

IN THE INCOME TAX APPELLATE TRIBUNAL
"H" Bench, Mumbai
Before Shri Shamim Yahya (AM) & Shri Ravish Sood (JM)
ITA Nos.1678 & 1679/Mum/2020
(Assessment Years: 2013-14 & 14-15)

ITO-6(3)(3) Room No.524, 5 th Floor Aaykar Bhavan, M.K.Road Mumbai-400 020	Vs.	Kamanwala Housing Construction Ltd. 405, 406, New Udyog Mandir-2 Mogul Lane, Mahim(W) Mumbai-400 016
PAN/GIR No. AAACK2434P		
(Assessee)	:	(Revenue)

Assessee by	:	Shri Anil Thakrar
Revenue by	:	Shri Neeraj Kumar

Date of Hearing	:	08.09.2021
Date of Pronouncement	:	23.11.2021

ORDER

Per Shamim Yahya(A.M.):

These appeals by the Revenue are directed against the respective orders of the learned Commissioner of Income Tax (Appeals), Mumbai ('ld.CIT(A) for short) pertain to the respective assessment years as above.

2. Since the issues are common and connected and the appeals were heard together, these have been consolidated and disposed of by this common order.

ITA No. 1679/Mum/2020

3. The grounds of appeal read as under:-

1. On the facts and in the circumstances of the case and in law, the learned CIT(A) erred in deleting the addition on payment of rent u/s 40A(2)(b) of the Act of Rs. 12,80,000/-.
2. Whether the Ld CIT(A) was right in deleting the addition of expenditure of Rs. 14,31,40,000/- on provision for construction cost of various sites in view of mercantile system of accounting.

3. The appellant prays that the order of the Ld. CIT(A) on the above grounds be set aside and that of the AO be restored.

4. Apropos ground No.1

Brief facts of the case are as under:-

During the assessment proceedings, A.O. has noticed that the appellant company made payments of Rs. 6,52,000/- to Mrs. Shobha Jain, Director of the company, and Rs. 6,28,000/- to Smt. Sudha Gupta, wife of Shri M.L. Gupta, Director of the company on account of rent expense. Thus, 'total payment of Rs. 12,80,000/- was made to two persons who are covered under section 40A(2)(b) of the Act. With a view to ascertain reasonableness of these rent payments, A.O. has examined the rental agreements and found that the arrangements for making claim of rent payments was not acceptable, as the same does not appeal to an ordinary business practice, more so when the owner of the flats was a Director, or spouse of a Director. AO has also recorded the finding that onus is on the assessee to prove that the said arrangement is real and is wholly and exclusively for its business purposes.

5. Upon assessee's appeal, Ld.CIT(A) decided the issue in favour of the assessee, he also inter-alia found that identical issue has decided by ITAT in assessee's own case for AY 2011-12. The order of Ld.CIT(A) in this regard is as under:-

“ The copy of agreement of leave*anc3' license' entered into between the appellant company and Smt Shobha Jain for the period 01.05.2012 to 31.10.2013 is brought on record. On perusal thereof, it is noted that the purpose for which the premises are to be used is mentioned in the terms and conditions thereto, as under:-

" The Licensor agrees to give on leave and license basis the Drawing Room and Kitchen as a pantry, three/four times in a day at Flat No.1, Jai Villa, Dev Shakti Building, Tilak Road, Santacruz (West), Mumbai-400054, hereinafter referred to as the said tenement to be used by the Licensee for office purposes and for holding business meetings with Contractors, Suppliers, Architect, B.M.C. Officers, Bank's Officers, Customers, etc.

The Licensor further agrees to provide furniture, eg. Tables, chairs, sofa. etc. for office use and holding business meetings and conferences"

Further, the copy of agreement of leave and license entered into between the appellant company and Mrs Sudha Gupta for the period 01,11.2012 to 31.10.2015 is brought on record. On perusal thereof, it is noted that the purpose for which the premises are to be used is mentioned in the terms and conditions thereto, as under,-

"The Licensor hereby grant "Leave and License" to the Licensee for the temporary use and occupation of the said premises for residential

purpose only to accommodate any of its directors, officers, employees etc., and for a period for Thirty Six months commencing from 1st November, 2012 till 31st October, 2015 (both days inclusive),"

Thus, it is evident from the terms and conditions to the relevant rent agreements that the premises were hired by the appellant company for the purpose of its business, namely for holding business meeting of executives and customers, as also for temporary use by directors or employees etc. The appellant has brought on record evidence to substantiate business use of the hired premises. Further, there is no factual finding in the assessment order to show that payment of rent made by the appellant company, in accordance with the rent agreements, was excessive or unreasonable having regard to the fair market value, within the meaning of section 40A.

I find that similar issue is involved in appellant own case for A.Y. 2011-12 & 2012-13. The issue has been decided in favour of the appellant by Hon'ble ITAT, Mumbai in its order dated 15.02.2017 arising out of appeals in ITA No. 921/Mum/2016 and ITA No. 1404/Mum/2016 for the A.Y. 2011-12, and in ITA No. 5488/Mum/2016 for A.Y. 2012-13. The relevant extracts of the ITAT order for A.Y. 2011-12 is as follows:-

We have gone through the facts and circumstances of the case as well as orders passed by the lower authorities and also the submissions made before us. Undoubtedly, the assessee is best judge to make any expenditure keeping in view commercial expediency and best interest of its business. But when a question is raised by the AO about the business necessity and genuineness of expenditure, especially when the payment has been made to related parties, there is bounder duty on the shoulders of the assessee to show that payment has been genuinely made and same has been utilized for the purpose of business of the assessee.

The facts of this case as were brought before us show that it was claimed by the assessee that the payment was made towards rental for using 50% share of the Flats owned by these two persons. It was explained that these premises were utilized as office(s) of the assessee and for organizing strategic business meetings and carrying out other day to day functioning also from these premises. The assessee placed before the lower authorities, details and evidences in the form of confirmation, agreements, copies of income tax returns of these payees and other details to show business use of these premises as well as confirmation of transaction and genuineness of payments. Thereafter nothing was brought on record by the AO to negate these facts and details/evidences.

Further, this fact cannot be ignored that the payments made to these persons have always been allowed in past by the AO. The rental income has been assessed by the income tax department in the hands of these payees. Under these circumstances, the AO was expected to maintain consistency in his approach and should not have disallowed the claim merely on the basis of his doubts.

Further, the AO invoked provisions of section 40A(2)(b), which do not permit full disallowance of expenditure. Only that part of expenditure can be disallowed which is in excess of market rates. Before making any such disallowance, the onus is upon the AO under the law to show that amount paid to a related party is more than market rates. No such exercise has been done by the AO in the case before us.

Thus, taking into account totality of the facts and circumstances of the case, we find that the assessee has been able to discharge its onus as was envisaged under the law, whereas the AO had wrongfully invoked provisions of section 40A(2)(b) and also erred in disallowing the expenditure in full. Thus, since disallowance made by the AO is contrary to law and facts, same is therefore deleted. Ground No.4 is allowed.

I have carefully considered the relevant and material facts on record in respect of this ground, as brought out in the assessment order and submissions made during appeal proceedings. I find that the issue is squarely covered by the order of ITAT, Mumbai for A.Y. 2011-12 (supra) in assessee's own case wherein Hon'ble ITAT has decided the issue in favour of the appellant, after duly taking note of the fact that assessee had been able to discharge its onus to prove business expediency for hiring of the premises. Therefore, respectfully following the decision of jurisdictional bench of ITAT in assessee's own case, I find that no disallowance was required to be made on account of rent paid to related persons under section 40A(2)(b). A.O. is directed to delete the addition of Rs. 12,80,000/- made in the assessment order on this account. Accordingly, this ground of appeal is **allowed.**"

6. Against the above order, revenue is in appeal before us.

7. We have heard both the parties and perused the records. We find that as noted by Ld.CIT(A) above, the issue is covered in favour of the assessee as ITAT in assessee's own case has decided the issue in favour of the assessee. It is not the case that order of ITAT has been reversed by Hon'ble Bombay High Court. Hence, respectfully following the precedent, we uphold the order of Ld.CIT(A).

Apropos ground No.2

8. On this issue, AO made the addition of claim for provision for construction expenses. Upon AO enquiry in this regard, about the provision made, assessee has responded that actually all these expenses were incurred next year. However in order to comply with matching concept of accountancy provision in this regard was made.

However, AO was not satisfied. He made impugned addition. The order of AO in this regard as under:-

“ During the course of assessment proceeding, it is seen that the assessee has claimed Rs.14,31,40,000/- towards provision for construction expenses. In order to verify the verification of assessee claim, assessee was asked vide order sheet noting dated 03.03.2016, to show cause why provision for construction cost made should not be disallowed.

In response to this, assessee submitted its reply vide letter dated 16.3.2016, which is placed on record. Assessee stated that all these expenses in total Rs.16,72,76,000/- incurred and paid in next year. However, in order to comply with matching concept of accountancy Provision for Rs. 14,31,40,000/- was made during the year under review.

The above submission of the assessee were carefully perused but not found to be acceptable. ^It is to be noted that provisions made in accountancy to comply with accounting standard is made on the basis of estimation which is only hypothetical value determined by the management. The convincing evidence to justify the basis of provision were not submitted also it is only a provisions made for next year expenses which are yet to be incurred which is not relevant to current year. It is well established principle in taxation that expenses are inadmissible which are provisional and hypothetical.

Therefore, in the light of above facts and circumstances of the fact, Rs.14,31,40,000/- is being disallowed and added back to the assessee's total income.”

9. Upon assessee's appeal, Ld.CIT(A) deleted the additions. In this regard he agreed with the assessee's contention that in order to comply with the matching concept, the booking of the expenditure as provision was justified. The Ld.CIT(A) has held as under:-

“I have carefully considered the relevant and material facts on record, in respect of this ground of appeal, as brought out in the assessment order and submissions made during appeal proceedings. The appellant company is consistently following the mercantile system of accounting. This is an admitted position. It is also noted from the profit and loss account (*Note 22- Revenue from operations*) that the appellant has been maintaining showing revenue from sales of flats in various projects separately. Further, as per Note 1 on Significant Accounting Policies, which forms part of the accounts, the method of revenue recognition is mentioned as under:-

"Revenue from sale of flat is recognized on issue of letter of allotment/execution of agreement (whichever is earlier) and also sale completely recorded on booking of previous years as the project is near to completion.

The disclosure of accounting policy makes it clear that the sales are being recognized when the project is near completion, regardless of the fact whether or not the sales consideration has been completely realized. In particular, in respect of the Manavsthal (Malad) project, the appellant has submitted a project account showing that sales of Rs. 61,06,47,262/- from Manavsthal (Malad) project was recognized as Revenue during the F. Y. 2012-13. This total sales amount includes receivable amount of Rs. 30,55,92,484/-, which is shown as Sundry debtors in the books. As against this Sales, total direct expenses of Rs. 33,88,25,752/- towards construction cost have been claimed in respect of the same project. This total direct expenses includes provision for amount of Rs. 14,31,40,000/- towards construction cost incurred in succeeding years. The appellant has contended that sales have already been recognized during the year, and the claim of expenses has been made in accordance with the matching principle of accountancy, i.e. direct expenses relating to the sales should be debited in the period when the corresponding sales are credited to the accounts.

Hon'ble Supreme Court in the case of Metal Box Co. of India Ltd. Vs Their Workmen (1969)(73 ITR 53)(SC) has held that in the case of an assessee maintain his accounts on mercantile system, a liability already accrued though to be discharged at a future date would be a proper deduction while working out the profits and gains of his business, regard being had to the accepted principles of commercial practice and accountancy. It is not as if such deduction is permissible only in case of amounts actually expended or paid. Just as actual receipts as well as those accrued due are brought in for income-tax assessment, so also liabilities accrued due would be taken into account while working out the profits and gains of the business.

Similar issue was involved in the case of Calcutta Co. Ltd. Vs CIT (1959) (37 ITR 1) (SC). In that case, the assessee was dealing in land and property and carried on land developing business. The assessee maintained its accounts as per mercantile system. During the relevant year, the assessee sold certain plots and recognized the entire amount of sale price of plots in credit side of books of accounts, even though assessee had received only a portion of sale price. As per terms ""- of sale deeds, assessee undertook to carryout developments within six months from date of sale. Accordingly, assessee estimated a sum as expenditure for developments to be carried out in respect of plots sold out during relevant year, and debited said sum in its books of account as accrued liability. On these feats, Hon'ble Supreme Court upheld the view that the estimated expenditure, which had to be incurred by assessee in discharging a liability which it had already undertaken was an accrued liability, and accordingly assessee was entitled to debit the same as per mercantile system of accounting. The relevant finding is reproduced as under, -

"We are definitely of opinion that the sum of Rs. 24,809 represented the estimated amount which would have to be expended by the appellant in the course of carrying on its business and was incidental to the same and having regard to the accepted commercial practice and trading principles was a deduction which, if there was no specific provision for it under section 10(2) of the Act, was certainly allowable deduction, in arriving at the profits and gains of the business of the appellant under section 10(1) of the Act, there being no prohibition against it, express or implied, in the Act."

On the facts and circumstances of the case, in view of the prevailing position of law, I find that no disallowance of provision of construction cost can be made, for the reasons elaborated in the above paragraphs. A.O. is directed to **delete** the disallowance of Rs 14,31,40,000/- made in assessment order on this account. This ground of appeal is **allowed**.

Ground No.6 relates to levying interest under section 234B & 234C of the Act. The levy of interest is mandatory as held by the Hon'ble Supreme Court in the case of **CIT V Anjum M H Ghaswala (2001) (252 ITR 1) (SC)**. Hence, the contention of the appellant cannot be considered to be legally tenable. Therefore this ground of appeal is dismissed.

In Ground No. 7 the assessee contested initiation of penalty u/s 271(1)(c). This ground of appeal does not have any merit as no prejudice is caused to appellant merely by initiation of penalty proceedings. Penalty is a separate proceedings and appellant is entitled to an opportunity of being heard before any levy of penalty. Therefore, this ground of appeal is premature and the same is hereby dismissed.

The next ground of appeal is that the appellant craves leaves to add, to alter, delete from or substitute the grounds of appeal. No such option has been exercised by the appellant during the appeal proceedings and hence, does not require any adjudication.

In the result, the appeal is allowed."

10. Further, Ld.CIT(A) placed reliance upon the decision of Hon'ble Supreme Court in the case of Metal Box Co. Of India Ltd. vs Their Workmen (1969)(73 ITR 53) (SC) and Calcutta Co. Ltd. vs CIT (1959) (37 ITR 2) (SC).

11. Against the above order, revenue is in appeal before us.

12. We have heard both the parties and perused the records. We note that on this issue, assessee's claim is that actually the expenditure is incurred in the next year, however in order to comply with matching principle/concept of accountancy, it has

recognized proportionate expenditure during the year. In this regard, we note that expenditure has to be accounted only when it has been incurred i.e either paid or it is accrued. If the expenditure is not accrued merely on the basis of matching principle any amount cannot be provided. The case laws referred by the Ld.CIT(A) also deal with the expenditures which have actually accrued. The Hon'ble Courts have held that expenses can be said to have been incurred only if they have accrued. Nowhere, it is provided that without accrual expenditure should be provided merely on matching concept. We note that Ld.CIT(A) has not at all given a finding that the quantum of the expenditure worked by the assessee had actually accrued. Merely because the expenditure is incurred in the next year, on the plank matching principle assessee cannot book a good portion of the expenditure during the year to adjust the profit as per its desire. Expenditure can be provided only, if the expenditure has actually accrued. Since in this case, Ld.CIT(A) has not given any finding that the expenditure has accrued, we deem it appropriate to remit the issue to the file of the Ld.CIT(A). The Ld.CIT(A) shall examine the issue afresh and give a finding whether the expenditure allowed by him can be considered to be the expenditure which is accrued during this year. We make it clear that adjusting on the plank of matching principle of the expenditure which has not actually accrued is not legally sustainable. With these directions, we remit the issue to the file of the Ld.CIT(A).

13. In the result, appeal by the revenue is partly allowed for statistical purpose.

ITA No. 1678/Mum/2020

14. Grounds raised are similar to the grounds for AY 2013-14 . Hence, aforesaid adjudication applies mutatis mutandis for this AY. Hence, this appeal also stands partly allowed for statistical purpose.

15. In the result, both appeals filed by the revenue are partly allowed for statistical propose.

Order pronounced in the open court on 23 .11.2021

Sd/-
(RAVISH SOOD)
JUDICIAL MEMBER

Sd/-
(SHAMIM YAHYA)
ACCOUNTANT MEMBER

Mumbai; Dated :. 23 .11.2021

Thirumalesh, Sr. PS

Copy of the Order forwarded to :

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

BY ORDER,
(Dy./Asstt.Registrar)
ITAT, Mumbai