

आयकर अपीलीय अधिकरण, विशाखापटणम पीठ, विशाखापटणम

**IN THE INCOME TAX APPELLATE TRIBUNAL,
VISA KHAPATNAM BENCH, VISA KHAPATNAM**

श्री वी. दुर्गा राव, न्यायिक सदस्य एवं श्री डि.एस. सुन्दर सिंह, लेखा सदस्य के समक्ष

**BEFORE SHRI V. DURGA RAO, JUDICIAL MEMBER &
SHRI D.S. SUNDER SINGH, ACCOUNTANT MEMBER**

**आयकर अपील सं./I.T.A.No.319/Viz/2019
(निर्धारण वर्ष/Assessment Year : 2015-16)**

The Asst. Commissioner of
Income Tax
Circle-2(1)
Guntur

Vs. M/s Polisetty Somasundaram
Pvt. Ltd.
D.No.3-30-17,
Sundaram Colony, Ring Road,
Gujanagulla, Guntur

[PAN : AABCP3168Q]

(अपीलार्थी/ Appellant)

(प्रत्यर्थी/ Respondent)

**Cross Objection No.99/Viz/2019
(Arising out of I.T.A.No.319/Viz/2019)
(निर्धारण वर्ष/Assessment Year : 2015-16)**

M/s Polisetty Somasundaram
Pvt. Ltd.
D.No.3-30-17, Sundaram Colony,
Ring Road, Gujanagulla
Guntur
[PAN : AABCP3168Q]

Vs. The Asst. Commissioner of
Income Tax
Circle-2(1)
Guntur

(प्रत्यर्थी/ Respondent)

राजस्व की ओर से / Revenue by : Shri S.Ravi Shankar Narayan,
CIT, DR
निर्धारिती की ओर से / Assessee by : Shri G.V.N.Hari, AR
सुनवाई की तारीख / Date of Hearing : 20.01.2020
घोषणा की तारीख/Date of
Pronouncement : 30.01.2020

आदेश / ORDER

Per Shri D.S.Sunder Singh, Accountant Member :

This appeal is filed by the revenue against the order of the Commissioner of Income Tax (Appeal) [CIT(A)]-1, Guntur vide appeal No.19/2017-18 dated 06.03.2019 for the assessment year (A.Y.)2015-16 and cross objections are filed by the assessee in support of the order of the Ld.CIT(A).

2. All the grounds of appeal are related to the disallowance of expenditure of Rs.5,86,00,000/- incurred in connection with the termination of Memorandum of Understanding (MoU) entered by the assessee with M/s LEPL Projects Ltd (LEPL) claimed under capital gains. The assessee is in the business of trading and export of tobacco. For the A.Y.2015-16, the assessee has filed the return of income admitting total income of Rs.24,01,89,770/- and the case was selected for scrutiny. During the course of scrutiny, the Assessing Officer (AO) found that the assessee has made the payment of Rs.5,86,00,000/- to LEPL for termination of MoU entered with them in connection with two plots of land sold by the assessee. The AO called for explanation of the assessee as to why the expenditure should not be disallowed, since the expenditure was not prima

facie appeared to be incurred for the purpose of development of the property. The assessee explained that it had entered into MoU with LEPL to develop a shopping mall on the lands of the assessee for which the assessee was to receive 40% of revenue realized. The MoU was entered into by the assessee on 10.04.2008. The assessee further explained that on termination of the agreement, the company compensated LEPL on account of expenses incurred by LEPL towards preparing the lay outs, drawings, blue prints, consultation, architectural engineering, professional fee, legal expenses, soil tests, survey staff etc., and incidental expenses including the expenses in liasoning with the Government authorities for the purpose of the proposed project of developing the shopping mall. The assessee was asked to produce the proof for incurring the expenses by LEPL, since the assessee failed to submit any proof regarding the expenses incurred, the AO searched from the Google Earth and found no intangible changes were made to the land. The sale agreement also did not make any reference to the MoU or any of the drawings, lay out or permission from government which would have led to increase in the value of land and the land was exactly the same as prior to condition of MoU. Therefore, the AO viewed that there was no improvements in the land, hence, no cost of improvement required to be allowed. At this juncture, the assessee made alternate plea

requesting to allow the expenditure as wholly and exclusively incurred for transfer of the land. The alternate plea also did not find favour before the AO. The AO viewed that termination of MOU and the sale of land were two independent transactions, but not inter related to each other. He further viewed that since, the Joint Development Agreement (MoU) failed to materialize the assessee has entered into the sale transaction and on sale deed there was no reference in respect of JDA, hence, the AO contended that the assessee's request to consider the expenditure as wholly and exclusively incurred in connection with the transfer of land was also not tenable. Assessee furnished the PAN number and the address of LEPL but the LEPL did not respond to the notice issued by the AO. Therefore, the AO disallowed the entire payment made to LEPL and made the addition of Rs.5,86,00,000/- in the hands of the assessee. The reason for addition in a nut shell is explained by the AO in para No.2.3.16 which reads as under :

"2.3.16. Thus in conclusion the amount spent as payment to LEPL could not be allowed as:-

- 1. It was not a cost of improvement to the land*
 - a. No physical changes to the land.*
 - b. Land appreciated on its, own and not due to efforts of the company or the effects of the MOU.*
 - c. No proof was offered of any clearances/permissions or intangible addition made to the land.*
 - d. The sale deed does not talk of any improvement and the schedule of the property is exactly the same as it was prior to the MOU.*

2. *The alternative plea of it being an expenditure incurred wholly and exclusively for the purposes of the sale too is incorrect as*
- a. *The MOU was terminated earlier and independent of any possible transfer in the future. The termination of the MOU and the sale of the land were two distinct transactions without any connection whatsoever.*
 - b. *The MOU had forbidden any informal agreement or talk of sale of the land during its existence. The termination agreement too does not reference any potential sale for which the land was needed free of encumbrance*
 - c. *The assessee failed to prove that the amount paid in any case was fully and exclusively to gain back the rights. The Termination agreement speaks of reimbursement of expenses and not payment for terminating the agreement 5 months in advance.*
 - d. *There is no link between the sale and MOU termination as in the sale, there was no diversion of income overriding title and thus the amount could not be claimed as an expense for the assessee.*
 - e. *In the absence of proof of any connection, expenditures cannot be claimed as spent "incurred wholly and exclusively in connection with such transfer". In the absence of proof of connection, there may be a mischief of linking all expenditures and activities on the capital asset as necessary to clear the land for sale. It is this link that is absent from the records and is unsubstantiated."*

3. Against which the assessee went on appeal before the CIT(A) and the Ld.CIT(A) allowed the appeal of the assessee. During the course of appeal proceedings, the assessee filed additional evidence under Rule 46A of Income Tax Rules. The Ld.CIT(A) admitted the additional evidences filed by the assessee i.e. MoU, copy of Income Tax return of LEPL for the A.Y.2015-16 and ledger account copies of Sri R.Satyanarayana an associate of LEPL along with bank account on 06.06.2018. Additional evidences filed by the assessee were admitted by the Ld.CIT(A) and forwarded to the AO

for his comments. It is seen from the remand report extracted by the Ld.CIT(A) that the AO reiterated the observations made in the assessment order without examining the merits and the additional evidences submitted by the assessee and justified the assessment order placing relying on the decisions in the case of Paramanand Bhai Patel and Jyotsna Devi Patel Vs. CIT (1984) 149 ITR 80 (MP) and M/s Industrial Credit & Development Syndicate Ltd. Vs. CIT (2001) 251 ITR 720 / 118 taxman 705 (Kar.). The Ld.CIT(A) considered the submissions of the assessee, additional evidences, remand report and allowed the appeal of the assessee holding that the payment was made in connection with transfer of sale of property. The Ld.CIT(A) given a finding that the transfer of property and the payment made to LEPL is inter linked. Without the payment to LEPL the property cannot be transferred. Therefore, held that the payment made to LEPL is inter linked and interrelated, hence, held that the expenditure incurred in connection with the sale of property was wholly incurred for the purpose of transfer of property and accordingly allowed the appeal of the assessee.

4. Against which the revenue is in appeal before us. During the appeal hearing, the Ld.DR submitted that the assessee had sold the property to M/s Jyothirmayee Properties Private Limited (JPPL) for a consideration of

Rs.30 crores and claimed the deduction of Rs.5,86,00,000/- from the capital gains. The said payment was stated to be incurred for reimbursement of the expenses or compensation paid to M/s LEPL for preparing the layouts, drawings, blue prints etc. During the assessment proceedings, the assessee was asked to furnish the proof for incurring the expenditure and the assessee failed to furnish the proof. Even the AO has made efforts to call for the information from LEPL but the LEPL did not respond to the notice issued by the AO. Therefore argued that the AO has rightly held that the expenditure does not represent the improvements made to the property, thus rightly disallowed the same. On the other alternate plea, the Ld.DR submitted that the assessee company had entered into MoU with M/s LEPL on 10.04.2008 for development of land belonging to the assessee which was valid for a period of six years for which the parties agreed to sign the Joint Development Agreement (MoU). The MoU was to build commercial mall with multiplex and hotel. The assessee was to receive 45% of the gross revenue generated out of the profit. The construction was to be completed in 24 months from the date of receiving the approval from the government. The cost was to be borne by M/s LEPL. On 19.10.2009, a second MoU was signed by the parties, wherein, the assessee had agreed to give license to LEPL over the scheduled property for development of commercial complex

and as per the agreement, the assessee was to be entitled for share of 40% of gross revenue generated out of the project. The said agreement was terminated on 15.05.2014, since, the project could not take place. As per the understanding between the parties, the assessee has to reimburse LEPL, a sum of Rs.5.86 crores incurred or expended by the LEPL on account of preparing layouts, drawings, layouts, liaison expenses etc. However, during the course of assessment proceedings, the assessee did not submit any evidence. The Ld.DR argued that the Termination Agreement was entered on 15.05.2014 and the land was sold on 24.07.2014, both the transactions are independent transactions and not inter linked. Therefore, argued that the payment made to LEPL cannot be treated as incurred wholly and exclusively in connection with the transfer of land. The Ld.DR further submitted that the assessee has created a charge by entering into MoU, which is a self created charge, neither related to development nor transfer of the land. Expenditure incurred on such encumbrances created by the assessee are not allowable deductions u/s 48 of the Act. The Ld.DR relied on the decision of Hon'ble High Court of Madras in the case of CIT Vs. N.Vajrapani Naidu, 107 taxmann 277 (Madras) and the decision of Hon'ble Supreme Court in the case of CIT Vs. Attili N.Rao, 119 taxman 1030 (SC) and argued that the assessee is not entitled for claiming deduction.

Therefore, requested to set aside the order Of the Ld.CIT(A) and allow the appeal of the revenue.

5. Per contra, the Ld.AR submitted that the assessee had entered into MoU on 10.04.2008 with M/s LEPL for development of the property as shopping mall with an understanding that the assessee would get 40% of the revenue. Subsequently the supplementary MoU was entered on 19.10.2009. Further as per the MoU, the assessee is barred from entering into any other agreement directly or indirectly or arrangement with any person / party / company in regard to development of the scheduled property in any manner prejudicial to the interest of LEPL. The project could not take place even after six years. Therefore, the assessee in it's best interest searched for the buyer i.e. M/s Jyotirmayee Projects Private Limited for consideration of Rs.30 crores. Since the impugned property was given possession to M/s LEPL as per the MoU, the assessee is not allowed to transfer the property without settling the dispute with M/s LEPL Projects Ltd., therefore, the assessee is forced to settle the dispute with the LEPL for a sum of Rs.5.86 crores towards the reimbursement of expenditure stated to be incurred by LEPL towards preparing layouts, drawings, blue prints, consultations, architectural engineering, professional fees, legal expenses, soil tests, survey, staff etc and incidental expenses

including expenses in liaising with the Govt. Authorities to make the property freehold. Unless the property is made free from all encumbrances, the assessee can't deal with it for transfer. The assessee had accepted for reimbursement of expenses and entered into sale agreement with M/s Jyothirmayee Properties Private Ltd., and from the advances given by R.Satyanarayana of M/s JPPL the assessee paid compensation to M/s LEPL Projects Ltd. and got terminated the MoU entered into with M/s LEPL Projects Ltd. Therefore, argued that termination of MoU is a precondition or prerequisite for the assessee to enter into sale agreement or dispose off the property. Without cancelling the MoU, the assessee is barred from making any transactions, such as sale, mortgage or development with any other party. Therefore, argued that the expenditure incurred for payment of compensation to M/s LEPL is incurred wholly and exclusively for transfer of property. Thus, argued that the expenditure is allowable expenditure, hence requested to allow the expenditure and uphold the order of the Ld.CIT(A) and dismiss the appeal of the revenue. The Ld.AR further submitted that the Ld.DR argued that the assessee had created the encumbrance for his own benefit. In fact no liability was created by the assessee for his own purpose and it was only an MoU reached for development of the property in the business interest. The assessee neither

mortgaged the property nor created any charge against the property and taken personal loans. Therefore, argued that the case laws relied upon by the Ld.DR were related to the charges created by the assessee for which the expenses were incurred for removal of encumbrance, hence the case laws relied upon by the DR are distinguishable. Therefore, argued that the case laws relied upon by the Ld.DR are distinguishable, hence not applicable in the assessee's case.

6. We have heard both the parties and perused the material placed on record. The assessee had entered into MoU on 10.04.2008 with M/s LEPL Projects Limited for development of the property. As per the MoU, M/s LEPL has to develop the property within three years and extendable to further period as per mutual understanding. The MoU was for development of the land as commercial complex i.e. shopping mall, multiplex or hotel. The property consisting of Ac.3.75 cents/18,175 sq.yds of land located at T.S.No.507, Block No.17, Ward No.17 (Old) 20 (News) bearing D.No.25-11-6, G.T.Road, Guntur. As per the agreement, the assessee is entitled to receive 40% of the revenue from the developed commercial complex. The developer did not take up the project though more than six years were lapsed and no progress was made. Neither the assessee was receiving the rent nor getting any benefit by handing over the

land to M/s LEPL for more than six years. The land was kept idle and no indication of taking up the project. Therefore, the assessee has decided to sell the property. However, as per Clause 16 of the MoU, the assessee is barred from entering into any agreement / arrangement or associate itself directly or indirectly with any other person, party or company in regard to the development of the Schedule Property. Therefore, it was incumbent upon the assessee to cancel the agreement for disposal of the property. Cancellation of MoU is a prerequisite for transfer of the property. Therefore, the assessee had to enter termination agreement by an agreement dated 15.05.2014 and agreed for payment of compensation of Rs.5.86 crores to release the charge of M/s LEPL and to surrender the rights of M/s LEPL vested by them by virtue of MoU and to make the property as freehold property. M/s LEPL stated to have incurred the expenditure on account of preparing layouts, drawings, blue prints, consultation, architectural engineering, professional fee, legal expenses, soil tests, survey staff etc. and incidental expenses including expenses in liaisoning with the Government authorities for the purpose of taking up the project as per Termination Agreement dated 15.05.2014 vide Clause No.02, page No.4 of the agreement placed in page No.34 of the paper book. Accordingly, the assessee has made payment to M/s LEPL to release the

property. For the purpose of making payment to M/s LEPL, the assessee has taken funds from Sri R.Satyanarayana of M/s JPPL and from the payment received from Sri R.Satyanarayana, the assessee has made the payment to M/s LEPL. Thus, the assessee's termination of MoU, payment and drawals from R.Satyanarayana of M/s JPPL are inter linked and inter connected. Only on release of the property from the possession of M/s LEPL Projects, the assessee is permitted to transfer the property. The assessee has not created any charge against the property for which the assessee has gained independently by way of loan or given the subject land as security for any other loans taken or mortgaged. The assessee has given the property for development in the best interest of the business for which the developer had incurred the expenses which were reimbursed by the assessee as mandatory obligation. The AO did not doubt the genuineness of the payment. During the assessment proceedings, the AO asked for the details and bills and vouchers of expenses incurred by LEPL projects for which the assessee failed to produce proof of the expenses. The AO searched Google Earth and found that no intangible changes were found with regard to development or improvement made on land. Since the expenses were incurred towards preparing lay out, drawing, blue print, consultation, architectural engineering, professional fee, legal expenses,

soil tests, survey staff etc. which are incurred for the services rendered but not for any physical development, naturally, Google Earth cannot show any development, thus, the AO could not find any development. The presumption of the AO with regard to physical development of the land or improvement of the land on the services rendered in connection with the drawings, blue prints, architectural engineering were not based on proper material. Further the expenses were incurred by the M/s LEPL in various assessment years which could be verified from the assessment records of LEPL which is possible only to the department. The income tax assessment details were given by the AO to the assessee. The AO ought to have verified the expenses incurred by M/s LEPL in the respective assessment years as per the powers vested in the AO u/s 131, 133(6) or from the assessment records. Non responding to the notice issued by the AO is not the reason for making any addition when the AO is vested with the powers under Income Tax and to make the enquiries and to enforce the assessee or witness to submit the information. Further, the AO simply relied on information of Google Earth and landed in a conclusion that there was no development which is incorrect. Apart from furnishing income tax particulars and payment details, the assessee could not furnish any details before the AO since the assessee also could not collect the said information

at the time of assessment. Naturally, the assessee has no access to the records of LEPL and has no powers to call for the information and depend on the mercy of LEPL. During the appeal proceedings before the first appellate authority, the assessee has submitted additional evidence in the form of income tax returns of LEPL, MoUs, ledger account copy of R.Satyanarayana along with bank account on 06.06.2008. The Ld.CIT(A) admitted additional evidence. The AO without verifying any facts, relying on images of Google Earth, submitted the remand report which shows the casual attitude of the AO in dealing with remand issues. In the instant case, M/s LEPL Projects is stated to have incurred the expenses towards various services rendered by them to take up the projects as discussed above and the assessee has satisfied with the genuineness of the expenses paid the same from the advance received from Sri R.Satyanarayana, associate of M/s JPPL and made the payment for termination of agreement. Both the parties to MoU have no grievance. The property was in possession of LEPL by virtue of MoU and had rights over the property and it can bar the assessee to make any transfer, sale by virtue of MoU dated 10.04.2008. The LEPL can raise unnecessary litigation if the assessee intends to proceed to sale without clearing the issue / dispute with LEPL. Since the issue is mutually settled, LEPL did not file any suit for violating the terms of MoU by the

assessee, but only demanded the reimbursement of expenses incurred by LEPL. Hence, we agree with the finding of the Ld.CIT(A) that the termination of MoU and sale of land are inter dependent transactions. In view of the above the observation of the AO that the termination of MoU and the sale of land to M/s JPPL are not inter linked is incorrect and ill founded. Having held that the transaction of cancellation of MoU is a pre requisite to enter into any transfer arrangement or sale by the assessee, the expenses incurred for surrender of the rights of LEPL required to be considered as an expenses wholly and exclusively incurred in connection with the transfer of the land and allowable u/s 48 of the Act. The case laws relied upon by the Ld.DR are distinguishable on facts. All the case laws are related to the charges created by the assessee on the property such as mortgage, security etc. In the instant case, no such charge was created by the assessee for personal gain. Therefore, the case laws have no application in the assessee's case. It is observed from the order of the Ld.CIT(A) that the other party i.e. LEPL had offered this amount of Rs.5.86 crores as income in their hands. Hence, we uphold the order of the Ld.CIT(A) and dismiss the appeal of the revenue.

7. The assessee filed cross objection supporting the order of the Ld.CIT(A). Since the appeal of the revenue is dismissed, cross objection filed by the assessee becomes infructuous, hence dismissed.

8. In the result, the appeal of the revenue as well as cross objections of the assessee are dismissed.

Order pronounced in the open court on 30th January, 2020.

Sd/-

Sd/-

(वी.दुर्गा राव)

(V. DURGA RAO)

न्यायिक सदस्य/JUDICIAL MEMBER

विशाखापटणम /Visakhapatnam

दिनांक /Dated : 30.01.2020

L.Rama, SPS

(डि.एस. सुन्दर सिंह)

(D.S. SUNDER SINGH)

लेखा सदस्य/ACCOUNTANT MEMBER

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

1. राजस्व/The Revenue – The Asst.Commissioner of Income Tax, Circle-2(1)
Guntur
2. निर्धारिती/ The Assessee - M/s Polisetty Somasundaram Pvt. Ltd., D.No.3-30-
17, Sundaram Colony, Ring Road, Gujjanagulla, Guntur
3. The Pr.Commissioner of Income Tax, Guntur
4. The Commissioner of Income Tax (Appeals)-1, Guntur
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, विशाखापटणम/DR, ITAT, Visakhapatnam
- 6.गार्ड फ़ाईल / Guard file

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आदेशानुसार / BY ORDER

Sr. Private Secretary
ITAT, Visakhapatnam