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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ ITA 494/2018

COMMISSIONER OF INCOME TAX

..... Appellant

Through: Mr. Sanjay Kumar, Senior Standing
Counsel for Revenue with Ms. Easha
Kadian, Advocate.

versus

SOMNATH BUILDTECH PVT. LTD

..... Respondent

Through: Mr. Kapil Goel, Advocate through
Video-conferencing.

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Date of Decision: 13th October, 2022

CORAM:

HON'BLE MR. JUSTICE MANMOHAN

HON'BLE MS. JUSTICE MANMEET PRITAM SINGH ARORA

J U D G M E N T

MANMEET PRITAM SINGH ARORA, J (ORAL):

1. Present appeal has been filed under Section 260A of the Income Tax Act, 1961, ('the Act') for setting aside the impugned order dated 22nd November, 2017, passed by the Income Tax Appellate Tribunal ('ITAT') in ITA No.2940/Del/2014 for the Assessment Year ('AY') 2009-10.
2. The learned counsel for the appellant, Revenue, states that the ITAT has erred in deleting the addition of Rs. 4,50,38,586/- made by the Assessing Officer ('AO') in the hands of Assessee as a capital expense. He states that ITAT has erred in upholding the Assessee's reliance on Accounting Standard (AS-7) and the Guidance Note issued by the Institute of Chartered Accountants of India (ICAI), as the Assessee is admittedly a "developer" and not a "contractor", sums received as advances by it were not under a

“construction contract” and the Assessee was not following the ‘Percentage of Completion Method’ (‘POCM’). He states that the ITAT itself made the self-contradictory finding that the respondent was following the “completed contract method” (‘CCM’). Therefore, the said expenses being capital in nature should have been disallowed in accordance with provisions of Section 37(1) of the Act. He states that the ITAT failed to appreciate that the expenses incurred by the Assessee were not intended to earn revenue during the subject AY and were spent for an ‘enduring benefit’ of the real estate project over a significant period of time, consisting of a number of AYs till the completion and sale of the project.

3. He states that the ITAT fell in error in holding that the amount expended by the Assessee towards ‘advertisement expenses’ and ‘business promotion expenses’ are related to the ‘general administrative cost’ of the Respondent. He states that ITAT erred in holding that the amount expended by the Assessee towards ‘brokerage and commission’ was incurred for the purpose of sale of the project, whereas admittedly the project was ongoing and unsold in this AY and the Assessee was following the CCM method which necessitates that the additions by the AO should be capitalised till the completion of the relevant project in a later AY. He further states that the ITAT erred in holding that the amount expended by the Assessee towards ‘software development charge’ has been incurred for the purpose of day to day operations of the Respondent as the ITAT failed to appreciate that the said expense was in the nature of one-off payment, which included customization of such software for the benefit of the Assessee.

4. He states that ITAT erred in holding that the disallowed expenses were revenue in nature, merely by relying on the classification of such sums

by the Assessee in its books of accounts. He further states that the said expenses, in view of the provision of Section 37(1) of the Act, are barred from being deducted against taxable income under the head of 'profits and gains from business or profession' irrespective of purported 'revenue neutrality' of classification of such expenses by the Assessee.

5. In reply, the learned counsel for the Respondent, Assessee, has contended that both the Commissioner of Income Tax (Appeal) ['CIT(A)'] and the ITAT, after perusing the documents on record, have returned concurrent findings of fact that the disallowance of expenses made by the AO is incorrect. He submits that the expenses on advertisement, business promotion, brokerage and commission and software development charges aggregating to Rs. 450,38,586/- are revenue expenses and were rightly classified as such by the Assessee in accordance with the binding Accounting Standards (AS-7), which were followed in preparation of accounts as per Sections 209 and 211 of the erstwhile Companies Act, 1956.

6. He also relies upon the judgment of this Court in ***Gopal Dass Estates & Housing Pvt. Ltd vs. CIT*** in ITA 210/2003 dated 20th March, 2019 for supporting classification of the aforesaid expenses as 'revenue expense' and judgment of the Supreme Court in ***Commissioner of Income Tax vs. Excel Industries Ltd., 2014 13 SCC 459*** to substantiate the reasoning of the ITAT with respect to the classification of the expenses being a 'revenue neutral' exercise.

7. We have heard the counsel for the parties and perused the paper-book. The brief facts are that the Assessee is a developer engaged in the business of real estate and in the relevant assessment year was constructing residential and commercial projects in the state of Rajasthan. The Assessee

had undertaken its first residential-cum-commercial project on 26th November, 2007. The Assessee had collected advances from various customers to the tune of Rs. 21,38,62,554/- and recorded the same in the balance sheet of the relevant AY. The development of the project began during the Financial Year ('FY') 2008-09 and the company incurred expenses under several heads.

8. The Assessee filed its Return of Income ('ITR') on 30th September, 2009. In the ITR, the Assessee claimed expenses of 16,52,57,997/- under various heads, which included the sums incurred towards purchase of land and cost of construction amounting to Rs. 11,21,57,074/-. The expense incurred by the Assessee towards cost of land and cost of development were capitalised as stock-in-trade.

The balance expenses amounting to Rs. 5,31,00,923/- was charged to the Profit & Loss Account and claimed as business expense. The Assessee had total twenty eight (28) heads of indirect expenses, the AO disallowed the following four (4) heads of expenses as revenue expenditure and instead re-classified the same as capital expenses:-

| | |
|-----------------------------|---------------------------|
| Advertisement Expenses | Rs.16,67,436.00 |
| Business Promotion | Rs.1,12,141.00 |
| Brokerage & Commission | Rs. 4,30,54,009.00 |
| Software Developing Charges | Rs.2,05,500.00 |
| Total | Rs. 4,50,38,586.00 |

The AO capitalised the aforesaid expenses towards the cost of the project. Pertinently, the genuineness of the said expenses is not in dispute.

9. The Assessee aggrieved by the order of the AO filed an appeal before the CIT(A). The CIT(A) held that the AO's action of disallowing four (4) items of expenses out of twenty eight (28) items appears to have been driven by the fact that the benefit of such expenses shall be of 'enduring nature' and the Assessee shall receive the benefits beyond the current assessment year. The CIT(A) after perusing the record concluded that the said expenses have been incurred for the business purpose of Assessee and these expenses cannot be tagged with any specific asset as the expenses are indirect expenses of the entire project. The CIT(A), therefore, concluded that the AO's action in treating the select four (4) indirect expenses as capital expenditure is not justified and directed the said disallowance to be deleted. The relevant finding of the CIT(A) in this regard is as follows:-

“10.2. The appellant has challenged the AO's action in treating these expenses as capital expenditure as such action would be in total disregard to section 209 and 211 of the Companies Act 1956 and accounting standards framed by the ICAI which are mandatory for every company. It was emphasized that the accounting treatment of various expenses in real estate business has been done as per accounting standards and accordingly all direct costs were capitalized and the indirect cost mostly pertaining to selling and distribution expense like commission to brokers and advertisement expenses etc were charged to revenue as they are related to the revenue once the business activities of the appellant have commenced. The appellant has given the complete ledger accounts of these four expenses and it was submitted that out of total 28 heads of expenses under the indirect expenses, the AO's action in choosing only four

expenses is arbitrary and hence not justified. The appellant has cited the decisions of various courts in support of its submissions.

- 10.3. On considering the facts of the case as well as the submissions made by the appellant, it is observed that so far as the AO's observation that it agreed for capitalization of four expenses during the assessment proceedings, the same is not supported with the fact that it is being contested in appeal. In its submissions, the appellant has highlighted that the treatment of such expenses as capital expenditure instead of revenue shall no way impact the taxation of the appellant because in case of treating the same as capital expenditure, this expense will be allowed in the year when the transfer of property takes place or the sale is booked. However, it was again highlighted that it would not be as per the accounting standards issued by ICAI and would be in complete disregard to the provisions of section 209 & 211 of the Companies Act, 1956. Secondly, there is no basis for selecting only four items out of 28 items on expenses claimed by the appellant under the indirect expenses head, it appears that the AO had chosen these heads of expenses solely on the ground that the benefits of such expenses shall be of enduring nature and the appellant shall reap the benefits beyond the current assessment year. **However, the AO has lost sight of the fact during such action that these expenses in no way were directed to the specific asset as the business of the appellant is in real estate. Thus, these expenses cannot be tagged with any of the specific asset as these expenses are indirect expenses of the entire projects. At the same time, it is also noticed that no tangible asset is being created by treating these expenses as capital expenditure. Since the expenses are necessarily being incurred for the business purposes of the appellant, these are allowable expenses.** In support of its claim the appellant has relied upon the decisions of Hon'ble Courts in the case of M/s Godrej Tea Ltd. vs. DCIT (2010) (4) ITR 649 (Mum.), Southern Roadways Ltd. (2008) 220 CTR 298 (Mad.), CIT Vs. Indian Visit Com. (P) Ltd. (2009), 176 Taxman 164 (Del) and Brehan Maharashtra Sugar Syndicate Ltd. Vs. DCIT (2009) 28 DTR 265 (Bom) and Club Resorts Pvt. Ltd. vs. CIT

(2006) 203 CTR 587 (Mad.). On considering the facts and details mentioned hereinabove as well as the judicial decisions of the Courts on the subject, the AO's action in treating the expenses under the abovementioned four heads as capital expenditure is not justified and the same is directed to be deleted. Ground No. 2, 3 & 4 of the appeal are allowed.”

(Emphasis supplied)

10. The Revenue aggrieved by the said order filed an appeal before the ITAT. The ITAT referred to the Guidance Note provided by the ICAI for accounting in the case of real estate projects. The ITAT held that the said guidelines are applicable to the facts of the case of the Assessee. The ITAT concluded that the expenses under the four (4) heads disallowed by the AO are covered by paragraph no. 2.4 of the Guidance Note and are therefore, administrative expenditure and thus, these expenses cannot be carried forward and should be expensed. The ITAT also held that the classification of the said expenditure as revenue expenditure would not place the Revenue at any disadvantageous position whereas it may put the Assessee to some disadvantage. This finding of the ITAT as regards ‘revenue neutrality’ has not been disputed by the learned counsel for the Respondent. The finding of the ITAT reads as follows:-

“7. The expenditure that is stated to be capitalized by the Ld. Assessing Officer are the advertisement expenses and business promotion expenses which are related to the general administrative cost of the assessee. The brokerage and commission expenditure are related to selling costs, which is not disputed. Further, the software development expenditure incurred by the assessee are for the purpose of day to day running of the company and not related to the specific project. As stated in the guidance note of the Institute of chartered

accountants of India, as per para No. 2.4 that on relate administrative expenditure as well as the selling cost should not be carried forward and capitalizing the project cost but should be expensed. **The Ld. departmental representative could not point out that how the accounting made by the assessee is not proper with respect to the guidance note issued by the Institute of chartered accountants of India. Further, none of the expenditure incurred by the assessee were not found to be not genuine.** Looking from the another angle about the expenditure claimed by the assessee, it would be apparent that if the assessee follows the completed contract method, then the assessee would be carrying on the cost of the project for the period till the project is sold. Naturally the cost of the project would be increased by these amounts and the revenue is duty bound to grant the deduction of this cost of project at the time of sale. Therefore in that particular scenario, the amount of expenditure incurred by the assessee would be allowed to the assessee is a deduction in that particular year. If the deduction is allowed to the assessee during this year and the assessee has incurred loss assessee is duty bound to set of this loss within a specified number of assessment year specified under section 72 of the Income Tax Act, i.e. 8 years. If the assessee cannot set of these losses during that particular period then the assessee forgoes the tax advantage of claim of the loss. **Therefore, even if the expenditure is allowed to the assessee for this year as deduction, it does not make the case of the revenue at any disadvantageous position, in fact, it puts assessee into some disadvantage.**

(Emphasis supplied)

11. The appellate authorities have after perusing the evidence placed on record before them, returned findings of fact that the genuineness of the expenditure incurred by the Assessee is not in dispute. The appellate authorities have further concurred that the said expenses have to be allowed as a revenue expenditure in conformity with the then applicable Accounting Standard (AS-7) and these expenses cannot be assigned to a specific asset.

This court similarly in case of a developer in the case of **Gopal Dass** (*Supra*) with respect to classification of expenses incurred held as under:

“....

26. *There is merit in the contention of the Assessee, based on AS 2 that compensation paid subsequent to the completion of the project is an 'extraordinary item'. It was not 'cost' of completion of the project and therefore, such compensation could not be added to the value of the stock and trade of the Assessee. AS 2 governs valuation of inventories. 'Cost' comprises all of the costs of purchase, cost of completion and other costs incurred "in bringing the inventories to their present location and condition". That which is not relevant to bringing the stock to its present condition or location cannot be part of its value.*

.....
27. *There is, therefore, merit in the contention of the Assessee that the compensation paid to the flat buyers upon surrender of the respective allotted commercial spaces cannot be added to the value of 'stock and trade'. In the considered view of the Court, the view expressed by the CIT(A) merits acceptance. The conclusion of the ITAT that the payment was made for 'extraneous consideration' appears to be based on surmises and conjectures.*

.....
31. *The result of the above discussion is that the Court holds that the payment made by the Assessee to the allottees of the flats for their surrendering the rights therein should be allowed as business expenditure of the Assessee.*

.....”

12. The Revenue in these proceedings admits to the genuineness of the expenditure. There is also no dispute that the Assessee is bound to draw up its Profit and Loss account and balance sheet in compliance with the accounting standards of the ICAI. The learned counsel for the Respondent has failed to point out any ground for contending that the Guidance Note issued by ICAI for applying the Accounting Standard (AS-7) is not

applicable to the Assessee. The contention of the Revenue that the disallowed expenses are of an 'enduring nature' and should therefore be capitalized to the cost of the project is not based on any legal principle. The Revenue does not dispute that these expenses are not a direct cost of the specific project but are indirect costs incurred by the Assessee for development of its real estate business. The Revenue does not dispute that these expenses are admittedly not incurred as cost towards completion of the on-going real estate project and therefore in our considered view these expenses cannot be added toward the cost of valuation of the specific asset.

The expenses such as advertising expenses, business promotion and brokerage and commission have been incurred by the Assessee towards building its reputation and network in the real estate market and so also the software development charges are incurred towards administrative expenses.

13. We do not find any error in the findings of the ITAT, which holds that the said expenses incurred by the Assessee are in the nature of general administration cost and selling cost as classified by the Guidance Note issued by ICAI. The said expenses had been incurred by the Assessee for its business and therefore, it qualifies for deduction as revenue expenditure, as per the decision of this court in *Gopal Dass (Supra)*.

14. Further, the appellant's contention that the expenses should be capitalised and added to the value of the project in effect postpones the realisation of the said expense to the year of sale and would be liable for deduction in the hands of the Assessee in the year of sale of the project. The admissibility of the deduction is therefore not denied by Revenue but it is only the year of deduction which is sought to be postponed. It is in these facts the ITAT has held the classification of the expense is revenue neutral.

It would be pertinent to note the decision of the Supreme Court on the issue of “revenue neutrality” wherein the Apex Court in the decision of *Excel Industries Ltd. (Supra)* held as follows:

“...

28. Thirdly, the real question concerning us is the year in which the assessee is required to pay tax. There is no dispute that in the subsequent accounting year, the assessee did derive benefits under the advance license and the duty entitlement pass book and paid tax thereon. Therefore, it is not as if the Revenue has been deprived of any tax. We are told that the rate of tax remained the same in the present assessment year as well as in the subsequent assessment year. Therefore, the dispute raised by the Revenue is entirely academic or at best may have a minor tax effect. There was, therefore, no need for the Revenue to continue with this litigation when it was quite clear that not only was it fruitless (on merits) but also that it may not have added anything much to the public coffers.
.....”

15. We, therefore, do not find any infirmity in the order of the ITAT and that any substantial question of law arises for consideration in the present appeal. Accordingly, the same is dismissed.

MANMEET PRITAM SINGH ARORA, J

MANMOHAN, J

OCTOBER 13, 2022/msh/tb