IN THE INCOME TAX APPELLATE TRIBUNAL
"B" BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT AND
SHRI B. R. BASKARAN, ACCOUNTANT MEMBER

ITA No.1689/Bang/2016
Assessment Years : 2012-13

M/s. Waterline Hotels Pvt. Ltd., 10th Floor, Gamma Block, Sigma Soft Tech Park, No.7, Airport Varthur Road, Whitefield, Bengaluru– 560 066. **PAN : AACW 8059 N**	Vs.	DCIT, Circle – 7(1)(2), Bengaluru.
APPELLANT		RESPONDENT

Appellant by	:	Shri. S. V. Ravishankar, Advocate
Respondent by	:	Ms. Neera Malhotra, CIT, Shri. Sankar Ganesh K, JCIT (DRs)(ITAT), Bengaluru

Date of hearing	:	09.09.2021
Date of Pronouncement	:	20.09.2021

O R D E R

Per N.V. Vasudevan, Vice President

This is an appeal by the Assessee is against the order of CIT(A)-7 dated 21.7.2016 and it relates to AY 2012-13.

2. The only issue that arises for consideration in this appeal is as to whether the revenue authorities were justified in disallowing the claim of the Assessee for deduction of a sum of Rs.8,84,829 towards depreciation. The AO added a sum of Rs. 8,84,829/- being depreciation claimed on capitalisation of Rs. 88,48,290/- being pre-commencement rent and other expenditure incurred under various heads which were capitalized to the building as the same is incurred before the commencement of the operation of the Assessee.

3. The plea of the Assessee was that since the hotel work was still under construction, the same ought to be capitalized. The Assessee incurred various expenditure which are essential for starting a business like rent, salaries and other administrative expenses. The assessee capitalized the same to building as the same was incurred in relation to the asset coming into existence. The Assessee relied on Accounting Standard 10 issued by Institute of Chartered Accountants of India (ICAI), all expenses incurred in relation to bring an asset into existence have to be capitalized. This being the case the appellant has following the standard issue by ICAI and hence the same deserves to be allowed in full. The Assessee also relied on the facts that the Central Government has notified the Income Computation and Disclosure Standards(ICDS). These computation standards are though applicable for AY 2016-17 onwards, the principles would indicate the intent of the law in treatment of the amounts as required by the ICDS. ICDS-V relates to the tangible fixed Assets. As per the ICDS-V the components of the actual cost incurred inter alia includes expenses which are specifically attributable to the construction of a project or the acquisition of a tangible fixed asset or bringing it to its working condition and the same shall be included as part of cost of project or as part of tangible fixed asset. The Assessee submitted that it has included various expenses which are directly attributable to the construction of the Building and hence capitalized the same to the value of the asset. Hence the capitalization is in line with the accounting Standard 10 issued by the Institute of Chartered Accountants of India and also ICDS though been notified at a subsequent date. It was submitted that the depreciation on the building deserves to be allowed in full.

4. The CIT(A) concurred with the view of the AO for the following reasons:

> *"5.4.1 All the expenses incurred before the commencement of business cannot be capitalised. Generally any expenditure should be capitalised if.its value is retained in the form of an asset. When any expenditure is incurred on services such as rent, salary and other utilities they do not become as asset becauSe they don't have-any marketable item in exchange for their outlay. Only the services that increase the value of an asset e.g. construction or renovation of the building are capitalised. On the other hand depreciation is an expense to the cost of a capitalised asset overtime, The decay in assets value, which is predictable, is claimed as depreciation expenses. Therefore, the capitalisation and depreciation are related but there are expenses which cannot be capitalised keeping in the nature of the expense and therefore depreciation cannot be allowed on such expenses. In the instant case there is no dispute on the nature of expenses which is said by the appellant to he rent, salary and other administrative expenses. As these expenses do not increase the value of asset thus it cannot he capitalised. Accordingly the addition of Rs.8,84,829/- made by the AO on this issue is sustained."*

5. We have heard the rival submissions. It is undisputed that the expenditure that was capitalized were incurred prior to commencement of business when the hotel was under construction. The Assessee capitalized the costs incurred prior to commencement of business to the capital asset buildings as the expenses were incurred during the time of construction of building in the form of hotel which was yet to commence. Section 32 of the Act allows depreciation on actual cost of the asset, which means the actual cost to the assessee. This cost should be construed in ordinarily commercial manner. AS-1O regarding "accounting for fixed assets" issued by the ICAI specifies the components of cost of a fixed asset. Thus, the purchase price of an asset includes import duties, levies, non-refundable taxes and any other cost directly attributable to the asset for bringing it to the working condition. The examples given in AS-1O are site preparation, initially delivery and

handling cost, installation cost, such as laying foundations, and professional fees for architects and engineers. The preliminary project expenditure, indirect expenditure relating to construction and other indirect expenditure not related to construction have been included in the cost of the asset. Accordingly, the expenses are required to be capitalised and that the allocation has been made by the assessee on a reasonable basis in the ratio of cost of the asset to the total cost. Section 43(1) of the Act defines “actual cost” to mean actual cost of the asset to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.

6. In the case of CIT Vs. Food Specialities Limited, (1982)136 ITR 203 (Delhi), it has been mentioned that it seems that the Tribunal was not wrong in holding that the expenditure of test runs was a capital expenditure. Therefore, expenses involved in purchase of milk and determining that the factory was in proper working condition and making adjustment does not seem to be anything more than steps in setting up and finalisation of the factory, which is the capital asset. After tests have been carried out, it can be said that the factory had been set up and it is ready for commercial production. Therefore, the expenses can be said to have been incurred as cost of the plant and machinery. When comparing the facts of the case, it can be said that the expenses incurred on kitchenware and consumption of material during trial run are to be capitalised towards the cost of plant and machinery.

7. In the case of Challapalli Sugars Limited Vs. CIT (1975) 98 ITR 167 (Supreme Court), it has been held that interest of Rs. 2,38,614/- incurred on borrowed capital for purchase of plant and machinery, accruing to the date

of installation of the machinery is a capital expenditure, on which depreciation and development rebate are admissible. From this decision it can be said that if an expenditure which is otherwise of revenue in nature, has been incurred towards acquisition of a capital asset, it will be the cost of the asset provided it has been incurred upto the date of installation of the asset. However, it is also clear that there should a direct nexus between expenditure and putting up of the asset.

8. In the case of CIT Vs. Lucas-TVS Limited (No.2), (1977)110 ITR 346, one of the questions before the court was – whether, on the facts and in the circumstances of the case, it has been rightly held that the sum of '1,30,768/- representing indirect expenditure on salaries, rent, lighting, etc. and allocated to various assets formed part of the capital asset for the eligibility of depreciation allowance and in relation to the cost of the machinery was eligible for development rebate also? The facts of the case are that the assessee-company acquired land near Madras and erected buildings, plant and machinery etc. It also took on lease adjoining land for its use from integral coach factory. After completing the work of erecting the factory to certain stage, the production commenced on 01.12.1962. The accounts of the assessee were closed for the first time on 30.11.1962, during which it incurred total expenditure of '5,86,509/- relating to salaries, rent, lighting etc. This expenditure was capitalised and allocated to the capital assets in the ratio of direct cost of the assets. Depreciation allowance and development rebate were claimed. The Assessing Officer held that the expenses amounting to '1,30,768/- were in no way connected with installation of assets. Therefore, he excluded this amount and recomputed the cost of assets. The Honourable Court mentioned that the question is covered by the decision of Supreme Court in the case of Challapalli Sugars

Limited Vs. CIT (supra) and CIT Vs. Hindustan Petroleum Corporation, (1975) 98 ITR 167, in which it has been held that accepted accountancy rule for determining cost of fixed assets is to include of expenditure necessary to bring such assets into existence and to put them in working condition. Therefore, the question was decided in favour of the assessee and against the revenue.

9. Having considered the facts of the case, we are of the view that they are similar and, therefore, the ratio of this case is applicable. We accordingly hold that the expenses incurred by the assessee are required to be capitalised in the light of the decision in the case of Food Specialities Limited and Lucas-TVS Limited (supra). We hold and direct accordingly and allow the appeal of the Assessee.

10. In the result ITA No. 1689/Bang/2016 is allowed.

Pronounced in the open court on the date mentioned on the caption page.

Sd/-	**Sd/-**
(B. R. BASKARAN)	**(N. V. VASUDEVAN)**
ACCOUNTANT MEMBER	**VICE PRESIDENT**

Bangalore,
Dated : 20.09.2021.
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Copy to:

1. Appellant 2. Respondent 3. CIT 4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.