

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES : E : NEW DELHI

BEFORE SHRI J. SUDHAKAR REDDY, ACCOUNTANT MEMBER
AND
MS SUCHITRA KAMBLE, JUDICIAL MEMBER

ITA Nos.5455 to 5457/Del/2010
Assessment Years : 2003-04 to 2005-06

Meerut Development Authority,
CA Anupam Sharma,
16, Hans Plaza,
Opp. Amarpali Cinema,
Garh Road,
New Delhi.
PAN: AAALM0124D

Vs. Addl.CIT,
Range-1,
Meerut.

(Appellant)

(Respondent)

Assessee By : Shri Kapil Goel, Advocate
Department By : Shri S.K. Jain, Sr. DR

Date of Hearing : 24.08.2016
Date of Pronouncement : 29.09.2016

ORDER

PER J. SUDHAKAR REDDY, AM:

All these appeals are filed by the assessee for the assessment years
2003-04, 2004-05 and 2005-06 are directed against the orders of the

CIT(A) dated 31.8.2010. As the issues arising in all these appeals are common, for the sake of convenience, they were heard together and are disposed of by way of this common order.

2. The assessee is an urban development authority formed by an Act passed by the Uttar Pradesh Legislature Assembly and is engaged in urban development of Meerut and for providing low cost housing to general public. Two grounds for all the assessment years are identical. For the assessment year 2004-05 one other ground has been taken by the assessee, which relates to *ad hoc* disallowance of 56% of expenses. The two common grounds that arise in all the three appeals are: (a) disallowance of interest pertaining to closing stock; and (b) treatment of grants received from the Government of Uttar Pradesh as revenue by the AO.

3. We have heard Shri Kapil Goel, Id. counsel for the assessee and Shri S.K. Jain, Id.Sr. DR. The assessee has filed a paper book running into 29 pages. He also filed copies of various decisions and argued his

case at length. The Id. DR made submissions on behalf of the Revenue and mainly relied on the order of the Id.CIT(A). The Id. DR also filed written submissions.

4. We have considered rival submissions. The first issue that arises for our consideration is whether the interest paid on loans taken should be capitalized and added to the value of the closing stock of the assessee or not. The AO held that the interest on loans taken for development of schemes, from HUDCO, NCR, State Government, etc. (as per column No.6 of Schedule 1 of annual accounts) amounting to Rs.4,04,05,345.84, has to be included in the valuation of closing stock as on 31.3.2003. The assessee had disclosed this interest expenditure as development expenditure. The first appellate authority held that the expenditure in question was relatable to the stock held by the assessee. He further held that the assessee has not demonstrated that the interest claimed as revenue expenditure was allowable and not to be capitalized as cost of stock. He gave a finding that the AO has not interfered with the method

of valuation of stock, but, has only added the interest cost to the value of stock.

5. Before us, the ld. counsel for the assessee submitted that the AO has disturbed the method of valuation of stock followed by the assessee year after year. He submitted that the AO has only interfered with the valuation of the closing stock, but, has not disturbed the valuation of opening stock and hence, such action is bad in law. He relied on the decision of the Hon'ble Bombay High Court in the case of *Lokhandwala Construction*, 131 Taxman 810, the decision of the 'B' Bench of the ITAT Delhi in ITA No.2677/Del/2011 for assessment year 2006-07 in the case of *DLF Ltd.*, Order dated 11th March, 2016, as well as the decision of the ITAT Kolkata 'B' Bench, in ITA No.1101/Kol/2012, Order dated 19th February, 2014 in the case of *Cellica Developers Pvt. Ltd.*, and submitted that in all these cases, under similar circumstances, the expenditure incurred on loans borrowed, were allowed as revenue expenditure and was not capitalized to the value of closing stock.

6. The Id. DR, on the other hand, opposed the contentions of the assessee and submitted that the issue for adjudication is not whether the amount in question is allowable u/s 36(1)(iii) or not and that the only issue is whether the interest incurred on loans taken was to be considered for the purpose of valuation of closing stock or not. He submitted that the expenditure is relatable to the closing stock and hence, both the AO as well as the CIT(A) has correctly decided the issue. He argued that the onus is on the assessee to prove that the Market value of the stock was less than the cost so arrived by the AO. He drew the attention of the Bench to page 2 of the AO's order and submitted that value of opening stock cannot be interfered with. He distinguished the case law relied upon by the assessee.

7. After hearing the rival submissions, we are of the considered opinion that the AO was wrong in changing the method of valuation of closing stock. This method is being followed by the assessee, year after year and has been accepted by the Revenue. Loading of interest cost to closing stock is definitely changing the method of valuation of stock.

Interest expenditure incurred on loans used for acquiring current assets, which includes closing stock, is allowable u/s 36(1)(iii). The Hon'ble Bombay High Court in the case of Lokhandwala Constructions, 260 ITR 579 (Bom), has held as follows:-

“4. From the facts found by the Tribunal on record, it is clear that assessee undertook two-fold activities. It bought and sold flats. Secondly, the assessee was also engaged in the business of construction of buildings. The profits from the both the activities were assessed under Section 28 of the Income-tax Act. In this case, we are concerned with the second activity (hereinafter referred to, for the sake of brevity, as "Kandivali Project"). According to the Commissioner, loan was raised for securing land/development rights from the Mandal. That, the loan was utilised for purchasing the development rights, which, according to the Commissioner, constituted a capital asset. According to the Commissioner, since the loan was raised for securing capital asset, the interest incurred thereon constituted part of capital expenditure. This finding of the Commissioner was erroneous. In the case of India Cements Ltd. v. CIT, Madras, reported in 60 ITR Page 52, it was held by the Supreme Court that in cases where the act of borrowing was incidental to carrying on of business, the loan obtained was not an asset. That, for the purposes of deciding the claim of deduction under Section 10(2)(iii) of the Income-tax Act 1922 [section 36(1)(iii) of the present Income-tax Act], it was irrelevant to consider the purpose for which the loan was obtained. In the present case, the assessee was a builder. In the present case, the assessee had undertaken the Project of construction of flats under the Kandivali Project. Therefore, the loan was for obtaining stock-in-trade. That, the Kandivali Project constituted the stock-in-trade of the assessee. That, the Project did not constitute a fixed asset of the assessee. In this case, we are concerned with deduction under Section 36(1)(iii). Since the assessee had received loan for obtaining stock-in-trade (Kandivali Project), the

assessee was entitled to deduction under Section 36(1)(iii) of the Act. That, while adjudicating the claim for deduction under Section 36(1)(iii) of the Act, the nature of the expense - whether the expense was on capital account or revenue account -was irrelevant as the Section itself says that interest paid by the assessee on the capital borrowed by the assessee was an item of deduction. That, the utilization of the capital was irrelevant for the purposes of adjudicating the claim for deduction under Section 36(1)(iii) of the Act (See judgment of the Bombay High Court in the case of Calico Dyeing and Printing Works v. CIT, Bombay City-II, reported in 34 ITR 265). In that judgment, it has been laid down that where an assessee claims deduction of interest paid on capital borrowed, all that the assessee had to show was that the capital which was borrowed was used for business purpose in the relevant year of account and it did not matter whether the capital was borrowed in order to acquire a revenue asset or a capital asset. The said judgment of the Bombay High Court applies to the facts of this case. (*emphasis ours*)

8. This decision was followed by the Delhi Benches of the Tribunal in the case of *DLF Ltd.* (supra) and by the Kolkata Bench of the Tribunal in the case of *Cellica Developers Pvt. Ltd.* (supra). No contrary decision has been brought to our notice by the ld. DR. The AO chose only to disturb the valuation of closing stock, but, has not applied the same yardstick to the valuation of opening stock of the assessee.

9. For all these reasons and respectfully following the propositions laid down by the Hon'ble Bombay High Court in the case of

Lokhandwala Constructions to the facts of this case, we direct the AO to exclude the interest incurred on loans from the valuation of closing stock and allow the same as deduction u/s 36(1)(iii) of the Act.

10. In the result, this ground of the assessee for all the three years are allowed.

11. The second common ground for all the three assessment years is whether the amount of grants received from Government of Uttar Pradesh is to be treated as revenue in nature. The amounts were received from the Housing Department of Government of UP vide DO No.152/9-A-1998 dated 15.1.1998. The Id.CIT(A) held that, on going through the facts and Notifications of UP Government relied upon by the assessee, he was of the considered view that the 90% of incomes were not collected on behalf of any other body or person and the sums have been directed to be incurred on development of infrastructure by the assessee. He records that the impugned sums have been directed to

be earmarked and spent on specific items only and not as per the free will of the assessee. The CIT (A) upheld the finding of the AO.

12. The Id. counsel for the assessee relied on the decision of the jurisdictional High Court, Lucknow Bench in the case of CIT, Lucknow vs. Lucknow Development Authority and other cases, 219 Taxman 162 and submitted that this very Notification of the Government of UP was considered and the Hon'ble High Court held that the sums received from the Government of UP in pursuance of this Notification cannot be treated as belonging to the authority and that the receipt is not taxable in nature. He also relied on the decisions of the co-ordinate Bench 'G' of the Tribunal in ITA No.131 and 132/Del/2009 for the AY 2003-04 and 2005-06 in the case of Saharanpur Development Authority vs. ACIT, Order dated 8th April, 2010, wherein the fund received has been held as not taxable as income of the assessee. The Id. DR relied upon the order of the AO as well as the CIT(A) and submitted that the amounts have been received by the assessee from the Government of UP for incurring of certain expenditure to develop infrastructure, and, merely because

certain restrictions have been placed on the application and utilization of the income, it cannot be said that the receipt in question is not income. He distinguished the case law relied upon by the assessee.

13. After hearing rival contentions, we find that the jurisdictional High Court in the case of Lucknow Development Authority, Gomti Nagar, Lucknow (supra), has observed as follows:-

“From the record, it also appears that the ‘authority’ had been maintaining infrastructure, development and reserve fund (IDAR) as per the Notification dated 15.1.1998. The money transferred to this fund is to be utilized for the purpose of the object as specified by the committee having constituted by the Government under the said Notification and the same could not be treated to be belonging to the ‘authority’ or the receipt is taxable in its hands.”

14. The Hon’ble High Court was considering the same DO No.15/9-A-1998 dated 15.1.1998. This judgment is binding on us.

15. Delhi Bench ‘G’ of the Tribunal in the case of Saharanpur Development Authority in ITA No.566/Del/2010, Order dated 5th April, 2010, held as follows:-

“4. Upon assessee’s appeal the Id.CIT(A) noted the assessee submissions that on identical issue in the AY 2004-05 the ITAT in order no.ITA 02/Del/2008 vide order dt. 23.12.2008 had deleted the

addition. The Tribunal in that case has referred to the decision of Hon'ble Delhi High Court in case of CIT vs. Delhi Industrial Development Fund and also ITAT decision in the case of Karnataka Urban Infrastructure Development and Finance Corporation. The Tribunal also noted that the said decision of the ITAT was upheld by the Hon'ble High Court also in the judgement reported in 284 ITR 582. Thereafter the Tribunal held "that the case law relied upon the assessee are squarely applicable on the facts of the present case. The assessee had received the funds under the orders of the Govt. of Uttar Pradesh and it was required to use such funds as per the direction of high power committee. It has no control over the funds. More so AO has not brought to tax the principle amount as income of the assessee. If his logic is accepted then all the fees etc. over and above the expenditure ought to have been examined as income of the assessee....." Finding the facts of the case identical the Id.CIT(A) deleted the addition following the ratio from the ITAT order for AY 2004-05."

16. Consistent with the view taken therein and respectfully following the proposition of law laid down by the jurisdictional High Court, we hold that the amounts received by the assessee from Government of UP cannot be taxed as income of the assessee. The AO is directed to exclude the same from the taxable income of the assessee.

17. In the result, this ground of the assessee is allowed.

18. As stated, for the AY 2004-05, one additional issue arises. The AO in this year had disallowed on ad hoc basis 56% of the development

expenses. After hearing rival contentions, we find that the AO has not given any reason whatsoever in his order as to why he has disallowed 56% of the development expenditure. When the matter was taken up before the first appellate authority, the same was dismissed without addressing the contention of the assessee that no reason whatsoever was mentioned in the assessment order for making this disallowance. As the AO has failed to give any reason whatsoever, for disallowing 56% of the development expenses, and as the Id.CIT(A) failed to address this issue, the disallowance in question is hereby deleted and this ground of the assessee is allowed.

19. In the result, the appeals of the assessee for all the three years are allowed.

The order pronounced in the open court on 29.09.2016.

Sd/-

[SUCHITRA KAMBLE]
JUDICIAL MEMBER

Sd/-

[J. SUDHAKAR REDDY]
ACCOUNTANT MEMBER

Dated, 29th September, 2016.

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Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT (A)
5. DR, ITAT

AR, ITAT, NEW DELHI.