

IN THE INCOME TAX APPELLATE TRIBUNAL “C” BENCH: KOLKATA
[Before Shri M. Balaganesh, AM & Shri S.S. Viswanethra Ravi, JM]

I.T.A Nos. 2157 & 2158/Kol/2013
Assessment Years: 2007-08 & 2009-10

Deputy Commissioner of Income-tax, Circle-11, Kolkata. (Appellant)	Vs.	Kolkata West International City Pvt. Ltd. (PAN: AACCK4887A) (Respondent)
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Date of hearing: 24.08.2016
Date of pronouncement: 05.10.2016

For the Appellant: Shri G. Mallikarjuna, CIT, DR
For the Respondent: Shri A. K. Tulsiyan, AR

ORDER

Per Shri M. Balaganesh, AM:

Both these appeals by revenue are arising out of separate orders of CIT(A)-XII, Kolkata vide appeal Nos. 485 & 375/XII/11/11-12 both dated 22.04.2013. Assessments were framed by DCIT, Circle-11, Kolkata u/s. 143(3) of the Income tax Act, 1961 (hereinafter referred to as the “Act”) for AYs 2007-08 and 2009-10 vide his separate orders dated 27.12.2010 and 19.12.2011. Since issues are identical and facts are common and for the sake of brevity, we dispose of both the appeals by this consolidated order.

2. The first issue to be decided in these appeals is as to whether the ld CITA is justified in deleting the disallowance of expenses , made on account of Travelling & Conveyance, Brokerage & Commission, Advertisement, Publicity & marketing , legal & professional charges, service maintenance charges, rent, rates & taxes, security expenses, consultancy charges and miscellaneous expenses , in the facts and circumstances of the case.

2.1. The brief facts of this issue is that the assessee is a private limited company engaged in the business of development of Integrated Satellite Township in India. . The assessee filed its return for the Asst Year 2007-08 on 30.10.2007 declaring total loss of Rs. 11,83,94,738/-. The assessee recognized revenue by following Accounting Standard – 9 on ‘Revenue Recognition’ (AS-9 issued by ICAI) and guidance note on recognition of revenue by Real Estate Developers. During the relevant year under appeal, the development

activities being at the initial stage, the assessee did not recognize any revenue. Further the expenditure that were purely incidental to the project were transferred to work in progress and those not relating to project were debited to profit and loss account. The basis of allocation was duly verified and audited by the statutory auditors and no adverse comments were reported. The Id AO issued show cause notice to the assessee as to why the expenses, debited under the head 'Administrative and Marketing Expenses' other than normal filing fees and auditors remuneration which were not transferred to work in progress, should not be disallowed in the assessment. The assessee replied that for recognition of revenue, it is governed by the provisions of AS -9 and guidance notice on recognition of revenue by Real Estate Developers issued by ICAI. For valuation of its inventory, the assessee is governed by AS-2 wherein vide para 13, it is specifically provided that the following are to be excluded from the cost of inventories:-

"13. In determining the cost of inventories in accordance with paragraph 6, it is appropriate to exclude 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 conditions; and*
- (d) Selling and distribution costs."*

2.2. The assessee also placed reliance on AS-7 on 'Construction Contracts' which though not applicable to the assessee company, but it provides guidelines as to what cost should form part of contract cost and what not. Para 19 of the said accounting standard provides as under:-

"19. Costs that cannot be attributed to contract activity or cannot be allocated to a contract are excluded from the costs of a construction contract. Such costs include :

- (a) general administration costs for which reimbursement is not specified in the contract ;*
- (b) selling costs ;*
- (c) research and development costs for which reimbursement is not specified in the contract ; and*
- (d) depreciation of idle plant and equipment that is not used on a particular contract.*

Accordingly, it was submitted that on perusal of AS -2 for valuation of Inventory and AS-7 for valuation of contract cost in construction contracts, it could be observed that following costs are not considered as part of inventory :-

- (i) administrative overheads that do not contribute to bringing the inventories to their present location and condition ; and
- (ii) selling and distribution costs

2.3. The assessee submitted that during the relevant year under appeal, it incurred various expenses under the major group head which included Construction Expenses, Expenses on Employees, Administrative and Marketing Expenses and Interest cost. The expenses which were directly allocable to Project or were indirectly identifiable with project development have been transferred to WIP as part of cost of WIP. Other expenses, which are related to administrative office or selling/marketing expenses being not allocable to Project have been debited to the P/L account. Following is the break up of expenses which have been transferred to WIP and those debited to P/L account.

Figures in (000)

Head of expenses	Total amount	Transferred to WIP	Debited to P/L Account	Remarks
Construction Expenses	3,21,885	3,21,885	Nil	Being directly related to Project development cost
Expenses on employees	11,577	3,121	8,456	Cost of Employees involved in project have been allocated to Project cost
Administrative and Marketing Expenses	1,15,921	5,767	110,154	Expenses related to Project have been transferred to Project Cost. The other expenses being incurred for administrative and marketing purpose have been debited to P/L account.
Interest	32,229	27,217	Nil	Transferred to Fixed Assets Rs.5012
Sub- Total	4,81,612	3,57,990	1,18,610	
Less: Trnfd from WIP to Fixed Assets/Other Adjustments		45,732		
Total		3,12,258		

Accordingly it was explained that out of the total expenses incurred of Rs. 48,16,12,000/-, Rs. 31,22,58,000/- has been transferred to work in progress , Rs. 11,86,10,000/- being not related to project development was debited to profit and loss account and balance charge

was capitalized to fixed assets. The break up of various expenses which has been transferred to project and those which has been debited to profit and loss account as non-project expenses along with reasons for transfer / non-transfer to project was provided as below:-

Particulars of expenses	Total	Non Project	Project	Remarks
Figures In ('000)				
Advertisement	19,926	19,926	Nil	Being in the nature of selling and marketing expenses, not allocable to project cost
Publicity expenses	10,998	10,998	Nil	
Marketing expenses	8,573	8,573	Nil	
Brokerage & Commission	26,556	26,556	Nil	Being in the nature of selling and marketing expenses, not allocable to project cost
Car Hire Charges	789	789	Nil	Being incurred on head office account for administrative purpose and hence not allocable to project cost.
Insurance charges	41	41	Nil	Being expenses pertaining to solely towards insurance of head office, not includible in the Project Cost.
Travelling and Coveyance	14,652	10,713	4011	Expenses incurred on project managers travelling cost have been wholly transferred to Project cost. Similarly travelling expenses for administrative purpose are not allocable to project cost. Travelling expenses incurred by managerial persons involved both in administrative/Project purpose have been allocated on reasonable basis.
Electricity charges	1,683	383	1,300	Electricity payment to WBSEB for electricity connection at project has been allocated to Project. Other electricity charges paid for administrative office/purposes are not allocable to project cost.
Rent, rates and taxes	3,998	3,801	197	Rent expenses incurred on payment of apartment rent of Project managers have been allocated to Project cost. Rent expenses incurred in administrative office/non project managerial persons are not allocable to project.
Property Development expenses	4,352	4,352	Nil	Expenses being capital in nature have been suomotto offered to tax in the computation of income.
Printing & Stationery	514	514	Nil	Expenses are purely of administrative nature and hence not allocable to project.
Gifts	648	648	Nil	Being in the nature of selling and

				marketing expenses, not allocable to project cost
Communication expenses	1,567	1,396	171	Expenses of telephone of project site/Project Managers have been allocated to Project Cost. Other telephone expenses incurred for administrative/office purpose are not allocable to project cost.
Legal and Professional charges	8,626	8,626	Nil	Legal and Professional expenses incurred are purely to comply with various statutory formalities and are not allocable to project cost.
Service and Maintenance Charges	1,469	1,469	Nil	Includes expenses incurred on apartment maintenance, electrical maintenance, motor vehicle maintenance, office maintenance which are purely administrative expenses and are not allocable to project cost.
Security expenses	3,472	3,472	Nil	Being expenses on safety and security are not allocable to project cost.
Filing fees	1,252	1,252	Nil	Being purely in the nature of regulatory compliance, are not allocable to project cost.
Auditors remuneration	623	623	Nil	Being purely in the nature of regulatory compliance, are not allocable to project cost
My SAP Implementation charges	3,143	3,143	Nil	Incurred on account of consultancy charges for implementation of ERP package for maintenance of Accounts and for MIS reporting purposes. The same being purely for administrative purpose, are not allocable to project cost.
Miscellaneous Expenses	3,048	2,887	88	Food expenses and medical expenses incurred on project staffs have been allocated to Project cost. The other miscellaneous expenses being incurred for administrative staffs/purposes, are not allocable to project cost.
TOTAL	115,920	110,153	5,767	

2.4. It was further submitted that the mere fact that the company has not recognized revenue during the relevant year, does not entitle the administrative expenses/selling and distribution cost to form part of WIP. Expenses which forms part of WIP represents cost of stock in trade which does not include administrative expenses/selling/marketing expenses. The said expenses are incurred independent of sale of stock in trade/revenue generation and

are inherent in running of business. The business of the company being already commenced, the various administrative/marketing expenses being incurred for the relevant year have been charged to P/L account of the relevant year and allowable u/s. 37(1) of the Income Tax Act. The Id AO however proceeded to disallow majority of the expenditure as debited to profit and loss account under the head 'Administrative and Marketing Expenses' on the ground that the assessee was not able to provide any documentary evidences in respect of its claim. The facts for the Asst Year 2009-10 are also similar except with variance in figures.

2.5. Before the Id CITA, it was submitted that the Id AO had not pointed out as to how the method of charging of expenses to profit and loss account was erroneous. He had only simply expressed his opinion and had given his own personal view on the matter. It was further submitted that the mere fact that the assessee has not recognized revenue during the year, does not entitle the administrative / selling and distribution cost to form part of work in progress. The expenses which forms part of work in progress (WIP) represents stock in trade which does not include administrative /selling/ marketing expenses. The said expenses were incurred independent of sale of stock in trade /revenue generation and they are inherent in running of business. Since the business had already commenced, these expenses are squarely allowable as deduction u/s 37(1) of the Act. The Id CITA on going through the Guidance Note on Accounting for Real Estate Transactions (Revised 2012) together with AS -2 and AS -9 issued by ICAI accepted the method of accounting adopted by the assessee in allocation of expenses and deleted the disallowances made thereon. Aggrieved, the revenue is in appeal before us on the following ground:-

"1. That on the facts and circumstances of the case Ld. CIT(A) erred in deleting the disallowances of Travelling & Conveyance expenses of Rs.81,34,000/-, Brokerage & Commission expenses of Rs.2,65,56,000/-, Advt. publicity & marketing expenses of Rs.3,55,48,000/-, Legal & Professional charges of Rs.86,26,000/-, Service & Maintenance Charges of Rs.2,94,000/-, Rent, rates and taxes of Rs.38,01,000/-, Security expenses of Rs.26,04,000/-, Consultancy charges of Rs.31,42,720/- and Miscellaneous expenses of Rs.20,57,517/- aggregating Rs.9,07,63,237/- without appreciating the findings of the AO that the assessee has not recognized any revenue from the operations since the development activities are at initial stage and most of the expenses are relating to the work in progress of the project."

2.6. The Id DR took to the relevant portion of the Guidance note relied upon by the assessee and stated that the insurance portion is to be allocated to the cost of the project whereas, the assessee has claimed it as revenue expenditure. Hence, it has been rightly

disallowed by the Id AO. With regard to accounting standards followed by the assessee, they are relevant only for preparation of accounts under the Companies Act, 1956, whereas in Income Tax Act u/s 145(2), only Accounting Standards 1 (Disclosure of accounting policies) and Accounting Standard 4 (Prior Period and Extraordinary Items) are notified and hence assessee adopting AS 7 & AS 9 are not relevant for the purpose of income tax act. He accordingly supported the order of the Id AO.

2.7. In response to this, the Id AR filed a comparative chart of the treatment of the disputed expenditures with regard to allocation of the same to work in progress, charge to profit and loss account from Asst Years 2006-07 to 2013-14 and its treatment of the Id AO in section 143(3) and 143(1) proceedings. He stated that the treatment given by the assessee has been accepted by the revenue from Asst Years 2010-11, 2012-13 and 2013-14. For Asst Year 2011-12, minor additions were made towards the disputed expenditures and the appeal is pending before the Id CITA. He stated that for the Asst Year 2008-09, the assessment was completed u/s 143(1) of the Act. No such disallowance was made for the Asst. Year 2006-07. While this is so, he argued that there is no good reason for the Id AO to dispute the allocation of expenditure to various projects for Asst Years 2007-08 and 2009-10 alone (i.e the years under appeal before us). The Id AR also placed reliance on the paper book filed by him containing the copies of audited financial statements for the years ended 31.3.2006 to 31.3.2013 comprising of pages 1 to 204 of the paper book. He drew the attention of the bench to pages 20 & 21 of the paper book containing audit report for the year ended 31.3.2007 wherein the statutory auditor had stated the manner in which the statutory audit has been performed by him and the treatment of inventory at the end of the year. He also argued that the statutory auditor had not made any qualification in his audit report regarding the treatment of expenditure given by the assessee. He vehemently relied on the order of the Id CITA.

2.8. We have heard the rival submissions. We find that the assessee had followed the principles laid down in the AS-7, AS -9 and Guidance Note on Accounting of Real Estate Developers with regard to the treatment of expenditure and its allocation to project costs. Admittedly the Accounting Standards 7 & 9 issued by ICAI are mandatorily to be followed by the assessee as per the mandate provided in the provisions of section 210 of the

Companies Act, 1956. We find that the assessee had also followed the Guidance Note on Accounting for Real Estate Transactions wherein vide para 2.4, it is mentioned as below:-

2.4. The following costs should not be considered part of construction costs and development costs if they are material :

- (a) General administration costs ;*
- (b) Selling costs;*
- (c) Research and development costs;*
- (d) Depreciation of idle plant and equipment ;*
- (e) Cost of unconsumed or uninsalled material delivered at site ; and*
- (f) Payment made to Sub-contractors in advance of work performed.*

We also find vide para 2.5 of the said guideline as below:-

2.5. Costs that may be attributable to project activity in general and can be allocated to specific projects include :

- (a) Insurance ;*
- (b) Costs of design and technical assistance that is not directly related to a specific project ;*
- (c) Construction or development overheads ; and*
- (d) Borrowing costs*

Such costs are allocated using methods that are systematic and rational and are applied consistently to all costs having similar characteristics. The allocation is based on the normal level of project activity. Construction overheads include costs such as the preparation and processing of construction personnel payroll.

2.8.1. We find that out of the total expenses incurred of Rs. 48,16,12,000/-, a sum of Rs. 31,22,58,000/- was transferred by assessee to work in progress and Rs. 11,86,10,000/- being expenses not related to project development was debited to profit and loss account and balance sum of Rs. 5,07,44,000/- was transferred to fixed assets by way of capitalization. These facts are not in dispute before us. We find that the expenditure incurred towards advertisement, marketing, publicity expenses, printing and stationery, brokerage, commission, car hire charges, legal and professional charges etc fall under the head General Administrative Costs which should not be included in the project cost as per the guidance note supra. However, we find that the assessee had erroneously claimed insurance as a revenue expenditure instead of allocating the same to project costs as per the guidance note. To that extent, the argument of the Id DR is well appreciated. We find that the other expenditures incurred by the assessee supra are squarely to be allowed as revenue in nature as they are not related to project cost. Hence we find that the Id CITA had rightly

granted relief by deleting the disallowance made on that count. The decision rendered herein for the Asst Year 2007-08 would apply with equal force for the Asst Year 2009-10 also except with variance in figures. Accordingly, the ground no. 1 raised by the revenue for the Asst Years 2007-08 and 2009-10 is partly allowed.

3. The next issue to be decided in this appeal of the revenue for Asst Year 2007-08 is as to whether the Id CITA is justified in deleting the disallowance of gifts of Rs. 6,48,000/- in the facts and circumstances of the case.

3.1. The brief facts of this issue is that the Id AO observed that the assessee incurred a sum of Rs. 6,48,000/- on account of expenses incurred on gift in the course of sales promotion activities. The Id AO observed that the project is at its initial stage and in all likelihood such gifts were given to some dignitaries in connection with the project. He held that in the absence of specific details, it would not be unusual to hold such gifts were made gratuitously and hence does not qualify as business expenditure. Accordingly he held that the same needs to be taken to the project costs and not allowable as revenue expenditure in the Asst Year 2007-08. Before the Id CITA, the assessee vide its written submission submitted that the assessee had already booked number of flats in the concerned project and the prospective customers who visit the site were offered a small token gift. It was also submitted that the assessee had suffered fringe benefit tax (FBT) on the said gifts and filed FBT return accordingly. The Id CITA held that the business nexus of the said expenditure is proved that the same is given to customers who have booked flats at the project of the assessee. Accordingly, he deleted the disallowance. Aggrieved, the revenue is in appeal before us on the following grounds :-

“2. That on the facts and circumstances of the case Ld. CIT(A) erred in deleting the disallowance of gifts of Rs.6,48,000/- without appreciating the facts of the case that the said disallowance was made in absence of specific details/documents from the assessee.

3. That on the facts and circumstances of the case Ld. CIT(A) erred in deleting the disallowance of gifts of Rs.6,48,000/- without appreciating the findings of the AO that the same was not in connection with the business activities of the assessee since the project of the assessee was at the initial stage and gift to customers has no credibility.”

3.2. The Id DR argued that the business nexus of incurring this expenditure was not proved by the assessee. He vehemently relied on the order of the Id AO. In response to this, the Id AR argued that the gift expenses falls under the head ‘selling costs’ which are

not entitled to be taken to the project cost as per para 2.4 of the Guidance Note on Accounting of Real estate transactions and accordingly had been rightly charged off to revenue by the assessee.

3.3. We have heard the rival submissions. We find that the expenditure on gifts is related to the project of the assessee and hence the business nexus is proved beyond doubt. Hence the same is squarely allowable as deduction. Moreover, as per para 2.4 of the Guidance Note on Accounting of Real estate transactions, the said expenditure cannot be added to the project cost and hence the assessee had rightly charged off the same as revenue expenditure. Accordingly, the Grounds 2 & 3 raised by the revenue are dismissed for the Asst Year 2007-08.

4. The next common issue to be decided in these appeals is as to whether the Id CITA is justified in deleting the addition on account of interest in the sum of Rs. 10,00,000/- in the facts and circumstances of the case.

4.1. The brief facts of this issue is that the Id AO observed that the assessee had given interest free advance of Rs. 1 crore to Mr Ashoke Dasgupta in financial year 2005-06 relevant to Asst Year 2006-07. According to Id AO, the same was advanced out of loan funds of the assessee. The assessee replied that this advance was given in Asst Year 2006-07 to the said party for business purpose in connection with setting up facilities for future services to the company at concessional rate. The Id AO observed that when the assessee is paying interest on its borrowings used for the purpose of its project, there is no reason for not charging any interest on amount advanced to a party who would be supplying some services in future. Infact, any interest received / accrued thereon from such party would have gone to reduce the interest burden on the assessee. Accordingly he estimated the interest rate at 10% on the sum of Rs 1 crore advanced to Mr Ashoke Dasgupta and added a sum of Rs 10,00,000/- as interest income of the assessee.

4.2. Before the Id CITA, it was submitted that the loan borrowed from UTI Bank in Asst Year 2006-07 was a specific purpose loan and was not utilized for providing interest free advance. The interest free loan of Rs. 1 crore was given out of the receipt of collections

from customers against booking of bungalows. The said advance to Mr Ashoke Dasgupta was disbursed vide Cheque No. 032095 dated 27.2.2006 from Current A/c No. 191010200003148 with UTI Bank. An amount of Rs. 2 crores was transferred on 20.2.2006 from Escrow account with UTI Bank to the abovementioned current account with UTI Bank for the purpose of disbursement. Immediately before the transfer of Rs 2 crores , the balance lying in the said current account was Rs. 4,36,818/- only. Moreover, as per the terms of sanction of specific loan, all collections / receipts from customers were required to be deposited in Escrow account with UTI Bank. Thus the money lying in escrow account was receipts from customers. Hence it was proved by the assessee that the interest free advance of Rs 1 crore was given out of own funds of the assessee.

The Id CITA appreciating the aforesaid contentions of the assessee, held that only real income is to be taxed and not the notional income and deleted the addition of Rs. 10,00,000/- in the assessment. Similar relief was granted in Asst Year 2009-10 also. Aggrieved, the revenue is in appeals before us on the following ground:-

AY 2007-08

4. That on the facts and circumstances of the case Ld. CIT(A) erred in deleting the addition of Rs.10,00,000/- on account of interest without appreciating the finding of the AO.

AY 2009-10

2. That on the facts and circumstances of the case Ld. CIT(A) erred in deleting the addition of Rs.10,00,000/- on account of interest without appreciating the finding of the AO."

4.3. The Id DR vehemently relied on the order of the Id AO. In response to this, the Id AR argued that the interest free advance of Rs 1 crore was given only out of own funds of the assessee and this fact has been duly proved by the assessee before the Id CITA and accordingly prayed for non-interference in the order of the Id CITA in this regard.

4.4. We have heard the rival submissions. We find that the assessee had duly proved before the Id CITA that only the own funds lying in UTI Bank was utilized for advancing interest free advance to Mr Ashoke Dasgupta. Moreover , this advance was given in Asst Year 2006-07. In any case, we are in agreement with the argument of the Id AR that no notional interest income could be brought to tax. On what basis 10% rate of interest was assumed by the Id AO is not brought on record by the Id AO. The Id AO had not made any disallowance of interest paid by the assessee on its borrowings. This itself goes to prove

that the borrowed funds were utilized only for business purposes of the assessee. Hence it could be safely concluded that only the own funds were utilized for advancing interest free funds to Mr Ashoke Dasgupta. In such an event, whether to charge interest or not on the said advance, becomes the prerogative of the assessee and the business nexus of such advance has not been doubted by the revenue. Hence there is no question of adding the notional interest income of Rs 10,00,000/- on the said advance without any basis. Accordingly, the Ground No. 4 for Asst Year 2007-08 and Ground No. 2 for Asst Year 2009-10 raised by the revenue are dismissed.

5. In the result, the appeals of the revenue are partly allowed.

Order pronounced in the open court on 05.10.2016

Sd/-
(S.S. Viswanethra Ravi)
Judicial Member

Sd/-
(M. Balaganesh)
Accountant Member

Dated : 5th October, 2016

Jd.(Sr.P.S.)

Copy of the order forwarded to:

1. APPELLANT – DCIT, Circle-11, Kolkata
2. Respondent –M/s. Kolkata West International City Pvt. Ltd., 55 & 55/1, Chowringhee Court, 1st floor, Chowringhee Road, Kolkata-700 071.
3. The CIT(A), Kolkata
4. CIT , Kolkata
5. DR, Kolkata Benches, Kolkata

/True Copy,

By order,

Asstt. Registrar.