

**IN THE INCOME TAX APPELLATE TRIBUNAL
“B” BENCH, AHMEDABAD**

**BEFORE SHRI T.R. SENTHIL KUMAR, JUDICIAL MEMBER &
SHRI NARENDRA PRASAD SINHA, ACCOUNTANT MEMBER**

आयकर अपील सं./I.T.A. No. 438/Ahd/2022

(निर्धारण वर्ष / Assessment Years : 2018-19)

ACIT Circle 1(1)(1), Ahmedabad	बनाम/ Vs.	Sumedha Spacelinks LLP 25, Shukan Mall, 4 th Floor, Nr. Rajasthan Hospital, Shahibaug, Ahmedabad, Gujarat - 380004
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : ACDFS5396Q		
(Appellant)	..	(Respondent)

अपीलार्थी ओर से /Appellant by :	Shri Sudhendu Das, CIT. DR
प्रत्यर्थी की ओर से/Respondent by :	Shri S. N. Soparkar, Sr. Advocate & Shri Parin Shah, AR

Date of Hearing	27/08/2024
Date of Pronouncement	30/08/2024

ORDER

PER SHRI NARENDRA PRASAD SINHA, AM:

This appeal is filed by the Revenue against the order of the National Faceless Appeal Centre (NFAC), Delhi (in short ‘the CIT(A)’) dated 30.09.2022 for the Assessment Year 2018-19.

2. The brief facts of the case are that the assessee is LLP engaged in the business of real estate. The original return of income for A.Y. 2018-19 was filed by the assessee on 23.09.2018

by declaring income at Rs.1,13,76,460/-. Thereafter, a revised return was filed on 20.02.2019 reporting the same income. The assessment was completed under Section 143(3) of the Income Tax Act, 1961 (in short 'the Act') on 29.04.2021 at total income of Rs.85,93,94,775/-. In the course of assessment, the AO had made additions in respect of disallowance of general expenses, disallowance of WIP and undisclosed revenue. Aggrieved with the order of the AO, the assessee has filed an appeal before the First Appellate Authority, which was decided by the Ld. CIT(A) vide the impugned order, who had allowed substantial relief to the assessee.

3. Now, the Revenue is in appeal before us.

4. The following grounds have been taken in this appeal:

- 1) *"Whether the Ld. CIT(A) has erred in law and on facts in restricting the disallowance of general revenue expenses of Rs. 42,65,761/- to Rs. 19,28,265/- without appreciating the facts of the case*
- 2) *Whether the La CIT(A) has erred in law and on facts in deleting the addition of Rs. 82,53,21,404/- towards undisclosed portion of profit pertaining to Phase 1, without appreciating the facts that the assessee was following Accounting Standard-7 (popularly known as Percentage of completion method) and the project had already been completed 100%?"*
- 3) *"Whether the Ld.CIT(A) has erred in law and on facts in deleting the addition of Rs.1,84,31,150/- being profit on unrecorded sales without appreciating the facts of the case?"*

- 4) *"The appellant craves leave to amend or alter any ground or add a new ground, which may be necessary"*
- 5) *"It is, therefore, prayed that the order of Ld. CIT(A) may be set aside and that of the Assessing Officer be restored".*

5. The first ground pertains to disallowance of general expense of Rs.42,65,761/-. The assessee was engaged in the construction of a project in the name of "Casa Vyoma", which was being constructed in two phases. While Phase-1 was 100% complete, Phase-2 was only 22% completed. The assessee was following percentage completion method to recognize its revenue. The assessee had claimed total general expenses of Rs.1,54,94,955/-, the details of which are as under:

<i>Description</i>	<i>Phase-1</i>	<i>Phase-2</i>	<i>General</i>
<i>Employee Cost</i>	0	0	43,96,826
<i>Finance Charges</i>	9,79,56,947	0	0
<i>Brokerage & Comm</i>	28,30,269	0	0
<i>GST Waive off</i>	21,56,830	0	0
<i>Other Expenses</i>	0	0	1,10,98,129
<i>Total</i>	10,29,44,046	0	1,54,94,955

The total general expenses of Rs.1,54,94,955/- was bifurcated by the AO into two parts according to the cost incurred in ratio of Phase-1 & Phase-2 project. Accordingly, an amount of Rs.42,65,761/-, being in the ratio of 27.53% of cost incurred for Phase-2 project, was apportioned and disallowed by the AO for the reason that revenue of Phase-2 was not recognized during the year. The Ld. CIT(A) restricted this disallowance to Rs.19,28,265/- only.

6. Shri Sudhendu Das, Ld. CIT.DR submitted that when the AO had made the disallowance on the basis of ratio of cost incurred between Phase-1 & Phase-2, the Ld. CIT(A) was not correct in restricting the disallowance of Rs.19,28,265/- only. Per contra, Shri S. N. Soparkar, Ld. Sr. Counsel appearing for the assessee submitted that the Ld. CIT(A) had examined the nature of the entire general expenses and thereafter, rightly allowed relief to the assessee.

7. We have carefully considered the rival submissions. The action of the AO in apportioning the general expenses on the basis of cost incurred for the two projects, without examining the actual nature of the expenses, cannot held as correct. The Ld. CIT(A) has given a categorical findings that out of total general expenses of Rs.1,54,94,955/-; the expenses of Rs.1,02,79,961/- was exclusively pertaining and attributable to Phase-1. This comprised of selling and marketing expenses of Rs.33,88,529/-, consultancy charge of Rs.20,12,799/- for RERA & GST, travelling expenses of Rs.6,25,904/-, office renovation expenses of Rs.15,05,967/-, other expenses of Rs.16,89,241/- etc. After excluding these expenses directly attributable to Phase-1, the Ld. CIT(A) had apportioned the remaining general expenses of Rs.41,64,473/- between Phars-1 & Phase-2 in the ratio of cost allocation. Accordingly, the addition of Rs.19,28,265/- only was upheld by the Ld. CIT(A). The Revenue has not pointed out any defect in the finding of the CIT(A) in respect of expenses

pertaining to Phase-I and in the allocation of balance expense as made by the Ld. CIT(A). We, therefore, do not find anything wrong with the order of the Ld. CIT(A) on this issue. Accordingly, the disallowance of Rs.19,28,265/- on account of general expenses as restricted by the Ld. CIT(A) is upheld and the ground taken by the Revenue is dismissed.

8. Ground No.2 pertains to addition of Rs.82,53,21,404/- towards cost of construction of unsold flats pertaining to Phase-1 and Ground No.3 pertains to addition of Rs.1,84,31,150/- being profit margin of flats sold. As both these issues pertain to Phase-1 of the construction, we deem it proper to address both the grounds together. In the Phase-1 of the project, the construction of which was complete, there were 158 flats, out of which only 9 flats were booked and revenue of Rs.6,15,09,143/- was realized. The construction cost of these flats was Rs.87,62,99,497/-. According to the AO, since the assessee was following percentage completion method and Phase-1 of project was completed 100%, therefore, the revenue should have been recognized for all these flats. Since, the assessee had not recognized the revenue for the unsold flats, the cost of construction of 149 unsold flats was worked out by the AO at Rs.82,53,21,404/- and was added to income. Further, 9 flats that were booked and for which revenue of Rs.6,94,09,143/- was realized, the construction cost of these 9 flats was worked out at Rs.5,09,78,093/-. The profit margin of these 9 flats was, thus

worked at Rs.1,84,31,150/- and was also added to income. The Ld. CIT(A) has deleted both the additions.

9. The Ld. CIT.DR supported the order of the AO. On the other hand, Shri S. N. Soparkar, Ld. Sr. Counsel submitted that the AO had made the additions on wrong presumptions and the Ld. CIT(A) has rightly disallowed both the additions. He explained that the assessee was following percentage completion method and was recognizing its revenue as per the Accounting Standard-7. Merely because the percentage completion was being followed, it doesn't mean that 100% of the revenue would be recognized even without the flats being sold. The cost of construction of flats had to be booked in the year in which they were incurred and the AO was not correct in disallowing the cost of unsold flats. Further, when the assessee had already recognized the revenue of Rs.6,94,09,143/- in respect of 9 flats that were booked, there was no question of making further addition in respect of profit margin on these flats. He further submitted that some of these booked flats were cancelled and the amount was refunded. The Ld. Sr. Counsel has also drawn our attention to the audited accounts of the assessee to explain that the Percentage Completion Method was correctly followed by the assessee and the addition made by the AO was based on wrong presumptions.

10. We have carefully considered the rival submissions. We do not find any merit in both the additions as made by the AO. The additions had been made on wrong presumption of the accounting standards. The Percentage Completion method doesn't stipulate that all the flats will be deemed to be sold on completion of the project and that revenue will be deemed to be realized without actual sale of the flats. Therefore, the addition of Rs.82,53,21,404/- in respect of cost of construction of 149 unsold flats is found to be based on total wrong presumption. The addition of Rs.1,84,31,150/- in respect of profit margin of booked flats is also not found correct. The finding given by the Ld. CIT(A) in respect of these additions is found to be as under:

"I have gone through the facts of the case and submission made by the appellant in this regard. The AO's action of addition of Rs.82,53,21,404/- being cost of construction of 149 flats, which were not sold and shown as inventories, is prima facie erroneous. The cost of construction can never be said as profit in any method of accounting. So far as the 0 booked flats are concerned, the appellant stated that booking of 4 flats were cancelled and for remaining 5 flats the booking amount received were less than 10% of total consideration, therefore, in respect of remaining 5 flats also revenue cannot be recognized considering the specific accounting procedure laid down in AS-9 (Revenue Recognition), AS-7 (Construction Contract) and Guidance Note on Accounting for Real Estate Transactions (Revised) 2012.

During assessment proceedings, the AO adopted the view that Phase-I of the project is completed 100%, therefore, revenue in all 158 cases has to be recognized according to Percentage of Completion Method. However, to arrive at proper conclusion one has to deal Accounting Standard-7, Accounting Standard-9 and Guidance Note on Real Estate Business (Revised 2012) simultaneously

Accounting Standard-7 (Construction contracts) is applicable for businesses engaged in construction on someone else property on a

contract basis and issue a sale bill at the end of the construction containing the cost of materials, labour and other expenses. Sale of developing flats under project, as per agreement to sell, is an example of real estate transaction, which is in substance, similar to construction contracts. Reason for the same is that once an agreement to sale is entered, buyers become owner of the property and now the developer is only constructing the flat on behalf of buyer. Although, it is not a construction contract but its substance is almost same, thus developer will have to record his transaction as per percentage of completion method.

Accounting Standard-9 (Revenue Recognition) is also applicable for the person engaged in real estate business, purchases land, constructs building on the same and sell it to the prospective buyers.

Explanation part (para 5) of AS-9 says that revenue recognition is mainly concerned with the timing of recognition of revenue in the statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue.

Main principles of AS-9 in para 10, 11 & 12 deals with revenue recognition reads as follows:-

10. Revenue from sales or service transaction should be recognized when the requirements as to performance set out in paragraphs 11 and 12 are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

11. In a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled. (i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership, and (1) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

12. In a transaction involving the rendering of services, performance should be measured either under the completed

service contract method or under the proportionate completion method, which ever relates the revenue to the work accomplished Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration.

In the instant case, the appellant is the owner of all 158 flats, the flats were not transferred to the buyers, therefore, all significant risks and rewards of ownership lies with the appellant. However, 5 flats were booked but revenue recognized in these flats were less than 10%. In respect of remaining 153 flats significant uncertainty exists regarding the amount of the consideration.

An entity can also record revenue from such real estate transaction in accordance with the Guidance Note on Accounting for Real Estate Transactions (Revised 2012), This Guidance Note was introduced to specially provide accounting treatment for real estate transactions because of the peculiar nature of transactions.

Para 3.3 of the guidance note deals with the accounting for real estate transaction.

3.3 For recognition of revenue in case of real estate sales, it is necessary that all the conditions specified in paragraphs 10 and 11 of Accounting Standard (AS) 9, Revenue Recognition, are satisfied. As stated above, real estate sales take place in a variety of ways and may be subject to different terms and conditions as specified in the agreement for sale, Accordingly. the point of time at which all significant risks and rewards of ownership can be considered as transferred, is required to be determined on the basis of the terms and conditions of the agreement for sale. In case of real estate sales, the seller usually enters into an agreement for sale with the buyer at initial stages of construction. This agreement for sale is also considered to have the effect of transferring all significant risks and rewards of ownership to the buyer provided the agreement is legally enforceable and subject to the satisfaction of conditions which signify transferring of significant risks and rewards even though the legal title is not transferred or the possession of the real estate is not given to the buyer. Once the seller has transferred all the significant risks and rewards to the buyer, any acts on the real estate performed by the seller are, in substance, performed on behalf of the buyer in the manner similar to a contractor. Accordingly, revenue in such cases is recognised by applying the percentage of completion method on the basis of the

methodology explained in AS 7, Construction Contracts. Further, where individual contracts are part of a single project, although risks and rewards may have been transferred on signing of a legally enforceable individual contract but significant performance in respect of remaining components of the project is pending, revenue in respect of such an individual contract should not be recognised until the performance on the remaining components is considered to be completed on the basis of the aforesaid principles. This Guidance Note, thus, provides guidance in the application of:

- *Principles of AS 9 in respect of sale of goods for recognizing revenue, costs and profits from transactions of real estate which are in substance similar to delivery of goods where the revenues, costs and profits are recognised when the revenue recognition process is completed; and*
- *Percentage completion method for recognising revenue, costs and profits from transactions and activities of real estate which have the same economic substance as construction contracts.*

This guidance note provides that the substance of the transaction is similar to delivery of goods, principles of AS-9 will apply with respect to the sale of real estate. Revenue in such cases shall be recorded on fulfillment of para 11 and para 12 of AS 9. Also the substance similar to construction contract, principle of AS-7 will apply.

Para 5 of this guidance note deals with application of percentage completion method The relevant portion of para 5 is reproduced as under:

5.3 Further to the conditions in paragraph 52 there is a rebuttable presumption that the outcome of a real estate project can be estimated reliably and that revenue should be recognised under the percentage completion method only when the events in (a) to (d) below are completed.

- (a) *All critical approvals necessary for commencement of the project have been obtained. These include, wherever applicable*
 - (i) *Environmental and other clearances.*
 - (ii) *Approval of plans, designs, etc.*
 - (iii) *Title to land or other rights to development/construction*

(iv) *Change in land use*

(b) *When the stage of completion of the project reaches a reasonable level of development. A reasonable level of development is not achieved if the expenditure incurred on construction and development costs is less than 25 % of the construction and development costs as defined in paragraph 2.2 read with paragraphs 2.3 to 2.5*

(c) *At least 25% of the saleable project area is secured by contracts or agreements with buyers.*

(d) *At least 10% of the total revenue as per the agreements of sale or any other legally enforceable documents are realised at the reporting date in respect of each of the contracts and it is reasonable to expect that the parties to such contracts will comply with the payment terms as defined in the contracts. To illustrate - If there are 10 Agreements of sale and 10% of gross amount is realised in case of 8 agreements, revenue can be recognised with respect to these 8 agreements*

Para 5.3 of guidance note on accounting for real estate transactions (Revised 2012) say that the outcome of a real estate project can be estimated reliably and that revenue should be recognised under the percentage completion method only when the events in (a) to (d) above are completed.

In the instant case, as per criterion 'a', the appellant may have taken the necessary critical approval for commencement of project. Since the project is completed at 100% criterion 'b' is also fulfilled. The fact is here that whether 25% or more saleable area covered by agreement. Since out of 158 flats only 5 flats are booked which is lesser than 4%, therefore it is not possible that lesser than 4% of booked flats covers 25% or more of saleable area. According to last criterion 'd', 10% or more of total revenue is realized in respect to each of the contract as per agreement of sell. However, in the instant case, maximum 8% and minimum 6% of revenue were realized in respect of booked flats. The case of the appellant didn't fulfill the criteria 'c & 'd', therefore, the appellant was not required to apply the method of percentage completion.

AO has not brought out any fact in his order wherein it can be concluded that appellant has taken advance of more than 10% even for 9 booked flats. Therefore, the conditions stipulated in AS-7 read with Guidance Note on Real Estate Business do not trigger for recognition of revenue even for these 9 flats.

Considering the accounting policies and Guidance Note issued by the ICAI the appellant has followed legitimate accounting principle and was not required to recognize revenue of 158 flats of Phase-I. The appellant gets relief in these grounds. Hence, the addition made by the AO based on percentage completion method in respect of profit margin of 9 booked flats of Rs.1,84,31,150/- as well as the disallowance of WIP of 149 flats of Rs.82,53,21,404/- is deleted. These grounds of appeal are allowed.”

11. The Ld. CIT(A) has correctly appreciated the principles of Accounting Standards and the methodology adopted by the assessee to recognize its revenue and has rightly allowed the relief in respect of both the additions. It was held by the Hon'ble Gujarat High Court in the case of *CIT v Shivalik Buildwell P Ltd (2013) 40 taxmann.com 219 (Guj.)* that in case of developer of project, profit would arise only on transfer of title of property and the receipt of advance or booking amount cannot be treated as trading receipt of year under consideration. As rightly held by Ld. CIT(A), the guidelines of AS-7 didn't trigger recognition of revenue for booked flats, as the advance received was less than 10%. Hence, the addition of Rs.1,84,31,150/- was rightly deleted by Ld. CIT(A). Further, the addition of Rs.82,53,21,404/- in respect of cost of construction of 149 unsold flats was also without any basis. The cost of construction as already incurred by the assessee cannot be disallowed on an arbitrary basis. The books of accounts of the assessee were audited and the Auditor had certified that the assessee was correctly following the Percentage Completion Method to recognize its revenue. No discrepancy or any infraction in the accounting system of the assessee was pointed out by the Auditor or any other authority.

Since, the accounting of income in this case was in accordance with the guidelines of ICAI, we do not find any basis for the additions as made by the AO. Therefore, the order of the Ld. CIT(A) in deleting both the additions, is upheld. The grounds taken by the Revenue are dismissed.

12. In the result, appeal preferred by the Revenue is dismissed.

This Order pronounced on 30/08/2024

Sd/-
(T.R. SENTHIL KUMAR)
JUDICIAL MEMBER

Ahmedabad; Dated 30/08/2024
S. K. SINHA

Sd/-
(NARENDRA PRASAD SINHA)
ACCOUNTANT MEMBER

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

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. संबंधित आयकर आयुक्त / Concerned CIT
4. आयकर आयुक्त(अपील) / The CIT(A)-
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, अहमदाबाद / DR, ITAT, Ahmedabad
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, अहमदाबाद / ITAT, Ahmedabad