

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH “B” MUMBAI**

**BEFORE SHRI PRAMOD KUMAR (VICE PRESIDENT) AND
SHRI RAVISH SOOD (JUDICIAL MEMBER)**

**ITA No. 1658/MUM/2020
(Assessment Year: 2015-16)**

Deputy Commissioner of Income-
tax CC-7(3), Room No. 655,
Aaykar Bhawan, M.K Road,
Mumbai – 400 020

Vs.

M/s Macrotech Developer Ltd.
(Since Lodha Estate Pvt. Ltd. merged with
Macrotech Developer Ltd.),
412, 17G, Vardhman Chamber,
Cawasji Patel Marg, Fort,
Mumbai – 400 001.

PAN No. AAACL1723E

(Revenue)

(Assessee)

Assessee by : Shri Niraj Sheth, A.R
Revenue by : Shri. Rahul Raman, CIT D.R

Date of Hearing: 05/10/2021
Date of pronouncement: 11/10/2021

ORDER

PER RAVISH SOOD, J.M:

The captioned appeal filed by the revenue is directed against the order passed by the CIT(A)-49, Mumbai, which in turn arises from the order passed by the A.O u/s 143(3) of the Income-tax Act, 1961 (for short ‘Act’) dated 29.12.2017 for A.Y 2015-16. The revenue has assailed the order of the CIT(A) on the following effective grounds before us :

- “1. Whether on the facts and the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition of Rs. 5,26,52,120/- made by the assessing officer u/s 36(1)(iii) of the I.T Act.
2. Whether on the facts and the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition of Rs. 2,02,86,452/- towards sales promotion expense and Rs. 6,68,13,114/- on account of Advertisement expenses made by the Assessing Officer by capitalizing the same to the work-in-progress.”

2. Briefly stated, the assessee company that was merged with M/s Lodha Developers Limited (now known as Macrotech Developers Limited) is engaged in the business of construction and development of real estate. Return of income for A.Y 2015-16 was e-filed by the assessee on 31.08.2015, declaring a loss

of Rs.10,62,17,774/-. Subsequently, the case of the assessee was selected for scrutiny assessment under CASS. Assessment was thereafter framed by the A.O vide his order passed u/s 143(3), dated Nil and the income of the assessee company was determined at Rs. 3,35,33,911/- after making the following disallowances :

Sr. No.	Particulars	Amount
1.	Disallowance u/s 36(1)(iii) of interest expenditure pertaining to the investment made by the A.O in Optionally Convertible Debentures (OPCD) of M/s Sarvavasa Buildtech & Farms Pvt. Ltd. and M/s Kundam Realtors with a coupon rate of 01.1% p.a	Rs. ,5,26,52,120/-
2.	Disallowance of Sales promotion expenses (capitalized by the A.O to the WIP cost)	Rs. 2,02,86,452/-
3.	Disallowance of Advertisement expenses (capitalized by the A.O to the WIP cost)	Rs. 6,68,13,114/-

3. On appeal, the CIT(A) found favor with the claim of the assessee that as it had sufficient own funds which were far more than the investments made in the Optionally Convertible Debentures (OPCD) of M/s Sarvavasa Buildtech & Farms Pvt. Ltd. and M/s Kundam Realtors, therefore, it could safely be presumed that the investments were made from such own funds. Backed by his aforesaid observation, the CIT(A) concluded that no part of the assessee's claim for deduction of interest expenditure was liable to be disallowed. The CIT(A) while concluding as hereinabove had relied on the judgments of the Hon'ble High Court of Bombay in the case of CIT vs. Reliance Utilities, 313 ITR 340 (Bom) and CIT-2, Mumbai Vs. HDFC Bank Ltd., 366 ITR 505 (Bom). Accordingly, the CIT(A) backed by his aforesaid deliberations directed the A.O to vacate the disallowance of interest expenditure of Rs. 5,26,52,120/- made u/s 36(1)(iii) of the Act. Insofar the disallowance by the A.O of the assessee's claim for deduction of Sales promotion expenses of Rs. 2,02,86,452/- and Advertisement expenses of Rs. 6,68,13,114/- were concerned, it was observed by the CIT(A) that the A.O had treated the same as part of the work-in-progress cost of the assessee company. It was observed by the CIT(A) that there was no dispute about the fact that the assessee had actually incurred the aforesaid expenditure for launching of its project and attracting the customers. It was observed by the CIT(A) that as per Accounting Standard 2 – Para 11 and Para 13 it was evident that selling and distribution costs, advertisement cost etc. had to be excluded from the cost of inventories a/w those expenses that do not contribute to bringing the inventories to their present location and condition. It was further observed by the CIT(A) that the business promotion expenses and advertisement expenses were neither deferred revenue expenditure nor capital in nature since these are

incurred repetitively to promote the project. Observing, that the assessee was consistently following AS-2 issued by ICAI whereby the direct costs are added to the capital work-in-progress while for the indirect expenses being general overheads are charged to the Profit & loss a/c, the CIT(A) after placing reliance on certain judicial pronouncements concluded that the assessee's claim for deduction of sales promotion expenses and advertisement expenses as being in order. Accordingly, the CIT(A) directed the A.O to allow the assessee's claim for deduction of the aforesaid expenses aggregating to an amount of Rs. 8,70,99,566/-. Accordingly, the CIT(A) on the basis of his aforesaid observations allowed the appeal of the assessee.

4. The revenue being aggrieved with the order of the CIT(A) has carried the matter in appeal before us. The Id. Departmental Representative (for short "D.R") relied on the assessment order.

5. Per contra, the Id. Authorised representative (for short "A.R") for the assessee relied on the order of the CIT(A). It was submitted by the Id. A.R that the CIT(A) had rightly concluded that as the assessee had sufficient self-owned funds to justify the investment in the OPCD, therefore, no disallowance of any part of the interest expenditure was called for u/s 36(1)(iii) of the Act. Apropos, the disallowance of the sales promotion expenses and advertisement expenses made by the A.O, it was submitted by the Id. A.R that the CIT(A) had rightly observed that as per AS-2 – Para 11 & 13 the selling and distribution costs, advertisement expenses etc. are to be excluded from the cost of inventories.

6. We have heard the Id. authorized representatives for both the parties, perused the orders of the lower authorities and the material available on record, as well as considered the judicial pronouncements that have been pressed into service by the Id. A.R to drive home his aforesaid contentions. We shall first deal with the disallowance by the A.O of the assessee's claim for deduction of interest expenditure u/s 36(1)(ii) of the Act. Briefly stated, the assessee had raised loans from Lodha Developers Limited @13.40% p.a. It was noticed by the A.O that the assessee had during the year under consideration invested in OPCD. Although, it was the claim of the assessee that OPCD was redeemable at an aggregate return of 12% p.a, however, the same did not find favor with the A.O as he was of the view that the assessee had invested in OPCD @0.1% p.a. Observing, that the OPCD could be redeemed prematurely and it may not necessarily result in an aggregate return of 12%, the A.O dubbed the transaction under consideration as diversion of the assessee's interest bearing funds for making the aforesaid interest free investment. Accordingly, the A.O disallowed the assessee's claim for deduction of correlating interest expenditure of

Rs. 5,26,52,120/- . On a perusal of the orders of the lower authorities we find that the assessee had following interest free funds available with it :

Sr. No.	Particulars	As per Balance sheet as on 31 st March, 2015 (Rs. in lacs)	As per Balance sheet as on 31 st March, 2014 (Rs. in lacs)
1.	Share Capital	1.99	1.99
2.	Reserves and Surplus	6,950.64	7,681.60
	Total	6,952.63	7,683.59

On the other hand the investments made by the assessee in OPCD's were as follows :

Sr. No.	Particulars	As per Balance sheet as on 31 st March, 2015 (Rs. in lacs)	As per Balance sheet as on 31 st March, 2014 (Rs. in lacs)
1.	Sarvavasa Buildtech & Farms Pvt. Ltd. (date of investment : 15.07.2013)	2,005.00	2,005.00
2.	Kundan Realtors Pvt. Ltd. (date of investment : 28.06.2013)	3,000.00	3,000.00
	Total	5,005.00	Rs. 5,005.00

In the backdrop of the aforesaid facts, we concur with the view taken by the CIT(A) that as the assessee had own funds which were far more than the investments in OPCD, therefore, the presumption would be that the investments were made from own funds and no disallowance of any part of interest expenditure claimed by the assessee u/s 36(1)(iii) was called for in the hands of the assessee. Our aforesaid view is fortified by the judgments of the Hon'ble High Court of Bombay in the case of CIT vs. Reliance Utilities, 313 ITR 340 (Bom) and CIT-2, Mumbai Vs. HDFC Bank Ltd., 366 ITR 505 (Bom). We, thus, finding no infirmity in the view taken by the CIT(A) as regards the aforesaid issue under consideration uphold his order to the said extent. The **Ground of appeal No. 1** is dismissed.

7. We shall now deal with the grievance of the revenue that the CIT(A) had erred in law and the facts of the case in deleting the addition of Rs. 2,02,86,452/- towards sales promotion expenses and Rs. 6,68,13,114/- on account of Advertisement expenses made by the A.O by capitalizing the same to the work-in-progress. As observed by us hereinabove, the assessee had during the year under consideration claimed deduction of Sales promotion expenses of Rs. 2,02,86,452/- and Advertisement expenses of Rs. 6,68,13,114/-. Observing, that the assessee which was following percentage completion method of recognition of revenue as per the accounting standards prescribed for real estate sector had during the year recognized revenue of only 40.68 lac, the A.O called upon it to put forth an explanation as regards its claim for deduction of the aforesaid expenses. In reply, it was submitted by the assessee that the sales promotion and advertisement expenses were high due to launch of a new project by the assessee

company. Also, it was submitted by the assessee that sales promotion expenses and advertisement expenses represented selling expenses which had to be debited to Profit & loss a/c and cannot be considered as cost of the project. However, the A.O was not inclined to accept the aforesaid explanation of the assessee. Being of the view that pending recognition of revenue the sales promotion expenses and advertisement expenses could not be allowed as a deduction, the A.O capitalized the same as work-in-progress cost of the assessee. On appeal, the CIT(A) observed that there was no dispute about the fact that the assessee had actually incurred the aforesaid expenditure for launching of its project and attracting the customers. It was observed by the CIT(A) that as per Accounting Standard 2 – Para 11 and Para 13, it was evident that selling and distribution costs, advertisement costs etc. had to be excluded from the cost of inventories a/w those expenses that did not contribute to bringing the inventories to their present location and condition. Backed by his aforesaid view, it was observed by the CIT(A) that the business promotion expenses and advertisement expenses that were incurred year after year to create awareness about the project were neither deferred revenue expenditure nor capital in nature since these were incurred repetitively to promote the project. Observing, that the assessee was consistently following AS-2 issued by ICAI whereby the direct costs are added to the capital work-in-progress, while for the indirect expenses being general overheads are charged to the Profit & loss a/c, the CIT(A) concluded that the assessee's claim for deduction of sales promotion expenses and advertisement expenses was in order.

8. We have deliberated at length on the issue in hand in the backdrop of the orders of the lower authorities and the contentions advanced by the Id. Authorized representatives for both the parties. Admittedly, the assessee had incurred the sales promotion expenses of Rs. 2,02,86,452/- and advertisement expenses of Rs. 6,68,13,114/- for launching of its project and attracting the customers. The A.O had treated the aforesaid expenses as a part of the project cost i.e W.I.P cost, and thus, declined the assessee's claim for deduction of the same as a revenue expenditure. In our considered view, as observed by the Id. CIT(A), and rightly so, the sales promotion expenses, advertisement etc. cannot be capitalized to work-in-progress as per the Accounting Standards prescribed for the real estate sector as well as the accepted accounting policies and judicial pronouncements. The assessee had consistently been following the method of valuing its inventory in accordance with AS-2. We find that Accounting Standard 2 (AS 2) provides as under :

“Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to included overheads

other than production overheads or the costs of designing products for specific customers in the cost of inventories.”

Further, Para 13 of the AS-2 provide for some exclusions from the cost of inventories as under ;

“Exclusions from the Cost of Inventories :

13. In determining the cost of inventories in accordance with paragraph 6, it is appropriate to excluded certain costs and recognize them as expenses in the period in which they are incurred. Examples of such costs are :

- (a). abnormal amounts of wasted materials, labour, or other production costs;
- (b). storage costs, unless those costs are necessary in the production process prior to a further production stage;
- (c). administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
- (d). selling and distribution costs.”

On a perusal of the aforesaid, we find that the selling and distribution costs, advertisement expense etc. are to be excluded from the cost of inventories as they do not contribute towards bringing the inventories to their present location and condition. Our aforesaid view that selling costs are no to be considered as a part of the project cost i.e W.I.P cost is also supported by the “Guidance Note on Accounting for Real Estate Transactions” (Revised 2012) wherein at Para 2.4(b) it is provided that selling costs are not to be considered as part of the construction costs and development costs. Further, we find that the Hon’ble High Court of Delhi in the case of Gopal Das Estates & Housing Pvt. Ltd. Vs. CIT (2019) 412 ITR 489 (Del), had observed, that that the expenditure incurred on advertising being necessary for promotion of its business is to be allowed as a business expenditure and would not form part of the project cost. Apart from that, we find that as the assessee’s claim for deduction of sales promotion, advertisement etc. was consistently allowed by the department not only in the preceding but also in the succeeding years, therefore, there was no justification on its part in declining the assessee’s claim for deduction of the said expenses during the year under consideration. Our aforesaid view is fortified by the order of the ITAT, Mumbai in the case of the assessee’s ‘sister concerns’, namely, M/s Lodha Palazzo, ITA No. 2298/Mum/2012; dated 10.12.2014; and M/s Macrotech Construction Pvt. Ltd., ITA No. 5283/Mum/2014. Also, support is drawn from the order of the Tribunal in the case of M/s Vardhman Developers Ltd., 35 Taxman.com 370. We, thus, in terms of our aforesaid observations finding no infirmity in the view taken by the CIT(A) who by a well reasoned order had vacated the disallowance of the assessee’s claim for deduction of sales promotion expenses of Rs.

2,02,86,452/- and advertisement expenses of Rs. 6,68,13,114/-, thus, uphold his order to the said extent.
The **Ground of appeal No. 2** is dismissed.

9. Resultantly, the appeal filed by the revenue being devoid and bereft of any merit is dismissed.

Order pronounced in the open court on 11.10.2021

Sd/-

(Pramod Kumar)
VICE PRESIDENT

Sd/-

(Ravish Sood)
JUDICIAL MEMBER

Mumbai;

Dated: 11.10.2021

*PS: Rohit

Copy of the Order forwarded to :

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

BY ORDER,
//True Copy//

(Sr. Private Secretary)
ITAT, Mumbai