follows-

A period of concession of 30 years was available to the Assessee, under the BOT contract entered into with the Government of Maharashtra to build road on BOT basis. The liability to undertake major repairs of road was definite and had accrued in the hands of the assessee as per the contractual terms.

The expenditure in building the road was amortized over the period of the concession i.e. thirty years, by following the CBDT Circular No.9 of 2014.

As per the terms of the said contract, the Assessee was required to carry out major repairs four times during the entire period of concession and the first of such repairs was to be carried out after expiry of seven years i.e. during the 8th year. As the said expenditure was to be a major expenditure and the liability of incurring such expenditure accrued over a period of seven years the Assessee had made provisions in the assessment year under consideration as well as for subsequent assessment years.

Reliance was placed by the assessee on the decision of the Tribunal Hyderabad Bench in the case of Mokama Munger Highway Limited Vs. DCIT (ITA No. 1729, 2145 and 2146 of 2018) and also on the decision of the Supreme Court in the case of Bharat Earth Movers Vs. CIT, 245 ITR 428 (SC) and in the case of Rotork Controls India Pvt. Ltd. Vs. CIT, 314 ITR 62 (SC).

As per the terms of the agreement, the Assessee was required to compensate the Government of Maharashtra equivalent to the expenses to be incurred on major repairs undertaken during period of concession, on periodic basis, in a situation where the Government of Maharashtra was to take over the project, before the expiry of the contracted period of thirty years. The liability towards major repairs of road was definite and incurred by the assessee.

The last major repair was required to be carried on in the 30th year of concession and therefore the said expenditure was required to be provided and claimed on time proportion basis rather than only on expiry of the 30th year of concession.

Considering the aforesaid principles of law and having due regard to the nature of the agreement as entered into by the Assessee with the Government of Maharashtra, the CIT(Appeals) held that the Assessee had a present obligation to incur an expenditure and if a reliable estimate could be made of the amount required to discharge the said obligation and, in that situation, provisions could be made and such provision was allowable as a deduction.

Revenue went in appeal before the Appellate Tribunal.



The Tribunal held that if a business liability had definitely arisen in the accounting year and where the liability was capable of being estimated, the deduction was to be allowed although, the liability may have to be quantified and discharged at a future date. The Honourable Tribunal dismissed Revenue's appeal.

The Revenue preferred appeal before the High Court at Bombay.

Ruling of the Honourable High Court at Bombay:

Honourable High Court held that, considering the nature of the contract viz. the Concession Agreement entered into by the Assessee and on the basis of terms and conditions of the contract, the Assessee was required to discharge its contractual liability in a deferred manner and for which, the assessee made appropriate estimation of maintenance expenses that would have to be incurred. Such a provision for repairs was made on realistic estimation and on scientific assessment and could not have been disallowed, considering particularly, the well settled position in law as laid down in the several decisions noted by the CIT (Appeals) and also accepted by the Tribunal.

Honourable High Court upheld the approach of the CITA and the Tribunal and dismissed the appeal of the Revenue.

Citation:

ECA Infrastructure India [TS-1291-HC-2026(BOM)]

Our comments:

Honourable High Court has duly reckoned and reiterated the settled principle of law viz. a definite business liability incurred by an assessee employing mercantile method of accounting is eligible for deduction u/s 37 (1) of the Income Tax Act even though the liability may be quantified and discharged in future.

Honourable High Court has inter alia reckoned the observations and decision of Honourable Supreme Court in Bharat Earth Movers (245 ITR 428) and Metal Box Company of India Ltd. (73 ITR 53) wherein Honourable Apex Court upheld the principle that "if a business liability has arisen in the accounting year, the deduction should be allowed even if such a liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one. "

Honourable High Court has also impliedly upheld the proposition that, if the facts so justify, an assessee can spread and claim the business expenditure over a period of ensuing years, as, allowing the entire expenditure only in the year of actual incurrence, including at the end of concession period of thirty years, would give a distorted picture of the profits for that year as well as the earlier years.