

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES 'G', NEW DELHI**

Before Ms. Sushma Chowla, Vice President

Dr. B. R. R. Kumar, Accountant Member

ITA No. 4615/Del/2016 : Asstt. Year : 2010-11

Veolia India Pvt. Ltd. (Earlier known as Veolia Water (India) Pvt. Ltd.), B-1, Marble Arch, 9, Prithviraj Road, New Delhi-110011	Vs	DCIT, Circle-26(1), New Delhi
(APPELLANT)		(RESPONDENT)
PAN No. AABCV7389R		

Assessee by : Sh. R. Raghunath, CA

Revenue by : Dr. Anjula Jain, Sr. DR

Date of Hearing: 30.01.2020

Date of Pronouncement: 27.04.2020

ORDER

Per Dr. B.R.R. Kumar, Accountant Member:

The present appeal has been filed by the assessee against the order of Id. CIT(A)-33, New Delhi dated 09.05.2016.

2. Following grounds have been raised by the assessee:

"1. That on the facts and circumstances of the case the impugned order of the Ld. Commissioner of Income Tax (Appeals) [hereafter referred to as "CIT(A)"] is bad in law and on facts.

2. That, on the facts and circumstances of the case the learned CIT(A) has erroneously sustained the action of the AO alleging short recognition of contract revenue under "Accounting Standard (AS) 7 - Construction Contracts" (hereafter referred to as "AS 7") by incorrectly treating the 'revised work order value' of Rs.27,70,60,188 for Project Demo Zone as the 'contract value' (including the consideration for operation and maintenance services and all the applicable taxes of Rs 4,15,26000) instead of the construction contract value of Rs.21,94,78,821.

2.1 That, the learned CIT(A) has erred in misapplication of AS 7 to an item of Income/ revenue amounting to Rs 4,15,26,000 not related to construction activity carried out during the post construction period viz. Revenue from Operation and Maintenance (O&M) services during the regular O&M phase which is required to be considered only during the period when O&M activity actually takes place.

2.2 That, the learned CIT(A) has erred in considering amounts aggregating to Rs.26,839,975 towards Value Added Tax and Service Tax included in the customer's work order as constituting part of construction contract value for the purposes of recognizing revenue under AS7.

3. That the appellant may be allowed to add, supplement, revise or amend grounds raised hereinabove in the interests of justice."

3. The assessee company is engaged in activities relating to water distribution, supply, maintenance, treatment / management and / or sewage treatment/sanitation/related civil construction activities. It earns revenue from the execution of construction contracts for water infrastructural facilities as well as by way of income from operation and maintenance (O&M) of such facilities.

4. During the year under consideration, the assessee was offered and implementing construction contract of the Project Demo Zone (PDZ) pertaining to rehabilitation and implementation of water supply in the pilot area of Dharampeth of Nagpur Municipal Corporation. The contract received by the assessee consists of three parts namely,

- Study Phase
- Rehabilitation Phase and
- O&M Phase

5. The issue to be adjudicated is whether the costs and expenses pertaining to O&M Phase are includable or not while calculating percentage completion method as per the provisions of AS 7 (accounting standard relating to construction contract).

6. The AO has held that the entire contract value has to be considered while calculating percentage of completion method on the grounds that it is a composite contract consisting of three different parts and hence, the third part cannot be considered separately. The Id. CIT (A) held that the O&M phase of the contract of Rs.4,15,00,000/- is to be considered for computation as per AS 7 instead of AS 9. Before us during the argument, the Id. AR argued based on the submissions filed in the form of paper book page nos. 1 to 108. The Id. DR relied on the orders of the Id. CIT (A).

7. Heard the arguments of both the parties and perused the material available on record.

8. The facts relevant to the adjudication are that, notwithstanding the revised work order, the sanctioned expenditure pertaining to O&M phase stood at Rs.4,15,26,000/- (page no. 48 & 50 PB). The key points of the contract issued by the Nagpur Municipal Corporation is as under:(page no. 52 & 53 PB)

"The Nagpur Municipal Corporation (NMC) as the owner of the water supply infrastructure assets of the city of Nagpur declares that the company Veolia Water (India) Private Limited (VW India) a subsidiary of Veolia Eau-Compagnie Generale Des Eaux, France and having its registered office at B-1, Marble Arch, 9, Prithviraj Road, New Delhi-110011 was awarded the contract ("Contract")

for "Implementation of uninterrupted water supply and reduction of UFW with improvement in level of service to the consumer in pilot area of Dharampeeth Zone at Nagpur, Maharashtra, India." Vide work order No. W/EE/01/2007/JN115 dated June 7, 2007. The contract commenced on July 5, 2007 and is currently on going. Performance of VW India has been satisfactory under this Contract.

A. Under this Contract following key issues have been implemented successfully:

1. Providing customers with un-interrupted water supply at stipulated pressure.
2. Reduction of Un-account for Water (UFW) by reducing leakages and unmeasured supply.
3. 100% metering with good quality meters having long life spans.
4. Improved and efficient billing and collection mechanism including meter reading, bills generation, distribution & collection.
5. Better services to urban poor (customers in slums) by implementation of slum policy; individual connections have been provided by replacing public stand posts.
6. Attending customer complaints within the stipulated time.
7. Implement good engineering practices to upgrade existing network.
8. Bring accountability on design, implementation, and O&M with single agency through performance based contract.
9. Improved water quality
10. All the Key Performance Indicators (KPIs) required in the Contract are achieved

B. Contract Cost: Rs.302.6 million

i. Technical Services:

- | | |
|--------------------------|-------------------|
| • Study Phase | Rs.24.36 million |
| • Rehabilitation Phase | Rs.24.90 million |
| • O&M Phase (5 years) | Rs.41.50 million |
| ii. Rehabilitation Cost: | Rs.211.80 million |

C. Contract structure and tasks performed:

1. Phase-I: Study – 9 Months (completed): Following works were carried out in this phase:

- Topographic survey*
- Customer surveys for 17,500 households*
- Pipeline condition survey*
- Network modeling of water supply network including existing pipes and proposed rehabilitation and replacements using water GEM with a network length of 205 KM*
- Preparation of Rehabilitation Plan for rehabilitation of water assets (pipes, valves, meters customer connections, billing and collection system etc.)*

2. Phase Rehabilitation – 18 Months (completed): Following works were carried out in this phase

- Replacement of House Service Connction: 16,125 connections Rehabilitation of water pipe line network of about 205 KM including laying of new pipelines of about 90 KM (HDPE pipe 71 Km and DI 19 Km)*
- Establishment of monitoring points for flow & pressure – 15 nos.*
- Establishment of monitoring points for water quality – 10 nos.*
- Progressive O&M of the refurbished water supply system where 24 points for water quality – 10 nos.*
- Progressive O&M of the refurbished water supply system where 24×7 water was being delivered*
- Developed an efficient customer billing and collection*
- Establishment of customer care centre for water supply at Customer Facility Centre*
- Meter reading, bill preparation, distribution and collection of water bills on behalf of NMC.*

3. Phase- III: Operation & Maintenance – 60 Months (on-going)

- O&M of water supply network to deliver 24×7 water supply to all cuotomers;
Jul 2011 onwards No. of 24×7 Connections 16125*
- Quarterly volumetric billing for domestic customers*
- Monthly volumetric billing for bulk water customer and major consumers*

- *Collection of payment related to water charges and deposit the same with NMC*
- *Attending customer complaints within stipulated time frame*
- *Submit a quarterly performance report on KPIs prescribed in the Contract*
- *New connections & disconnections.*
- *Detection of illegal connections."*

9. As per the terms mentioned in the letter dated 31.01.2012, the phase-I pertaining to the study phase of 9 months stands completed and phase-II pertaining to rehabilitation for a period of 18 months also stands completed. As per the letter of the NMC, Phase-III consisting of O&M is for a period of 60 months and is ongoing. The letter also mentions that the O&M works involve volumetric building of the consumers, collection of payments, monitoring of new connections, disconnections and illegal connections. This maintenance work is for a period of 5 years which is post the execution of work. The same can be deciphered from para 3, phase-III of the letter of the Executive Engineer, NMC.

10. In this background whether O&M phase falls under the part of the composite contract liable to be apportioned in the percentage of completion method is examined. The relevant excerpts of AS 7 are as under:

"1. Types of Contracts

A Construction Contract is any contract which is entered into specifically for construction of an asset or a combination of assets that are closely inter-linked or inter-dependent w.r.t. their technology/design/function or the nature of their ultimate purpose or use.

A. Fixed Price Contract

A contract in which the contractor agrees to a fixed contract price. In some cases, there may be an element

of cost escalation clause in the contract which is mutually agreed to between the parties.

For example, the parties agree to include a clause in the contract for adjusting the Contract price on the basis of an increase in the cost of raw materials.

B. Cost-plus Contract

A contract in which the contractor is reimbursed for costs incurred or agreed costs, plus a percentage of these costs of a fixed fee.

2. Combining and Segmenting of Construction Contracts

I. Combining of Construction contracts - A group of contracts, either with one or more customers, shall be considered as a single construction contract when all the contracts are negotiated as a single package, are inter-linked and form part of a single project and are performed in a continuous sequence. F

For example, a contract for construction of three similar buildings (similar in all aspects) on a single plot negotiated all at once.

II. Segmenting of Construction contracts - Where a contract includes more than one asset, the construction of each asset should be treated as a separate construction contract when separate proposals have been given for each asset, each asset has been separately negotiated and the costs and revenues of each asset can be identified separately.

For example, a contract for construction of three different buildings on the same plot with different specifications and each building is separately negotiated with the contractor.

3. Revenue from a Contract

The revenue from a contract includes the following to the extent it is probable of generating revenue and is measurable:

i. The initial amount of revenue agreed in the contract;

ii. Claims and incentives on account of variations in contract work;

4. Costs of a Contract

The cost of a contract includes the following:

- i. Directly related costs that to the specific contract*
- ii. Costs which are generally attributable and allocated to the contract activities*
- iii. Other costs which are specifically chargeable to the customer under the terms of the contract*

5. Recognition of Revenue and Cost from a Contract

Where the result or outcome of any contract for construction can be projected, the related contract revenue and contract costs shall be recognized by taking into account the stage of completion of such contract. Expected losses shall be recognized immediately as expenses.

I. In case of a fixed price contract, the outcome can be estimated in a reliable manner when all the following conditions are satisfied:

- i. The entire revenue from a contract can be reliably measured*
- ii. It is apparent that the economic benefits of such contract will flow to the organization*
- iii. Both contract costs and stage of completion can be measured*
- iv. Contract costs can be clearly identified for a comparison between actual costs and prior estimates*

II. In case of a cost-plus contract, the outcome can be estimated in a reliable manner when all the following conditions are satisfied:

- i. It is probable that economic benefits of the contract will flow to the organization*
- ii. Contract costs attributable to the contract can be identified and measured clearly*

III. Percentage of completion method – This method defines the recognition of revenue and cost taking into account the stage of completion of a contract. Under this

method, revenue and cost are recognized in the statement of profit and loss in the accounting periods in which the work is performed.

IV. Contract work-in-progress – A contractor may incur costs that relate to future activity in a contract. Such costs are recognized as an asset if it is probable that they will be recovered.

6. Determination of the stage of completion

The stage of completion of a contract may be determined in different ways. Depending on the nature of the contract, the methods may include:

I. The proportion of contract cost incurred w.r.t. the total estimated cost of contract; (for example: if the total cost of the contract is Rs. 30 lakhs and the cost incurred till date is Rs. 15 lakhs, the stage of completion is regarded as 50% complete i.e. 15 lakhs / 30 lakhs)

II. Surveys of work performed; (for example: in a contract for construction of a bridge, the site inspector can do a survey and with regards to the technicalities of the project, inform how much work has been completed)

III. Completion of a physical proportion of contract work (for example: in a contract for construction of a five storey building, if three stories are complete, the stage of completion for the same is regarded as 60% i.e. 3 stories/5 stories)

When the outcome of a construction contract cannot be estimated, the revenue and cost should be recognized only to the extent of contract costs incurred whose recovery is probable.”

11. Similarly, the relevant part of the AS- 9 with regarding rendering of services is as under:

"Applicability of AS 9 Revenue Recognition

This standard was issued by ICAI in the year 1985 and in the initial years, it was re-commendatory for only Level I enterprises and but was made mandatory for all other enterprises from April 01, 1993.

As per ICAI, "Enterprise means a company as defined in section 3 of the Companies Act, 1956".

Level I enterprises are those enterprises whose turnover for the immediately preceding accounting year exceeds 50 crores. The turnover here does not include other income and is applicable for holding as well as subsidiary companies.

Explanation

Revenue recognition emphasizes on the timing of recognition of revenue in the statement of profit and loss of an enterprise.

The amount of revenue arising from a transaction is usually determined by an agreement between the parties involved in the transaction.

When uncertainties arise regarding the determination of the amount or its associated costs, these uncertainties may influence the timing of the revenue.

A. Sale of Goods

One key element for determining the recognition of revenue of a transaction involving the sale of goods is that the seller has transferred the property in the goods to the buyer for a consideration. In most cases, the transfer of property in the goods results in the transfer of the significant risks and rewards in ownership of the goods.

However, there are situations where the transfer of significant risks doesn't coincide with the transfer of goods to the buyer, in such cases revenue has to be recognized at the time of transfer of significant risks and rewards to the buyer. Example: Goods sent to the consignee on approval basis.

There are certain cases in the specific industry where the performance may be substantially complete prior to the execution of the transaction generating revenue.

In such cases, when the sale is assured under government guarantee or a forward contract or where the market exists and there is a negligible risk of

failure to sell, the goods involved are often valued at the net realizable value (NRV).

Such amounts are not defined in the definition of the revenue but are still sometimes recognized in the statement of profit and loss. Example: Harvesting of Agricultural Crops or extraction of mineral ores.

B. Rendering of Services

Revenue recognition of services depends as the service is performed. This is further divided into two ways:

(a) Proportionate Completion Method: This method of accounting recognizes revenue in the statement of profit & loss proportionately with the degree of completion of each service.

Here the service completion consists of the execution of more than one act. Revenue is recognized with the completion of each such act.

(b) Completed Service Contract Method: This method of accounting recognizes revenue in the statement of profit & loss only when the rendering of services under a contract is completed or substantially completed."

12. Further, we have gone through the payments made by the NMC to the assessee. The payment pattern reveals that the assessee has raised separate invoices for O&M phase on a regular basis as per Section 5 of TOR Clause 8.3 and the same have been duly accounted in the years in which it has been received. Thus, on going through the entire facts of the case, we find that the three different phases of the work which are totally separate in execution. Keeping in view the fact, that the O&M phase cannot be a part of the construction activity as the O&M phase involves the supply of water to the residence giving connections and monitoring the connections which is clearly a post construction activity, we hold that the amount allotted for O&M phase cannot be included in determining the percentage

of completion method in recognition of the revenue. We also find that the amounts of O&M phase have been duly offered to tax in the year of receipts. We also find that the Phase-I and the Phase-II are the preparatory construction phases over a period of 18 months whereas the operations & maintenance (O&M phase) of such constructed project is of 60 months. Hence, the maintenance activities cannot be clubbed with the construction activity. Having gone through the accounting standards (AS-7 and AS-9), we find that application of the standard to separately identifiable components of single contract is allowable while determining the percentage completion of the project. Since, the O&M phase commences after the construction of activity of rehabilitation phase, we hereby hold that the amount pertaining to O&M phase needs to be separately considered while determining the profits out of the construction activities. The appeal of the assessee on ground nos. 2 & 2.1 is hereby allowed.

Consideration of VAT for recognizing the revenue under AS-7:

13. Brief facts of the issue are that the contract given by the NMC include total taxes of Rs.2,68,39,975, the breakup of which is as under:

(A) Service Tax

(A1)

• Study Phase	-	Rs.30,10,893/-
• Rehabilitation Phase	-	Rs.30,83,944/-
• O&M phase	-	<u>Rs.51,32,614/-</u>
Total		<u>Rs.1,12,27,451/-</u>

(A2) Rehabilitation Cost - Rs.65,66,588/-

(B) Value Added Tax

- Rehabilitation Phase – Rs.90,45,934/-

14. The AO has considered this amount for calculating the revenues of the year.

15. The CBDT Circular No. 4/2008 dated 04.04.2008 clarified that service tax doesn't partake the nature of income. The Circular was issued while dealing with Section 194-I. Since, the sum and substance of the circular is that the service tax doesn't form a part of the income of the assessee, the same need not be considered for calculating the profits of the assessee for the year. Similarly, the Value Added Tax which do not form the part of the income of the assessee also needs to be excluded while determining the revenues of the year in the instant case. As a result, appeal of the assessee on ground no. 2.2 is hereby allowed.

16. In the result, the appeal of the assessee is allowed.

Order Pronounced in the Open Court on 27/04/2020.

Sd/-

(Sushma Chowla)
VICE PRESIDENT

Dated: 27/04/2020

Subodh

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

Sd/-

(Dr. B.R.R. Kumar)
ACCOUNTANT MEMBER

ASSISTANT REGISTRAR