

IN THE INCOME TAX APPELLATE TRIBUNAL
“B” BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI JASON P. BOAZ, ACCOUNTANT MEMBER

ITA No.1068/Bang/2016
Assessment year : 2012-13

M/s. Optum Health & Technology (India) Pvt. Ltd., # 570 & 571, Eapen’s Timber, 2 nd Floor, Sarjapura Road, 3 rd Block, Koramangala, Bangalore – 560 034. PAN: AADCP 6027A	Vs.	The Income Tax Officer, Ward 5(1)(2), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Shashishekar Chaugule, CA
Respondent by	:	Shri R.N. Siddappaji, Addl.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	10.01.2019
Date of Pronouncement	:	08.02.2019

ORDER

Per N V Vasudevan, Vice President

This is an appeal by the assessee against the order dated 08.03.2016 of the CIT(Appeals)-V, Bengaluru relating to assessment year 2012-13.

2. The only issue that arises for consideration in this appeal by the assessee is as to whether the revenue authorities were justified in making an addition of Rs.1,50,84,240 to the total income of the assessee. The material facts which are relevant for adjudication in this appeal are that the

assessee is a company and is engaged in the business of rendering counselling and consultation services. The assessee at the request of various business or other organisations, renders services in the form counselling to employees of the clients' organization like psychological aspects of the employee, stress management etc. It is not in dispute that as per the sales ledger maintained by the assessee, the total value of sales for the relevant previous year i.e., the value of services for which the assessee had contracts with the clients was a sum of Rs.3,15,97,038. The AO, however, found that from and out of the total sales, the assessee had reduced a sum of Rs.1,50,84,240. When the assessee was asked to explain why the aforesaid sum was reduced from the sales figure, the assessee explained that the counselling done on the clients' employee by the assessee is for the purpose of maximizing the performance of employee of the assessee's client. Since it was intangible in nature, the assessee recognizes accrual of income only when the bills are raised on the clients for services rendered. This position was not accepted by the AO, as according to the AO, such reduction from the sale value was not permissible in law.

3. Before the CIT(Appeals), the assessee made detailed submissions with regard to the nature of the amount debited in the profit & loss account by accepting that the total sales credit is a sum of Rs. 31,597,038 and reversal in the sales ledger account was a sum of Rs. 15,084,240. The Assessee submitted that in doing as above it followed the Accounting Standard 9 ("AS-9") issued by the Institute of Chartered Accountants of India (ICAI). AS-9 of ICAI requires the assessee in service sector to recognise their revenue as and when the service is performed, either by proportionate completion method or by completed service contract method. The Assessee explained that in order to record revenue in an accounting period, it creates a journal entry to record them as accrued revenue.

Accrued revenue is a sale that has been recognized by the seller, but which has not yet been billed to the customer. This concept is used in businesses where revenue recognition would otherwise be unreasonably delayed. The concept of accrued revenue is required in order to properly match revenues with expenses. The absence of accrued revenue would tend to show excessively low initial revenue levels and low profits for a business, which does not properly indicate the true value of the organization. Also, recognizing accrued revenue tends to result in much lumpier revenue and profit recognition, since revenues would only be recorded at the longer intervals when the invoices are issued. The Assessee submitted that accrued revenue concept is quite common in the services industries, since billings may be delayed for several months, until the end of a project or on designated milestone billing dates.

4. Since submission made before CIT(A) was a fresh submission supported by reasons never presented before the learned AO, a remand report was called for from the AO. The learned AO in his remand however, outrightly rejected the Assessee's fresh submission stating it to be the same submission made before the learned AO at the time of scrutiny assessment which was never submitted before the learned AO.

5. The CIT(Appeals), however, was not convinced with the aforesaid contentions put forth by the assessee. He held that the assessee follows mercantile system of accounting and was therefore bound to recognize revenue on the basis of accrual. Once income has accrued to the assessee, the assessee cannot *suo motu* refuse to recognize revenue on the pretext that the assessee follows proportionate completion method as per AS 9 of ICAI and therefore the revenue can be recognized only when services are substantially rendered by the assessee and when the bills are raised. This, in substance, is the conclusion of the CIT(Appeals).

6. Aggrieved by the order of the CIT(Appeals), the assessee has preferred the present appeal before the Tribunal.

7. We have considered the rival submissions of the Id. counsel for the assessee, who reiterated the submissions as were made before the lower authorities. The Id. counsel also filed before us a statement showing the reconciliation of reversal of provisional entry against the actual invoice booking. The Id. DR relied on the order of CIT(Appeals). At the time of hearing, the Id. counsel for the assessee, without prejudice to his submissions made before the CIT(Appeals) which were reiterated before the Tribunal, submitted that in the event of Tribunal not accepting the stand taken by the assessee, then the income which was not recognized by the assessee in the present assessment year and which was postponed and recognized in the subsequent assessment year, will suffer double taxation. His submission was that in such an event, where the same income is taxed in this year and offered to tax in the subsequent assessment year, should not be taxed and to this effect, appropriate directions should be given.

8. We have given a careful consideration to the rival submissions. Before us, an Affidavit was also filed by one Mr. Amber Alam, Director of the Assessee explaining the way in which accounting entries were passed by the Assessee in its books of Accounts. It has been explained in the affidavit that in the books of accounts the Assessee records revenues for a particular agreement on accrual basis but such entry is only provisional. When actual invoice is raised as per the agreement with the customer (which may be monthly, quarterly or half-yearly) a second entry reversing the recognition of revenue on accrual basis is passed. Thereafter, a third entry is passed recognizing revenue based on actual invoice raised on the customers and this is the actual revenue recognised in the books of accounts. The first entry and the second entry of reversal of the first entry

are purely for Management reporting purposes. It has also been explained that the income reported for income tax purposes is also the value of services declared as per the return filed for levy of service tax.

9. It is clear from the submissions made before CIT(A) and also the affidavit of the Director that there was accrual of income as per the mercantile system of accounting when the first entry is passed. The second and third entry are explained as entries which are passed in tune with Accounting Standard-9 (AS-9) issued by Institute of Chartered Accountants of India (ICAI). AS-9 deals with accounting standards for recognition of income. The following paragraphs, viz., Paragraphs-4, 5, 7, and 9 to 12 of AS-9 would be relevant for the purpose of the present appeal:-

“Definitions

4. The following terms are used in this Statement with the meanings specified:

4.1 Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.

4.2 Completed service contract method is a method of accounting which recognises revenue in the statement of profit and loss only when the rendering of services under a contract is completed or substantially completed.

4.3 Proportionate completion method is a method of accounting which recognises revenue in the statement of profit

and loss proportionately with the degree of completion of services under a contract. Explanation

5. Revenue recognition is mainly concerned with the timing of recognition of revenue in the statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition

7. Rendering of Services

7.1 Revenue from service transactions is usually recognised as the service is performed, either by the proportionate completion method or by the completed service contract method.

- (i) Proportionate completion method—Performance consists of the execution of more than one act. Revenue is recognised proportionately by reference to the performance of each act. The revenue recognised under this method would be determined on the basis of contract value, associated costs, number of acts or other suitable basis. For practical purposes, when services are provided by an indeterminate number of acts over a specific period of time, revenue is recognised on a straight line basis over the specific period unless there is evidence that some other method better represents the pattern of performance.
- (ii) Completed service contract method—Performance consists of the execution of a single act. Alternatively, services are performed in more than a single act, and the services yet to be performed are so significant in relation to the transaction taken as a whole that performance cannot be deemed to have been completed until the execution of those acts. The completed service contract method is relevant to these patterns of performance and accordingly revenue is recognised when the sole or final act takes place and the service becomes chargeable.

9. Effect of Uncertainties on Revenue Recognition

9.1 Recognition of revenue requires that revenue is measurable and that at the time of sale or the rendering of the service it would not be unreasonable to expect ultimate collection.

9.2 Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g., for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.

9.3 When the uncertainty relating to collectability arises subsequent to the time of sale or the rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

9.4 An essential criterion for the recognition of revenue is that the consideration receivable for the sale of goods, the rendering of services or from the use by others of enterprise resources is reasonably determinable. When such consideration is not determinable within reasonable limits, the recognition of revenue is postponed.

9.5 When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised.

10. Revenue from sales or service transactions should be recognised when the requirements as to performance set out in paragraphs 11 and 12 are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

11. In a transaction involving the sale of goods, performance should be regarded as being achieved when the following

conditions have been 135 fulfilled: (i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and (ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

12. In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the service.”

10. The main plea of the Assessee is that in tune with paragraph-12 of AS-9, in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. In a mercantile system of accounting revenue is recognised on accrual basis when the agreement to render service is entered into with the party for the whole value of services. Accomplishment of work is irrelevant under the mercantile system of accounting. When due to cancellation or modification of agreement to render takes place then and only then a reversal of entries under the mercantile system of accounting is possible. In the case of the Assessee no such modification of the agreement to render service with the clients exists. The Assessee on his own recognises revenue only when bills are raised on the customer. Doing so might be well in tune with AS-9 which is more concerned with the true and fair view of the state of affairs of the business of the Assessee, but that would not be in tune with the mercantile system of accounting as understood u/s.145 of the Act.

11. The relevant statutory provisions regarding method of accounting under the Act, have to be first seen. Sec.145 of the Act (prior to its amendment by the Finance Act, 2014 w.e.f. 1.4.2015 applicable in the present case) deals with **Method of accounting** and it reads thus:

“Sec.145: Method of Accounting: (1) Income chargeable under the head “Profits and gains of business or profession” or “Income from other sources” shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(2) The Central Government may notify in the Official Gazette from time to time Accounting *standards* to be followed by any class of assesseees or in respect of any class of income.

(3) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) or Accounting Standards as notified under sub-section (2) have not been regularly followed by the Assessee, the Assessing Officer may make an assessment in the manner provided in section 144.

12. Vide Notification No. 9949, dated 25-1-1996 [(1996) 130 CTR (St) 33], Accounting Standard I relating to disclosure of accounting policies and Accounting Standard II relating to disclosure of prior period and extraordinary items and changes in accounting policies had alone been notified as Accounting Standards to be followed by an Assessee and no other accounting standard has been notified.

13. AS-9 has not been notified u/s.145 of the Act and hence does not have statutory force. The Assessee follows mercantile system of Accounting. AS-9 cannot be said to be either Cash system or Mercantile system of accounting. AS-9 has trappings of both cash system or mercantile system but cannot be said to fall strictly within the parameters of either cash system of mercantile system of accounting. The Assessee

follows mercantile system of accounting and therefore under the Act, the AO is empowered and bound to compute income in accordance with the mercantile system of accounting. There is no dispute that under mercantile system of accounting debit of value of services to the tune of Rs.1,50,84,240 was not because of non-accrual of income but only because bills were not raised on the customers for value of services which had already accrued. The fact that bills were not raised does not stop accrual of income under the mercantile system of accounting. Therefore the claim of the Assessee which is purely based on AS-9 is not sustainable and the action of the revenue authorities in making the impugned addition was justified. We however wish to make it clear that the aforesaid observations will hold good only for AY upto AY 2012-13 because Sec.145 of the Act has undergone some statutory amendments and the position after such amendment is not and cannot be subject of decision in this appeal. The fact that value of services recognised for the purpose of levy of service tax is not relevant in the context of computation of total income for the purpose of levy of income tax under the Act. The concept of value of service for the purpose of levy of service tax and total income for the purpose of levy of income tax are different and are determined on relevant statutory provisions applicable.

14. We however wish to make it clear that the income recognition of which was postponed by the Assessee by following AS-9 cannot be regarded as income in the year in which it is offered to tax by the Assessee, because the law is well settled that same income cannot be taxed twice. The burden will however be on the Assessee to show as to how the income offered in a later assessment year was income which was not recognised in earlier Assessment year by reason of application of AS-9. Subject to these observations, we find no merit in this appeal by the Assessee and dismiss the same.

15. In the result, appeal by the Assessee is dismissed.

Pronounced in the open court on this 8th day of February, 2019.

Sd/-

(JASON P. BOAZ)
Accountant Member

Sd/-

(N.V. VASUDEVAN)
VICE PRESIDENT

Bangalore,
Dated, the 8th February, 2019.

/ Desai Smurthy /

Copy to:

1. The Appellant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar,
ITAT, Bangalore.