

आयकर अपीलीय अधिकरण, जयपुर न्यायपीठ, जयपुर  
IN THE INCOME TAX APPELLATE TRIBUNAL, JAIPUR BENCHE 'A' JAIPUR

श्री विजय पाल राव, न्यायिक सदस्य एवं श्री विक्रम सिंह यादव, लेखा सदस्य के समक्ष  
BEFORE: SHRI VIJAY PAL RAO, JM & SHRI VIKRAM SINGH YADAV, AM

आयकर अपील सं./ITA No. 988/JP/2018  
निर्धारण वर्ष/Assessment Year :2014-15

ITO, Ward- 2(2), Jaipur	बनाम Vs.	Shri Khatu Shyam Builders, 298, Ajmer Road, Opp. Hathroi School, Jaipur
स्थायी लेखा सं./जीआईआर सं./PAN/GIR No.: ABZFS6260Q		
अपीलार्थी/ Appellant		प्रत्यर्थी/ Respondent

राजस्व की ओर से/ Revenue by : Shri A. K. Mahala (JCIT)  
निर्धारिती की ओर से/ Assessee by : Shri Rohan Sogani &  
Shri Rajeev Sogani (CA)

सुनवाई की तारीख/ Date of Hearing : 07/03/2019  
उदघोषणा की तारीख/Date of Pronouncement: 16/04/2019

आदेश/ ORDER

PER: VIKRAM SINGH YADAV, A.M.

This is an appeal filed by the Revenue against the order of Id. CIT(A)-1, Jaipur dated 11.06.2018 for AY 2014-15 wherein the Revenue has taken the following grounds of appeal as under:-

- 1. Whether in the facts and in the circumstances of the case and in law, the Id. CIT(A) was justified in allowing the entire expenses claimed by the assessee ignoring the fact that the assessee has not incurred the expenses for the business purposes and hence the same are not allowable as per provisions of Income Tax Act ?*
- 2. Whether in the facts and in the circumstances of the case and in law, the Id. CIT(A) was justified in directing the AO to treat 'income from other sources' as business income and to allow set-off of expenses despite the fact that AO in his order*

*cited the case of Tuticorin Alkali Chemicals & Others vs CIT decided by Hon'ble Apex Court wherein it was held "Interest and finance charges alongwith other preproduction expenses will have to be capitalized and the interest income have to be taxed as income from other sources?"*

2. Briefly stated the facts of the case are that the assessee is engaged in the business of construction and development of Group housing projects. It filed its return of income on 15.11.2014 declaring business loss of Rs. 1,24,16,176/-. During the course of assessment proceedings, the Assessing Officer, after review of the assessee's profit and loss account, observed that the assessee is doing the work of construction and development, no sales have commenced till the end of financial year under consideration, however, the assessee has debited huge interest and other expenses in its profit & loss account and has declared and claimed current year loss of Rs. 1,24,16,176/-. The assessee company was asked to show-cause as to why the expenses claimed in profit & loss account may not be disallowed and capitalized, as the sale of project has not started. In response, the assessee submitted that it follows percentage project completion method for revenue recognition. The assessee had secured development rights in respect of plot of land and the loan was utilized for purchasing the land which constituted stock in trade in its hand as the assessee had undertaken the project of construction of flats and accordingly the interest incurred thereon constituted part of revenue expenditure. As per section 36(1)(iii), the interest paid by assessee on the capital borrowed by the assessee is an item of deduction and utilization of the capital was irrelevant for the purpose of adjudicating the claim for

deduction under section 36(1)(iii) of the I.T. Act where an assessee claims deduction of interest paid on capital borrowed for the purpose of the business. It was further submitted that other indirect expenses are not directly related to site and construction of building. These are related to general office expenses, administration expenses and related day-to-day working of business activities and the same have accordingly be debited in the profit & loss account as the same cannot be capitalized as part of stock of work in progress. The reply so filed by the assessee was considered, however, not found acceptable to the Assessing Officer. As per the Assessing Officer, the reply of the assessee that the expenses debited in the profit & loss account are not related to the site expenses is not correct as is clear from the schedule-15 of profit and loss account wherein the assessee has debited various sites expenses. It was further held by the AO that only those expenses are allowable which are incurred for business purpose or to earn the income. During the year, no income has accrued, therefore, no expenses are allowable. In support, reliance was placed on the Hon'ble Supreme Court decision in case of Tuticorin Alkali Chemicals vs. CIT wherein it was held that interest and finance charges alongwith other preproduction expenses will have to be capitalized. Further, in respect of interest income, the same was brought to tax as income from other sources and no set off against business loss was allowed. Thus, in view of decision of Hon'ble Apex Court, the expenses debited were capitalized and the loss claimed was disallowed and the interest receipt was brought to tax under head "income from other sources".

3. Being aggrieved, the assessee carried the matter in appeal before Id. CIT(A). It was submitted that the assessee firm, in the

relevant previous year and in the immediately preceding year, had purchased land in Jagatpura for the purpose of carrying out two real estate projects, the work on which started immediately. Such land formed part of the stock in trade of the assessee firm. It was further submitted that the assessee follows percentage of completion method in accordance with the guidance note on recognition of Revenue on Real Estate Transactions, issued by the Institute of Chartered Accountants of India for purpose of Revenue recognition. As per the guidance note, the Revenue should be recognized only when the stage of completion of the project reaches a reasonable level of development and reasonable level of development is not achieved if the expenditure incurred on construction and development costs, during the relevant previous year, is less than 25% of the total estimated construction and development cost for the entire project. During the year, given that the assessee company has incurred approximately 10% of the total estimated project cost, it has not recognized revenues. However, in the subsequent years, where the assessee company has incurred total expenditure on construction and development costs which was more than 25% of the total estimated construction and development costs on the project, revenues have been recognized in such financial years. It was further submitted that for computation of Revenue, the stage of completion was arrived at with reference to the entire Project Costs incurred including land costs, borrowing costs and construction and Development Costs. Thus, percentage of completion was applied on the Sale consideration of the flats sold, and such proportion was used to recognize revenue. The revenue already recognized till the previous reporting period, if any, was deducted and the balance was recognized as Revenue during the financial year under consideration. Further, the

matching proportionate costs, to be recognized in the Profit and Loss A/c, has been computed by multiplying the cost incurred, as on the reporting date, with proportion of area sold, as on such date, and total saleable area of the project which determined the cost which was recognized as on the reporting date, and costs, if any, already recognized were subtracted which gave the cost to be recognized in each of the financial year. The balance costs being left unrecognized was shown as WIP in the Balance Sheet. In view of the above, it was submitted that the assessee company has been consistently applying percentage of completion method for recognizing Revenue in accordance with the Guidance Note issued by ICAI.

4. It was further submitted that the interest expenses have been incurred by the assessee on the loan take for the purpose of purchasing the land which forms part of stock in trade of the assessee and the interest expenditure on such loan is to be allowed in the year in which they are incurred. In support, reliance was placed on the Co-ordinate Bench decision in case of Aditya Propcon (P) Ltd. (*ITA No. 762/JP/2012 vide order dated 30.01.2014*) which has subsequently been upheld by the Hon'ble Jurisdictional High Court in its order dated 10.10.2017. Further reliance was placed on the Kolkata High Court decision in case of Cellice Developers (P.) Ltd. [2015] 57 taxmann.com 119 (Calcutta). It was further submitted that the decision of Hon'ble Supreme Court in case of Tuticorin Alkali Chemicals & Fertilizers Ltd. so relied upon by the AO is distinguishable as the issue involved therein was in context of taxability of interest earned during the construction period on short term investment of funds. Accepting the aforesaid contentions, the Id CIT(A) has allowed the relief to the assessee and now the Revenue is in appeal before us.

5. We now refer to the relevant findings of the Id CIT(A) which are under challenge before us and the same are contained at para 3.1.2 of his order which are reproduced as under:-

*"3.1.2 Determination:*

*(i) I have duly considered the submissions of the appellant, assessment order and the material placed on record. The brief facts of the case are that the appellant firm was engaged in the business of developer and builder. In its profit and loss account for the year under consideration, it has not declared any sales but has debited various expenses totaling to Rs. 1,24,41,230/- and has claimed net loss of Rs. 1,24,16,176/-. In the assessment order, the AO has disallowed the entire expenses of Rs. 1,24,41,230/- by observing that since there was no income during the year under consideration, therefore, no expenses are allowable. It would be appropriate to summarize the expenses claimed by the appellant in its profit and loss account as under:-*

<i>Head of expenses</i>	<i>Amount (in Rs.)</i>
<i>Finance cost</i>	<i>225</i>
<i>Depreciation</i>	<i>1,95,731</i>
<i>Other expenses</i>	<i>77,39,725</i>
<i>Interest paid to partners</i>	<i>45,06,249</i>
<i>Total</i>	<i>1,24,41,930</i>

*(ii) It is an undisputed fact that there was no sale in the preceding year and the year under consideration. However, it is noted from the financial statements of the appellant that during the year under consideration, the appellant has purchased group housing plot and also purchased construction material involving huge amounts. Further, it*

*could be seen from details of other expenses that the major heads are relating to the advertising expenses, interest paid to parties, salary-site expenses etc. It is also noted that during the year under consideration, the appellant has received a sum of Rs. 2,07,81,618/- as advance from parties. Therefore, in view of these facts, in the absence of sales during the year under consideration, it cannot be said that there were no business activities. It is also noted that the interest expenses have been incurred by the appellant on the loan taken for the purpose of purchasing land which forms stock in trade of the appellant and the interest expenditure on such loan is to be allowed in the year in which it is incurred. The AO has placed reliance on the judgment of Hon'ble Apex Court in the case of Tuticorin Alkali Chemicals and Fertilizers Ltd. for making the disallowance under consideration but it is observed that the facts of the said case are entirely different from the facts of the instant case under consideration and hence, not applicable to the instant case under consideration.*

*(iii) It is also noted that in Notes to Financial Statements, it has been stated that since the firm deals with constructions contracts, 'Accounting Standard -7 (AS 7 – Construction Contracts)' was followed in preparation of financial statements. During the appellate proceedings, it was submitted by the appellant that the revenue is recognized on percentage of completion method in accordance with the Guidance Note on Recognition of Revenue by Real Estate Transaction issued by the Institute of Chartered Accountant of India and since, the expenditure during the year under consideration on construction and development cost was approximately 10% of the total estimated project cost, therefore, no revenue was recognized during the year under consideration. However, in the subsequent years i.e. AY 2015-16*

*and 2016-17, it has recognized revenue from operations to the tune of Rs. 6.71 Crore and 6.06 Crore respectively.*

*(iv) Therefore, in view of the above discussion and looking to the totality of facts and circumstances of the case, especially to the fact that the appellant is following percentage of completion method, I do not find any justification for the AO to disallow the total expenditure claimed by the appellant in its profit and loss account and thus, the AO is hereby directed to allow the same. Hence, this ground of appeal is hereby allowed."*

6. Both the parties were heard at length during the course of hearing and relevant material available on record have been examined.

7. We agree with the findings of the Id CIT(A) that mere absence of sales during the year cannot be a basis to hold that the business of the assessee has not commenced and consequently, the expenses claimed will be disallowed. In the instant case, the assessee has purchased the plot of land, hired manpower and has incurred expenditure on construction and other activities, and has also received advances from its customers. Therefore, mere absence of sale cannot be a basis to deny the claim of the expenses. At the same time, given that the assessee is in the business of development and construction of group housing project, it follows the percentage method of completion for the purposes of recognition of revenues and corresponding costs. Therefore, the taxability of revenues and the allowability of expenses have to be seen in due recognition of such method of accounting. The assessee has not recognized the revenues during the year as it has not achieved the prescribed threshold of 25% of total projected construction and development cost at the close of the financial year.

Accordingly, the revenues have been shown as advances during the year. Similarly, the construction and development cost have been shown as work-in-progress and not been debited in the profit/loss account. What has been debited in the profit/loss account is finance cost, depreciation, interest paid to partners and other expenses, and which have also been claimed for tax purposes as business loss and which is now being disputed by the Revenue. To our mind, once a particular method of revenue recognition and method of accounting has been followed by the assessee, there has to be consistency in such approach. The assessee cannot plead that for all its revenue recognition and cost allowability, it is following the prescribed method of accounting and for the purposes of claim of interest expenditure, it will deviate from the prescribed method of accounting and claim allowance under section 36(1)(iii) of the Act. No doubt section 36(1)(iii) provides for allowability of interest expenditure incurred for the purposes of business and there cannot be any denial of the said position, however, in the facts of the present case, where the assessee is accumulating all its construction and development costs as part of work-in-progress as well as accumulating the advances received from the customers, will it be correct to allow the interest cost on purchase of land as so claimed by the assessee in the year of incurrence or a better and consistent approach would be to accumulate such cost as any other development and construction cost, being intrinsic part of project cost, as work-in-progress and then allow the same as and when the assessee achieve the desired project completion threshold and starts recognition of revenues and corresponding costs.

8. As per guidance note on accounting for real estate transactions, project cost in relation to a project ordinarily comprise of borrowing

cost which are incurred directly in relation to a project or which are apportioned to a project in accordance with AS-16 on Borrowing costs. As per AS-16, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of cost of that asset and other borrowing costs are recognized as an expense in the period in which they are incurred. A qualifying asset has been defined as an asset that necessarily takes a substantial period of time to get ready for its intended use or sale which includes manufacturing plants, power generating facilities, inventories that require a substantial period of time to bring them to a saleable condition. In the instant case, interest cost has been incurred in relation to purchase of land which is stock-in-trade of the assessee and thus qualify as an qualifying asset. Given that the development of such plot of land as a housing project to make it saleable where finished residential units will be sold to customers will take its own time and is not an instantaneous activity, any interest cost incurred in relation to and for purchase of such plot of land will be required to be accumulated as part of the project costs and cannot be claimed in the year of incurrence. In our view, the provisions of section 36(1)(iii) have to be read in context of facts and circumstances of each case and in the instant case, where the assessee is in the business of development and construction of group housing project, the interest cost though allowable have to be accumulated as per the method of accounting followed by the assessee wherein it is accumulating all the project costs and the same is claimed as and when it achieves the prescribed construction and development threshold. More so, where it is the stated position of the assessee that for computation of revenues, the stage of completion was arrived at with reference to the entire project costs

incurred including land costs, borrowing costs and construction and Development Costs. In our view, such an approach will give a true and correct picture of state of affairs of the assessee's business activities and thus should precede over the claim of the assessee of such interest cost in the year of incurrence. The various decisions which have been relied upon by the Id AR were rendered solely in context of section 36(1)(iii) and the issue relating to the method of accounting, and the interplay between section 36(1)(iii) and method of accounting have not been examined in those decisions and hence, the said decisions doesn't support the case of the assessee. In the result, the finance cost and interest paid to partners and others will be required to be accumulated as part of work-in-progress and cannot be claimed in the year under consideration.

9. Further, in respect of other expenses debited in the profit/loss account, we find that these include JDA expenses, salary of employees at site, site office expenses. These expenses are directly related to construction and development activities and should therefore form part of work-in-progress and therefore, cannot be claimed in the year under consideration. Rest all expenses are in nature of general administrative and overhead expenses and has rightly been claimed for tax purposes.

10. In the result, we set-aside the order of the Id CIT(A) to the extent of the finance cost, interest paid to partners and others, JDA expenses, salary of employees at site and site office expenses as all these costs/expenses are directly connected to the housing projects being undertaken by the assessee and are required to be accumulated as part of work-in-progress and cannot be claimed in the year under consideration and the order of the Assessing officer to this extent is

sustained. In the result, the ground of revenue's appeal is partly allowed.

11. In ground no. 2, the Revenue has challenged the reclassification of income from the head of "Income from other sources" to business income and also the fact that the same has been directed to be allowed set-off against business loss claimed by the assessee. We find that in schedule 11: other income of the financial statements, the assessee has shown discount received of Rs 8494 and interest received of Rs 17,260. The discount receipt seems to be related to some business purchase and is clearly in the nature of business receipt. The nature of interest income is not clear from the record. Notwithstanding the same, as we have held above that the assessee is eligible to claim certain administrative and other overheads expenses incurred during the year, the same would result in a loss under the head "Business income" and the interest income even where classified under the head "Income from other sources" can be set off against such business loss. In the result, the ground of revenue's appeal is dismissed.

In the result, appeal of the Revenue is partly allowed.

Order pronounced in the Open Court on 16/04/2019.

Sd/-  
(विजय पाल राव)  
(Vijay Pal Rao)  
न्यायिक सदस्य / Judicial Member

Sd/-  
(विक्रम सिंह यादव)  
(Vikram Singh Yadav)  
लेखा सदस्य / Accountant Member

जयपुर / Jaipur

दिनांक / Dated:- 16/04/2019

\*Ganesh Kr.

आदेश की प्रतिलिपि अग्रेषित / Copy of the order forwarded to:

1. अपीलार्थी / The Appellant- ITO, Ward-2(2), Jaipur

2. प्रत्यर्थी / The Respondent- M/s Shri Khatu Shyam Builders, Jaipur
3. आयकर आयुक्त / CIT
4. आयकर आयुक्त / CIT(A)
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, जयपुर / DR, ITAT, Jaipur.
6. गार्ड फाईल / Guard File {ITA No. 988/JP/2018}

आदेशानुसार / By order,

सहायक पंजीकार / Asst. Registrar

