

**IN THE INCOME TAX APPELLATE TRIBUNAL
“D” BENCH, MUMBAI**

**BEFORE SHR PRAMOD KUMAR, VP &
SHRI AMIT SHUKLA, JM**

आयकरअपीलसं./ I.T.A. No. 7374/Mum/2019
(निर्धारणवर्ष / Assessment Year: 2014-15)

Asst. Commissioner of Income Tax-1(1)(1), 579,Ayankar Bhavan, M.K Road, Mumbai-400020,	बनाम/ Vs.	M/s Dosti Realty Ltd. (formally known as Friends Development Corporation (Imperia) Pvt. Ltd. 276,1st Floor, Lawrence & Mayo House, Mumbai - 400001,
स्थायीलेखासं ./जीआइआरसं ./PAN No AABCF5801A		
(अपीलार्थी/ Appellant)	:	(प्रत्यर्थी / Respondent)

अपीलार्थीकीओरसे/ Appellant by	:	Shri P.R. Rastogi, Ld. DR
प्रत्यर्थीकीओरसे/ Respondent by	:	Shri Dr.K.Shivaram & Rahul Hakani, Ld. AR
सुनवाईकीतारीख/ Date of Hearing	:	14.06.2022
घोषणाकीतारीख / Date of Pronouncement	:	06.09.2022

आदेश / O R D E R

Per Amit Shukla, Judicial Member:

The aforesaid appeal has been filed by the revenue against order dated 19.09.2019, passed by Ld. CIT (Appeals)-2, Mumbai for the quantum of assessment passed u/s 143(3) for AY 2014-2015.

The revenue has raised the following grounds:-

1. On the facts and in the circumstances of the case and in law, the Ld. CIT (A) erred in deleting the brokerage of Rs.29,50,168/- despite the fact that the brokerage is directly attributable to the ongoing project and therefore it should have been capitalized?

2. On the facts and in the circumstances of the case and in law, the Ld. CIT (A) erred in deleting the interest of Rs.15,04,76,347/- despite the fact that the interest was expended ultimately for acquiring a qualifying asset and therefore should have been capitalized as per provisions of section 36(1)(iii) of the Act?

3. On the facts and in the circumstances of the case and in law, the Ld. CIT (A) erred in deleting the advertising expenses of Rs.1,00,00,884/- despite the fact that the advertising expenditure was incurred with regard to the ongoing project "Dosti Intperia" at Thane, and the same should have been capitalized?

The appellant craves leave to add to, amend or withdraw the aforesaid grounds of appeal.

2. The facts in brief are that, assessee is engaged in the business of real estate development. As noted by the AO during the year, only one project 'Dosti Imperia' situated opposite R. Mall, Ghod Bunder Road, Thane (W) was in progress which included residential and commercial property. The revenue from such project was recognized

on 'Percentage of completion method' and accordingly, the revenue was recognized after achieving 25% of completion.

3. The assessee had debited direct and indirect cost relating to construction of the said project. AO noted that assessee has debited an amount of Rs. 70,95,375/- as brokerage and marketing and advertisement expenses of Rs. 3,28,43,191/- for the project 'Dosti Imperia'. The assessee has not debited the said expenses to work-in-progress albeit has claimed as expenses in the profit and loss account. The AO noted that the assessee had paid brokerage for sale of flats 'Dosti Imperia' and was also given the details of the progress, amount of brokerage paid and particulars of flat for which brokerage was paid in para 4 of his order. He observed that the brokerage has been paid for selling of the property which was only project in progress. The assessee has disclosed 51.6% of the project and since assessee following the percentage completion method, therefore, according to him, he allowed the deduction of 51.6% of brokerage expenses, i.e., Rs. 31,45,213/- and balance brokerage expenses Rs. 29,50,168/- was capitalized to work-in-progress account. In so far as the advertisement and marketing expenses

were not concerned, the AO treated Rs. 34,46,174/- as advertisement not related to the assessee at all. On the balance at Rs. 2,35,98,620/-, he estimated Rs. 87,95,205/- as advertisement not pertaining to assessee. Thus, total advertisement not pertaining to the assessee disallowed by him was Rs. 1,22,41,379/- and from the balance Rs. 2,28,48,370/-, he held that Rs. 1,00,00,884/- should be capitalized and balance Rs. 1,28,41,423/- was to be allowed as deduction.

4. The summary of his analysis has been given in detail in the impugned order. Thus final aggregate amount of Rs. 2,23,42,263/- was added to the income on account of disallowance of advertisement expenses.

5. In so far as the interest on debentures amounting to Rs. 15,04,76,347/- as raised in ground no. 2, the AO noted that the assessee has claimed interest of Rs. 15,04,76,347/- as interest on debentures which assessee has paid to debenture holders, which according to the AO should have been capitalized.

6. In the year 2010, the assessee has raised roughly Rs. 98.67 crores by estimating 15.25% fully convertible debentures out of the

said amount, Rs. 88 crores was given an advance to M/s Adrika Developers Pvt. Ltd. for procuring suitable land for development by the assessee. Assessee had entered into an agreement with the M/s Adrika Developers Pvt. Ltd. Adrika Developers had to make payment of earnest money for purpose of acquiring land and to render various services related to procuring land over a period of 6 years. Later on, M/s Adrika Developers Pvt. Ltd. had rendered money after expiry of 6 years as it was not able to procure the land. However, AO held as under:-

a) The money raised from debentures has been advanced for acquiring land for a Proposed New Project. This land has not yet been acquired. Therefore all expenditure incurred for the said New Project would be in the nature of Pre-operative Expenditure for the Proposed New Project. Such pre-operative expenditure is not an allowable expenditure. The interest of Rs 15,04,76,347/- paid is therefore in the nature of preoperative expenditure and cannot be allowed. On this ground the interest of Rs 15,04,76,347/- is disallowed.

b) Secondly, as stated earlier, even if the land is acquired, the cost of the land and the interest thereon forms part of the Inventory of the Proposed New Project as the assessee follows Percentage method of accounting. Hence on this ground also the interest of Rs 15,04,76,347/- is disallowed.

7. AO also held that in AY 2012-13, similar disallowance was made which was deleted by the Ld. CIT(A), however revenue has filed appeal before the Tribunal.

8. Ld. CIT (A) in so far as issue relating to selling /brokerage expenses and advertisement expenses which has been raised vide Ground No. 1 & 3 by the revenue, held that brokerage expenses and advertisement expenses being selling expenses cannot be capitalized to work-in-progress and have to be allowed as a period of cost. Before Ld. CIT(A), assessee has filed detail submission and also made an application u/s 46A to admit the additional evidence by way of bills of advertisement expenses incurred by the appellant company and the copies of bills of group companies in respect of advertisement contents relating to their business and not related to the assessee company alongwith the company statements and ledger extracts of the parties. Ld. CIT(A) called for the remand report from the AO which has been incorporated in page 13 and 14 of the appellate order.

9. Ld. CIT(A) with regard to disallowance of Rs. 2,23,42,263/- out of advertisement expenses has observed and held that the AO has disallowed an amount of Rs.34,46,174/- and Rs.87,95,205/- (i.e. Rs.122,41,379/-) as not pertaining to assessee's business. These expenses were considered by the AO to be pertaining to the other group companies as the content in the advertisement related to the appellant and or other group companies also. This issue was examined by the AO in remand proceedings wherein it has been verified by the AO that the vendors have billed the respective group companies separately, as per the content relating to them and the same has been paid separately. In view of above, Ld. CIT(A) found that there was no justification for making the addition aggregating to Rs. 122,41,379/- and the same was deleted.

10. Further, as regards the disallowance of Rs.100,00,884/-, Ld. CIT(A) observed that the same is not correct considering that as per the percentage completion method the direct and indirect cost which are related directly to construction and development of the project activities should have been considered towards allocation against revenue @ 51.6% and balance 48.4% towards WIP.

However, the advertisement expenses, which are incurred for the purpose of increasing the sales which assessee did not considered towards allocation to WIP, instead entire such amount was debited to Profit and Loss Account as period cost, following the accounting treatment laid down in guidance note issued by the Institute of Chartered Accountants of India for accounting of real estate transactions.

11. Ld. CIT(A) after relying upon the decision of ITAT, Mumbai bench in the case of Macrotech Construction Pvt. Ltd. vs. ACIT (2019) 103 taxmann.com 348 (Mum-Trib), held that the entire advertisement expenditure is to be allowed as revenue expenses.

12. Further against the disallowance of Rs. 29,50,168/-, Ld. CIT(A) held that the said finding of the AO is not justified in view of the fact that the brokerage expense is part of the selling costs and is not related directly to the activity of the construction of project. The entire amount of brokerage expense should have been allowed as period cost in view of the accounting method regularly followed by the assessee and the "Guidance Note on Accounting for Real Estate Transaction" issued by the Institute of the Chartered

Accountants according to which the selling cost should be excluded from the construction cost. Reliance was placed by him on the decision of ITAT Mumbai in the case of Macrotech Construction (P.) Ltd. vs ACIT, Circle- 6(3) Mumbai (2019) 103 taxmann.com 348 9 (Mumbai-Trib.). Thus, he held that the entire brokerage expense is to be allowed as revenue expenditure, as period cost and accordingly the Addition of Rs. 29,50,168/-, by treating the same as expense to be capitalized to WIP is to be deleted. Further the AO was directed to reduce the said expense of Rs. 29,50,168/- from the WIP, if the same has been added to the WIP.

13. In so far as disallowance of interest on debenture of Rs. 15,04,76,347/-, after considering the entire submission and agreement, Ld. CIT(a) has allowed the same as business expenditure on account of commercial and business expediency.

The relevant finding of Ld. CIT(A) reads as under:-

6.3.1 I find that both the appellant and Adrika are in the business of "real estate development and are related concerns, being subsidiaries of Dosti Realty Ltd. Adrika has a focus on purchase and development/sale of land and appellant has advanced the money to Adrika to be used as earnest money for the purpose of

acquiring land and to render various services related to the procuring of the land over a period of 6 years, like conducting a market study, identification of suitable parcels of land etc. The appellant has not charged any interest on such advance to Adrika and the interest paid on the debentures has been claimed as expenditure u/s 36(1)(iii) in the profit and loss account. I find that the said amount of advance is reflected in the accounts of Adrika under the head Other Liabilities. Adrika has further made advances towards purchase of land to various parties which is reflected under the head Land and Development Accounts amounting to Rs. 230,58,70,120/- as on 31.03.2014. Therefore, I find merit in the submission of the appellant that the said interest claim is in respect of the business expenditure as the advance was given to fellow subsidiary, also engaged in the business of real estate development, out of business expediency, in view of the decision of the Hon'ble Supreme Court in the case of S A Builders Ltd vs. CIT288 ITR 1.

6.3.2 The appellant has submitted that the claim of interest expenses, as revenue expenditure/period cost was made on the basis of accounting principles as per AS 16, as the funds are utilized for the purpose of its business of real estate and was not related to the construction project of Dosti Imperia carried out during the year. The appellant has incurred interest cost of Rs.27,657,503/- which relates to the project and have been charged to land and development account. The appellant is following this method consistently and the same has been

disclosed as part of the note given by the Auditors under the head 'significant accounting policies'. Further, it was submitted that the said expenditure was allowed by the AO in assessment year 2013-14 after examining this issue in the scrutiny proceedings, vide order u/s 143(3) dated 28.03.2016.

6.3.3 In this regard, I find that the AS 16, notified by the ICAI, prescribes accounting principles for accounting of borrowing cost as under:

6. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization should be determined in accordance with this Statement. Other borrowing costs should be recognized as an expense in the period in which they are incurred.

7. Borrowing costs are capitalized as part of the cost of a qualifying asset when it is probable that they will result in future economic benefits to the enterprise and the costs can be measured reliably. Other borrowing costs are recognised as an expense in the period in which they are incurred.

Borrowing Costs Eligible for Capitalisation

8. The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the

expenditure on the qualifying asset had not been made. When an enterprise borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that directly relate to that qualifying asset can be readily identified.

Considering that no land has been acquired or purchased by the appellant till 31.03.2014 in respect of the advances given to Adrika and no qualifying asset has come into existence the view taken by the AO that the interest cost of Rs.15,04,76,347/- should be allocated or Capitalized as a part of the WIP and therefore its claim in the Profit & Loss A/c should be disallowed is not found to be justified. The interest cost incurred in respect of borrowings, which has been utilized merely to giving of advance for purchase of land cannot be considered as borrowing cost eligible for capitalization unless there is an acquisition of the qualifying asset/capital asset.

Further, the view taken by the AO that the interest cost is in the nature of a pre-operative expense relating to a new project is not found to be justified since the appellant has not incurred such expense for any newly identified project. The appellant is already in the business of developing the project Dosti Imperia and its business has been set up. Thus the said interest expenditure cannot be said to be in the nature of pre-operative expenses. Under these facts and circumstances, the interest cost relating to debentures is found to be in the nature of an expense incurred in the course of running its real estate business and the

same is in the nature of 'other borrowing costs' to be allowed as period cost in the Financial Year in which it is incurred.

In view of above discussion, the disallowance of interest of Rs. 15,04,76,347/- is found to be not justified and is hereby deleted.

Ground No.5 is Allowed.

14. We have heard both the parties and perused the relevant findings given in the impugned order as well as relevant material placed on record before us. In so far as issue raised in Ground No. 1 & 3 relating to disallowance of brokerage expenses of Rs. 29,15,168/- and advertisement expenses of Rs. 1,00,00,884/-, the main issue is whether the said expenditure claimed by the assessee in the profit and loss account should be capitalized to work in progress or should be allowed in the year in which such expenditure has been incurred and debited to the profit and loss account. As per Accounting Standard-2 relating to 'Violation of inventories' and Clause-13 relating to 'Selling in distribution expenditure' are to be recognized as expenses in the period in which they are incurred. Even as per ICDS-11, the selling cost have to recognize as expenses. The selling cost is not considered as part of construction cost and development cost.

15. Further, as pointed by Ld. Counsel for the assessee that the Hon'ble Delhi High Court in **PCIT v. DLF Home Development Ltd. (2020) 114 taxmann.com 97 (Delhi) (HC)** held that brokerage and commission claimed by the assessee following percentage completion method is allowed in the year in which they are incurred.

16. Further, It has also been pointed out that in AY 2011-12, the said expense has been allowed by the AO and again in AY 2013-14 too. Thus, we do not find any infirmity in the order passed by Ld. CIT(A) and the same is confirmed.

17. In so far as issue on account of disallowance of interest also, the issue is whether the interest paid on full convertible debentures utilized for given an advance to M/s Adrika Developers Pvt. Ltd. for procuring the land is to be allowed u/s 36(1)(iii) /36(1) incurred for the purpose of business.

18. As per Accounting Standard 16 relating to Borrowings, interest on borrowings which is used for acquiring an asset can only be capitalized. Interests on other borrowings have to be treated as revenue expense. Since, there was no identifiable Asset

purchased by Adrika Developers, it was not possible to capitalize the interest. Proviso to Section 36(l)(iii) will apply only when borrowing is for acquiring a specific Asset and not for general business purpose. Interest cost of Rs 2,76,57,503/- which pertains to project Dosti Imperia have been capitalized by the assessee. The amount of interest of Rs 15.04 crore did not pertain to any asset, therefore the same has not been capitalized. The Hon'ble Bombay High Court in the case of **CIT v Lokhandwala Construction Inds. Ltd (2003) 260 ITR 579 (Bom)(HC)**, it was held that deduction of interest u/s 36(l)(iii) was allowable when capital was borrowed for obtaining stock in trade and not fixed Asset. The relevant portion of the judgement reads as under:-

"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(l)(iii). Since the assessee had received loan for obtaining stock-in-trade (Kandivali Project), the assessee was entitled to deduction under section 36(l)(iii) of the Act. That, while adjudicating the claim for deduction under section 36(l)(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(l)(iii) of the Act - Calico Dyeing & Printing Works v. CIT [1958] 34 ITR 265 (Bom.). 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.

Thus, in the present case also, since capital was borrowed for the business of the Assessee and the land purchased would be stock in trade, interest is an allowable deduction.

19. Ld. CIT(A) has already held that advance was given for commercial expediency and M/s Adrika Developers Pvt. Ltd. is a subsidiary of assessee. If the loan was given on account of commercial expediency, then the interest expenses has to be allowed as business expenditure. It has been pointed out before us by Ld. Counsel that in AY 2011-12 to 2013-14, the interest

expenditure on this loan has been allowed. Otherwise also, the aforesaid observation in the finding of Ld. CIT(A) as noted above is factual and legally correct, therefore the same is confirmed.

20. In the result, the appeal filed by the revenue is **dismissed**.

Orders pronounced in the open court on 6th September, 2022.

Sd/-
(Pramod Kumar)
Vice President

Sd/-
(Amit Shukla)
Judicial Member

मुंबई Mumbai;दिनांक Dated : 06.09.2022
Sr.PS. Dhananjay

आदेशकीप्रतिलिपिअग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी/ The Appellant
2. प्रत्यर्थी/ The Respondent
3. आयकरआयुक्त(अपील) / The CIT(A)
4. आयकरआयुक्त/ CIT- concerned
5. विभागीयप्रतिनिधि, आयकरअपीलीयअधिकरण, मुंबई/ DR, ITAT, Mumbai
6. गार्डफाईल / Guard File

आदेशानुसार/ BY ORDER,

उप/सहायकपंजीकार (Dy./Asstt.Registrar)
आयकरअपीलीयअधिकरण, मुंबई/ ITAT, Mumbai

