आयकर अपीलीय अधिकरण पुणे न्यायपीठ “ऐ” पुणे में
IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH “A”, PUNE

सुश्री सुषमा चावला, न्यायिक सदस्य एवं श्री आर. के. पांडा, लेखा सदस्य के समक्ष

BEFORE MS. SUSHMA CHOWLA, JM AND SHRI R.K. PANDA, AM

आयकर अपील सं. / ITA No.900/PN/2013
निर्धारण वर्ष / Assessment Year: 2009-10

M/s. Kumar Company
Kumar Capital, 1st Floor,
2413, East Street,
Pune – 411001 …. अपीलार्थी/ Appellant

PAN: AABFK6106A

Vs.

The Jt. Commissioner of Income Tax,
Range 5, Pune …. प्रत्यर्थी / Respondent

आयकर अपील सं. / ITA No.1147/PN/2013
निर्धारण वर्ष / Assessment Year: 2009-10

The Jt. Commissioner of Income Tax,
Range 5, Pune …. अपीलार्थी/ Appellant

Vs.

M/s. Kumar Company
Kumar Capital, 1st Floor,
2413, East Street,
Pune – 411001 …. प्रत्यर्थी / Respondent

PAN: AABFK6106A

Assessee by : S/Shri R.R. Vora and Rajendra Agiwal
Department by : Smt. M.S. Verma, CIT and
Shri Rajesh Damor

सुनवाई की तारीख / Date of Hearing : 17.12.2015		घोषणा की तारीख / Date of Pronouncement: 29.01.2016

आदेश / ORDER

PER SUSHMA CHOWLA, JM:

The cross appeals filed by the assessee and Revenue are against the order of CIT (A)-III, Pune, dated 02.01.2013 relating to assessment year 2009-10 passed under section 143(3) of the Income Tax Act , 1961.

2. The cross appeals filed by the assessee and the Revenue were heard together and are being disposed of by this consolidated order for the sake of convenience.

3. The assessee in ITA No. 900/PN/2013 has raised the following grounds of appeal:-

> *Based on the facts and circumstances of the case and in law, M/s Kumar Company ('the Appellant'), respectfully craves leave to prefer an appeal against the order dated 2 January 2013 passed by the learned Commissioner of Income-tax (Appeals) – III ['CIT(A)'] (received by the Appellant on 1 April 2013) under section 250 of the Income-tax Act, 1961 ('Act') on the following grounds which are independent and without prejudice to each other:*
>
> ***Addition on account of disallowance of interest***
>
> 1. *erred in confirming the addition of Rs.6,46,81,281/- to the income of the appellant on account of disallowance of interest paid on borrowed funds;*
>
> 2. *erred in confirming the action of the learned AO in capitalising the expenses incurred on interest debited to the Profit and Loss account by applying the Accounting Standard 16 (AS) "Borrowing Cost";*
>
> 3. *should have appreciated the fact that the Appellant is a developer and engaged in the business of real estate and hence, any interest paid for project would be allowable per the provisions of section 36(1)(iii) of the Act as incurred for the purpose of business;*

4. *failed to appreciate the fact that the Appellant has, followed a consistent accounting practice for recording interest expenses, wherein interest were never allocable to a particular project and the same has been accepted in past;*

5. *failed to appreciate that there is no such concept of qualifying asset and non-qualifying asset (as laid down by ICAI in AS16) in the Income-tax Act and the same cannot be imported, for considering allowability of interest expenses under section 36(1)(iii) of the Act;*

6. ***without prejudice to the above**, erred in not adjusting the entire interest free funds available with the Appellant against the qualifying assets, while computing the aforesaid disallowance.*

Erroneous levy of interest under section 234B

7. *has erred in levying interest under section 234B of the Act.*

   Any consequential relief, to which the Appellant may be entitled under the law in pursuance of the aforesaid grounds of appeal, or otherwise, may thus be granted.

   The Appellant craves leave to add, alter, vary, omit, substitute or amend the above grounds of appeal, at any time before or at, the time of hearing of the appeal, so as to enable the Hon'ble Tribunal to decide this appeal according to law.

4. The Revenue in ITA No. 1147/PN/2013 has raised the following grounds of appeal:-

1) *The CIT (A) has erred in law and on facts by partly allowing interest amount, disallowed u/s 36(1)(iii) of the Income Tax Act, 1961.*

2) *The CIT(A) should have upheld the order of the Assessing Officer by confirming Interest Disallowed Rs.11,26,17,000/- by AO u/s 36(1)(iii) of the I T Act, 1961.*

3) *The Order of the C1T(A) may be vacated and that of Assessing Officer be restored.*

4) *The appellant craves leave to add, amend or alter any of the above grounds of appeal.*

5. The issue in ground of appeal Nos.1 to 6 raised by assessee is against the addition made on account of disallowance of interest paid on borrowed funds at Rs.6,46,81,281/-.

6. The Revenue is in appeal against the partial allowance of interest by the CIT(A) as against the total disallowance made by the Assessing Officer under section 36(1)(iii) of the Act at Rs.11,26,17,000/-.

7. The assessee has also raised ground of appeal No.7 against the levy of interest under section 234B of the Act.

8. Briefly, in the facts of the present case, the assessees was a partnership firm engaged in the business of real estate, construction, development and also windmill power generation. The assessee was simultaneously engaged in the construction of various residential and commercial projects. During the assessment proceedings, the Assessing Officer noted that on total turnover of Rs.2987.52 lakhs, the assessee had offered sum of Rs.39.08 lakhs as profit from construction business, which worked out to 13.36%. During the year under consideration, the assessee was carrying on the construction activity in two types of projects i.e. where the sales of the respective units in different projects were offered to tax and other projects where no sales were offered to tax. The assessee had debited sum of Rs.14,43,90,385/- under the head 'finance charges' to the Profit & Loss Account. As per Schedule 17 attached to the audit report, out of the above said amount, sum of Rs.9,14,71,691/- was paid as interest on unsecured loan amounting to Rs.100.80 crores and the balance sum of Rs.5,29,18,694/- was paid as interest on secured loan amounting to Rs.15.44 crores. Further, from the Schedule attached to the Balance Sheet, the Assessing Officer observed that the assessee had paid sum of Rs.28,00,85,615/- towards advances for properties, had invested sum of Rs.33,90,22,732/- in properties shown as inventories, sum of Rs.93,94,61,134/- in project sites and work-in-

progress of various projects amounting to Rs.65.95 crores. The total investment worked out to Rs.221,79,45,000/-. In view of above, the Assessing Officer observed that the claim of deduction of entire amount of interest paid was without any basis as provisions of section 43(1) of the Act do not override the provisions of section 36(1)(iii) of the Act. The said section 43(1) of the Act talks of actual cost in so far as the interest paid on borrowings made for acquisition of capital assets are concerned. Since both the provisions co-existed under the Act, the Assessing Officer held that in such circumstances, the option exercised in the books of account would be decisive. In case of existing business, the interest paid on borrowings for acquisition of capital assets could be treated as revenue expenditure after the assets have been put to use, as well as capital expenditure, before it was put to use. Reliance was placed on Accounting Standard – 7 issued by the Institute of Chartered Accountants of India (ICAI), wherein it is prescribed that the finance costs are specifically attributable to a particular contract and the same had to be included as part of accounting contract costs. Further, the said accounting mandate is fortified by Accounting Standard – 16 issued in the year 2000. The Assessing Officer was of the view that building project would come under the definition of qualifying asset and the method to be adopted for treatment of finance costs in respect of qualifying asset, was prescribed at para 6 of Accounting Standard – 16. The relevant para reads as under:-

> *"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."*

9. In view thereof, the assessee was show caused as to why the proportionate interest out of finance charges relating to borrowed capital utilized for the investment and work-in-progress and assets which have not been to put

to use, during the year, should not be disallowed. The relevant show cause notice is reproduced at page 4 of the assessment order along with reply of the assessee at pages 5 to 13 of the assessment order. In response, the claim of the assessee was that the said finance cost where the funds are utilized for the purchases and also for the purchase of plots, would be eligible for deduction under section 36(1)(iii) of the Act. Referring to the proviso under section 36(1)(iii) of the Act, it was further pointed out that the proviso applies only in case the capital borrowed is utilized for the purpose of acquisition of 'asset for extension of existing business or profession', until the asset is put to use. Further, he made reference to the provisions of section 32 of the Act and Rule 5 of Income Tax Rules, 1962 (in short 'the Rules'), where the expression 'asset put to use' finds place. The assessee further stressed that 'put to use concept' apply only to capital asset and such expression was never used for the case of stock-in-trade, as the latter was always held for sale and not for put to use. The disallowance thus, as per the proviso would not apply and additionally where capital borrowed had been utilized for the purpose of normal business activities of the construction and trading in properties carried on by the assessee, and not for the purpose of extension of the existing business, on this ground also, the proviso would not be applicable. Further contention of the assessee was that it was entitled to claim interest paid on borrowed capital, where capital was used for business purpose irrespective of the purpose of using such borrowed capital. Reliance was placed on the ratio laid down by the Hon'ble Supreme Court in DCIT Vs. Core Health Care Ltd. (2008) 167 Taxman 206 (SC) that where during the course of manufacturing and selling, the assessee had installed new machinery, on which production was not started during the relevant year, the claim for deduction of interest on borrowings made for investment in machinery was allowed under section 36(1)(iii) of the Act. Further, reliance was placed on the ratio laid down by the Hon'ble Bombay High Court in CIT Vs. Lokhandwala Constructions Industries Ltd. reported in 260 ITR 579 (Bom), wherein following the aforesaid principle, it was held that the construction project undertaken by the assessee constituted its stock-in-trade and hence, interest payable on loan availed for execution of the said project was entitled for deduction under section 36(1)(iii) of the Act. The assessee further contended that AS-16 was not relevant and once the claim of deduction was covered by specific provision i.e. under section 36(1)(iii) of the Act, the same should not be disallowed. Further contention of the assessee in this regard was that even if AS-16 was to be applied and the interest cost was to be capitalized, the deductibility of interest for tax purpose would not be impaired and the assessee is entitled to claim the deduction for computing the taxable income.

10. The next contention in this regard was that the provisions of the Act would prevail over any other directions / rules / provisions of other statutes / bodies / regulators and where the expenditure was disallowable / allowable under the provisions of the Act, the same had to be given effect, irrespective of the mandate under such directions / rules / provisions of other statutes. Reliance was placed on the ratio laid down by the Hon'ble Supreme Court in Southern Technologies Ltd. Vs. JCIT (2010) 320 ITR 577 (SC).

11. Another claim of the assessee before the Assessing Officer was that similar interest expenses were being claimed as deduction based on accrual against the profits of the projects for all earlier assessment years and the same has been allowed as business expenditure, except for apportionment of interest cost amongst projects eligible 80IB(10) and non-eligible 80IB(10) projects. The assessee further contended that it was following unit sale / proportionate sale

method and was not following project completion method and hence, the ratio laid down by the Mumbai Special Bench of Tribunal in Wall Street Constructions Ltd. Vs. JCIT reported in 101 ITD 156 (SB) (Mum), was not applicable, wherein it was held that the interest identifiable with a project should be allowed only in the year when the project was completed and the income from that project was offered for taxation. Another point of distinction was that the method of accounting was not regularly followed in the matter before the Special Bench, whereas the assessee was following such method from year to year. Another plea before the authorities below was that the interest element which was charged to the Profit & Loss Account was related to spending in several projects at hand, plots in properties, working capital, etc. and could not be attributed or identifiable with a particular project. In such circumstances, where the interest cost could not be identified and attributed towards specific project, the partial disallowance of interest was not warranted. Reliance in this regard was placed on the decision of Pune Bench of Tribunal in DCIT Vs. Thakkar Developers reported in 115 TTJ 841. It was contended by the assessee that AS-16 was applicable only in cases where the cost directly attributable to construction of qualifying assets and where there is no such attribution, then the interest cost should not be capitalized and had to be recognized as interest expenses of the year. The assessee also contended that where mixed funds were available, a presumption would apply that non-interest bearing funds were utilized for making investment in qualifying assets and in this regard, the assessee drew statement of qualifying assets and non-qualifying assets under various heads and allocated interest expenses and pointed out that out of total borrowed funds of Rs.116 crores, Rs.112 crores had been utilized for spending on non-qualifying assets and spending on qualifying assets had largely been made through interest free source of funds. Accordingly, without admitting any disallowance, in view of the directions of the Assessing Officer, the disallowance of interest as per assessee's calculations could be restricted to Rs.52,15,480/-. Rejecting the explanation of the assessee, the Assessing Officer held that building project would come under the definition of qualifying asset and the method adopted for treatment of finance costs in respect of qualifying asset would be as per para 6 of AS-16, which provides that the borrowing cost that is directly attributable to the acquisition, construction or production of a qualifying asset, should be capitalized as part of the cost of that asset. Another contention raised by the assessee that the investment in land held for development and advances for property amounting to Rs.61.91 crores was non-qualifying assets, was not accepted by the Assessing Officer, since the assessee was not in the business of buying and selling of the land in general. The Assessing Officer further held as under:-

> *"5.3 The assessee has set off current liabilities and provisions – Rs.69,99,37,929/- and partners capital account – Rs.16,00,22,087/- against the qualifying asset which do not include advances to suppliers – Rs.1,55,90,817/-, other advances – Rs.2,99,06,297/- and deposits others – Rs.4,02,22,275/- totaling Rs.8,57,19,389/- which are held to have been made out of current liabilities and provisions and hence reduced from the same for set off against qualifying asset. Similarly, the assessee has invested an amount of Rs.18,87,95,608/- in capital balance with firms and JVs and hence the claim of the assessee for set off of capital amounting to Rs.16,00,22,087/- cannot be considered."*

12. The Assessing Officer re-worked the utilization of interest bearing borrowed funds. However, since mixed funds were utilized for investment in qualifying assets, the proportionate interest out of interest debited to Profit & Loss Account amounting to Rs.14.43 crores was disallowed, the same, as per the Assessing Officer, had been used for investment in qualifying assets and allowed to be capitalized. The interest capitalized was held to be set off against the profits derived from the qualifying assets. In view thereof, the Assessing Officer re-worked the proportionate interest relatable to such investments at Rs.11,26,17,700/-. The Assessing Officer also directed that the said interest cost

would be allowed to set off against the profits derived from the qualifying assets as and when declared by the assessee.

13. The CIT(A) after considering the submissions of assessee noted that the first issue to be decided was whether the borrowing cost was an admissible deduction under section 36(1)(iii) of the Act as claimed by the assessee notwithstanding the position that out of 17 building projects undertaken by the assessee, 12 projects were still in execution stage and no income was recognized from the said projects during the year. The CIT(A) was of the view that with reference to provisions of section 36(1)(iii) of the Act and its proviso, the issue has to be seen from the prospective that the interest paid excluded interest paid for execution of 12 projects at different locations and hence, the first condition that the interest was paid in respect of capital borrowed for acquisition of asset was satisfied. As regards second contention of the assessee that the extension of existing business has to be read in conjunction with the expression 'put to use', which applies only to capital assets and not in the context of stock-in-trade since the same was held for sale and not for 'put to use', was held to be not tenable. The CIT(A) was of the view that the word used is 'asset for extension of existing business' and proviso does not say for acquisition of capital asset, where the proviso does not make a distinction between current asset or capital asset. Reference was made to the recommendations made by the Kelkar Committee and the CIT(A) observed that in the proviso, the Legislature has used the word 'assets' in the final enactment, though in the recommendations of the Committee, the words were cost of capital assets. The CIT(A) held that where the language is clear, the intention of the Legislature was to be gathered from the language used. Reliance was placed upon the ratio laid down by the Hon'ble Supreme Court in CIT Vs. Kelvinator of India Ltd., reported in 320 ITR 561 (SC). As per

the CIT(A), the word used in proviso to section 36(1)(iii) of the Act, asset i.e. asset would include current assets also. With regard to the concept of extension of business, the CIT(A) observed that the assessee was doing some business of execution of building projects earlier and subsequently, new projects were added at different locations and this would result in extension of existing business. Though the same line of business was carried on by the assessee during the year, but since the scope of execution of projects had been enlarged by increasing the number of projects, therefore, the same was extension of business by the assessee and in CIT(A)'s view that the proviso to section 36(1)(iii) of the Act was applicable to the facts of the present case. Another aspect noted by the CIT(A) was that in respect of 12 projects which were in execution stage during the year, the expenses except finance cost incurred in respect of these projects were capitalized and shown as work-in-progress under the head projects as on 31.03.2009. No sales had been offered during the year from 12 projects on the ground that the assessee recognized the profits on transfer of significant risks and rewards associated with a particular unit in the projects and the said projects had not reached that stage. On the other hand, the deduction in respect of entire borrowing cost was claimed under section 36(1)(iii) of the Act against the receipts of other five projects and other income of the assessee. As per the CIT(A), this method of accounting finance cost results in distortion of profits in a particular year. As per him, true profits could be determined only when the entire cost of the incomplete projects, including the finance cost was capitalized and added to the value of work-in-progress of these projects. For this proposition of matching concept, reliance was placed on the ratio laid down by the Hon'ble Bombay High Court in Taparia Tools Ltd. Vs. JCIT (2003) 260 ITR 102 (Bom). The CIT(A) further held that the ratio laid down by the Mumbai Special Bench of Tribunal in Wall Street Construction Ltd. Vs. JCIT (supra), though not directly applicable to the facts of the present case, but the general principle laid down by the Special Bench was applicable and the interest relatable to a particular project had to be added to the work-in-progress till the income was recognized from the project. In respect of reliance on the decision in CIT Vs. Lokhandwala Constructions Industries Ltd. (supra), the CIT(A) observed that the same was not applicable as it was rendered prior to insertion of proviso to section 36(1)(iii) of the Act. Secondly, the controversy in the present case was not whether projects in questions are stock-in-trade or capital assets. The dispute was whether borrowing cost relatable to these projects, which take a substantial period of time to get ready for their intended use or sale, i.e. qualifying assets defined in AS-16 needs to be capitalized and added to the cost for the project. In respect of second reliance on the decision in DCIT Vs. Thakkar Developers (supra), the CIT(A) pointed out that the said decision was also rendered before the proviso was introduced. Secondly, Pune Bench of Tribunal did not have benefit of AS-16 while rendering the judgment. As regards the principles of estopel and res-judicata, the CIT(A) observed that the issue could always be decided with reference to the facts supporting it or changed legal position in any subsequent assessment year. In this regard, reliance was placed on the ratio laid down by the Hon'ble Bombay High Court in Kotak Mahindra Finance Ltd. Vs. DCIT (2004) 265 ITR 114 (Bom). In view thereof, the CIT(A) upheld the order of Assessing Officer in treating 12 projects in question of the value of Rs.90,93,75,727/- as qualifying assets for the purpose of capitalization of interest relatable to these projects.

14. Further, the CIT(A) considered the objections of the Assessing Officer in respect of interest attributable to the investment in properties (land) and advances for properties (land) at Rs.33,90,22,732/- and Rs.28,00,85,615/-. The

CIT(A) noted that during the year under consideration, the assessee had declared business profit of Rs.15,63,45,622/- from sale of properties, which indicated that the assessee was engaged in the business of purchase and sale of properties. Therefore, unlike building projects, in case of properties (land), where the assets were ready for intended use or sale soon after purchase or acquisition, the CIT(A) held that the proviso was not applicable. Even AS-16 recognized that the assets which are ready for use or sale when acquired are not qualified assets for the purpose of capitalization of borrowing cost. In view thereof, the CIT(A) held that the Assessing Officer was not justified in treating the land and advances for land of the aggregate value of Rs.61,91,08,347/- as qualifying assets for the purpose of capitalization of borrowing cost relatable to these two assets. The interest attributable to the same as per the CIT(A), could not be capitalized and added to the cost of properties either under proviso to section 36(1)(iii) of the Act or AS-16. The CIT(A) acknowledged the order of Assessing Officer, wherein it was observed that the funds utilized by the assessee in the course of business were mixed funds and loans were not raised for any specific project. The funds were drawn from common pool of funds for its business activities by the assessee. In this background, the CIT(A) held that for capitalization of interest in the case of incomplete projects and for ascertaining true profits of the year, recourse to relevant AS-16 was to be made, was the contention of the Assessing Officer, but the contention of the assessee in this regard was that in view of specific provisions of the Act i.e. section 36(1)(iii) of the Act, the same prevails over the treatment for the purpose of accounting and once any claim is allowable under the Act, the same could not be disallowed because of different treatment as suggested in any other Act, Rules, Regulations, Accounting Standards, etc. The CIT(A) admitted to the proposition that accounting treatment or accounting standards should not determine the allowance of deduction if there is a specific provision for deduction under the provisions of Income Tax Act. But, since the deduction under section 36(1)(iii) of the Act was not admissible in respect of interest relatable to 12 incomplete projects, which were in execution stage and the proviso to section 36(1)(iii) of the Act came to play in respect of these projects. In such circumstances, accounting principles or relevant accounting standards had to be taken into account to ascertain correct profits of the assessee for the year.

15. In respect of second contention of common pool of funds consisting of interest free and borrowed funds being utilized for business purpose, the CIT(A) was of the view that this was not a case of disallowance of interest before diversion of funds for non-business activities and interest expenditure was only be capitalized and added to the cost of qualifying assets, which was allowed in subsequent year as and when the income was recognized from these assets. Referring to the AS-16 and 12 projects under consideration being qualifying assets and looking at the utilization of borrowed and unborrowed funds, the CIT(A) worked out the interest attributable to qualifying assets at Rs.6,46,81,280/-, which was to be capitalized to form part of cost of the qualifying assets. While working out the proportionate interest relatable to qualifying assets, certain aspects were taken into consideration by the CIT(A), which are tabulated under para 5.3.7 at pages 42 and 43 of the appellate order and in this regard, disallowance to the extent of Rs.6,46,81,280/- was sustained.

16. The assessee is in appeal against the disallowance of Rs.6,46,81,280/-.

17. The Revenue is in appeal against the relief allowed by the CIT(A) and has stressed that the interest disallowance of Rs.11.26 crores by the Assessing Officer should be upheld.

18. The learned Authorized Representative for the assessee pointed out that the assessee was a promoter, developer and develops plots out of bigger plots and also develops buildings. The first contention raised by the learned Authorized Representative for the assessee was that the proviso to section 36(1)(iii) of the Act was not applicable. In respect of AS-16, it was pointed out that the same was not binding. He further pointed out that all accounting standards wherever applicable, have been made applicable w.e.f. 01.04.2015 and at the relevant time, no accounting standards were applicable, which could override the Income-tax provisions. He also submitted that the provisions of sections 80IB(10), 145, 10A and 10B of the Act are standalone provisions, under which profits had to be determined. Referring to the proviso to section 36(1)(iii) of the Act, he pointed out that the same applies for acquisition of assets 'for extension of existing business'. Dispute in the present appeal was in respect of stock-in-trade and as to whether proviso was applicable or main section applies. Our attention was drawn to the observations of CIT(A) at page 15 of the appellate order and it was pointed out that he applied AS-16 to the effect if no sales for 12 properties, then such assets were qualifying assets and the Assessing Officer at last page of the assessment order calculated the disallowance at Rs.11.26 crores against which, both the assessee and the Revenue are in appeal. Our attention was drawn to the observations of CIT(A) under paras 5 and 5.1 onwards at page 22 of the appellate order, wherein he referred to the asset meaning as work-in-progress. The next contention of the

learned Authorized Representative for the assessee before us was that as per AS-16, if there was no activity of purchases and sales, then it was a qualifying asset, but where the purchases were delayed, conservative approach had to be taken and interest could be written off. The learned Authorized Representative for the assessee pointed out that since the accounting standards, if any, are effectively to be applied from 01.04.2015, AS-16 was not binding at that time and it could not override the provisions of main section i.e. 36(1)(iii) of the Act. He further stressed that the proviso to section was not applicable. In respect of reliance placed upon by the authorities below on the ratio laid down by the Hon'ble Bombay High Court in Taparia Tools Ltd. Vs. JCIT (supra), the learned Authorized Representative for the assessee pointed out that the same was reversed by the Hon'ble Supreme Court in Taparia Tools Ltd. Vs. JCIT (2015) 372 ITR 605 (SC). The copy of the judgment was placed on record. In respect of second reliance on the decision in JCIT Vs. K. Raheja (P) Ltd. reported in 106 TTJ 874, the contention of the learned Authorized Representative for the assessee was that the same relates to the period when proviso was not there. Our attention was drawn to the decision of Mumbai Bench of Tribunal in K. Raheja Pvt. Ltd. reported in 102 ITD 414 (Mum), which has been approved by the Hon'ble Bombay High Court in ITA No.646 of 2008. The learned Authorized Representative for the assessee further placed reliance on the ratios laid down by the Kolkata Bench of Tribunal in Cellica Developers (P.) Ltd. Vs. DCIT reported in 45 taxmann.com 367, Jaipur Bench of Tribunal in ACIT Vs. M/s. Aditya Propcon (P) Ltd. in ITA No.762/JP/2012, relating to assessment year 2009-10, order dated 30.01.2014 and the Hon'ble Punjab & Haryana High Court in Nahar Poly Films Ltd. Vs. CIT reported in 13 taxmann.com 41. He further pointed out that Pune Bench of Tribunal in DCIT Vs. Thakkar Developers (supra) had held that the decision in Wall Street Constructions Ltd. Vs. JCIT (supra) was not applicable. Another point raised by the learned Authorized Representative for the assessee was that the said provision was inserted w.e.f. assessment year 2004-05 and no such adjustment was made in earlier years. However, the adjustment was made only in respect of working of interest cost under section 80IB(10) of the Act.

19. The learned Departmental Representative for the Revenue in reply, pointed out that under the proviso to section 36(1)(iii) of the Act, there were three conditions i.e. (a) it is to be applied against the acquisition of asset, (b) for extension of existing business and (c) whether capitalized or not. Since the asset was not defined under the Act, hence, reference is to be made to AS-16. Our attention was drawn to the order of CIT(A) at pages 25 to 28, who differentiated the current and capital assets. She further pointed out that the assessee himself had capitalized the cost of purchases as work-in-progress and hence, the interest cost has also to be capitalized. Further, reliance was placed on the order of CIT(A) on other aspects.

20. In rejoinder, the learned Authorized Representative for the assessee pointed out that the loan was borrowed for regular business activities and the assets acquired by the assessee were shown as stock-in-trade. It was pointed out that where the assessee was utilizing the borrowed funds for purchases, which were eligible for deduction under section 80IB(10) of the Act, allowance of part of cost of project was allowable. However, when the assessee has claimed the deduction under section 36(1)(iii) of the Act, then the same could not be disturbed. He further pointed out that stock-in-trade, extension of business and in view of various cases, loss in expenditure is met for carrying on of the business and the same is to be allowed as revenue expenditure. In respect of

AS-16, it was pointed out that the same was operating from 01.04.2015 and the same could be invoked, provided it was operating and binding on the assessee. First of all, the said AS-16 was not binding as the notification was issued by the CBDT on 31.03.2015, which made it effective from 01.04.2015, so it cannot be interpreted that the same was applicable retrospectively. Further contention of the learned Authorized Representative for the assessee was that AS-16 could not override judge made law of allowability of the expenditure. Reliance was placed upon the ratio laid down by the Hon'ble Bombay High Court in CIT Vs. M/s. Reliance Industrial Infrastructure Ltd. in Income Tax Appeal No.3611 of 2010, judgment dated 17.08.2015, wherein it has been held that Accounting Standards issued by the Institute of Chartered Accountants of India were not binding. Further, the CIT(A) had relied on the ratio laid down by Hon'ble Bombay High Court in Taparia Tools Ltd. (supra), which has been reversed by the Hon'ble Supreme Court.

21. We have heard the rival contentions and perused the record. The assessee was a partnership firm, engaged in the business of real estate, construction, development of housing projects, trading of land and windmill power generation. During the year under consideration, the assessee had undertaken several projects for development. Out of total 17 projects being developed by the assessee, the proportionate sale of 5 projects was recognized as revenue income and other 12 projects were under development and no part of the said projects were ready for sale. In addition, the assessee was also holding stock of lands and had also made advances for purchase of lands. During the year under consideration, the assessee had claimed interest expenditure of Rs.14,43,90,385/- as revenue expenditure. The claim of the assessee was that it had incurred the above said interest expenditure for the purpose of carrying on

its business and the same was allowable as revenue expenditure in its hands irrespective of some of the projects not being available for sale. The assessee for the year under consideration had shown total turnover of Rs.29.87 crores and had offered sum of Rs.39.08 lakhs as profit from construction business. The assessee was undertaking two types of projects i.e. one set of projects which were eligible for deduction under section 80IB(10) of the Act and the second set of projects which were not eligible for deduction under section 80IB(10) of the Act. The finance charges of Rs.14.43 crores debited to the Profit & Loss Account constituted of sum of Rs.9.14 crores paid as interest on unsecured loans amounting to Rs.100.80 crores and the balance sum of Rs.5.29 crores was paid as interest on secured loans amounting to Rs.15.44 crores. The case of the Assessing Officer was that where the assessee had made investment of Rs.221.79 crores, then the proportionate interest cost attributable to such investment was to be disallowed in the hands of the assessee under section 43(1) of the Act. On the other hand, the claim of the assessee was that the entire interest cost was attributable to funds utilized for carrying on the business of the assessee and hence, was allowable expenditure under section 36(1)(iii) of the Act. The Assessing Officer on the other hand, was also of the view that in view of the proviso to section 36(1)(iii) of the Act, where the assets have not been put to use, then the interest relatable such assets is not allowable as deduction in the hands of the assessee. In this regard, the Assessing Officer made a reference to the schedules attached to the Balance Sheet and noted that the assessee had paid sum of about Rs.28 crores towards advances for properties, had invested sum of Rs.33.90 crores in properties shown as inventories and sum of Rs.93.94 crores in project sites and work-in-progress of various projects amounting to Rs.65.95 crores, totaling Rs.221.79 crores. The Assessing Officer further relied on the Accounting Standard No.7 and Accounting

Standard No.16 issued by ICAI for the proposition that where the finance costs were specifically attributable to a particular contract, then the same had to be included as part of the contract costs. Since the assessee had recognized the revenue on sale of 5 projects only and the balance 12 projects were under construction, the Assessing Officer was of the view that the aforesaid building projects would come under the definition of qualifying assets as referred to in schedule 16 issued by ICAI and relatable interest cost had to be capitalized as part of cost of that asset. The case of the assessee before us on the other hand was that the interest cost was in the first instance relatable to the entire business carried on by the assessee whether i.e. for construction or for sale and purchase of properties and even if part of borrowed funds were utilized for construction of the infrastructure of the properties, sale from which is not recognized in the present year, were stock in trade of the assessee and hence, business assets and there was no merit in capitalizing any part of the borrowing cost being relatable to cost of such project. The assessee was recognizing the cost of the project, which had not been sold during the year under the umbrella of work-in-progress but the case of the assessee was that no part of finance cost was to be treated as part of work-in-progress since the provisions of section 36(1)(iii) of the Act made the interest cost as eligible for deduction.

22. The provisions of section 36(1)(iii) of the Act and the proviso thereunder read as under:-

> *"36(1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in Section 28 –*
>
> *(i) and (ii)*******
>
> *(iii) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession :-*

> *Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.*
>
> *Explanation. – Recurring subscriptions paid periodically by shareholders, or subscribers in Mutual Benefit Societies which fulfill such conditions as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause."*

23. The substantive provisions of the Act entitle the assessee to claim deduction on account of interest paid in respect of capital borrowed for the purpose of business or profession. The intention of the statute is to allow the expenditure on account of finance cost as allowable in the hands of the assessee where the capital borrowed has been utilized for the purpose of business or profession. The ambit of expression 'purpose of business' has to be considered for allowing the deduction on account of interest paid in respect of such capital borrowed, which in turn, has been utilized for carrying on the business of the assessee. The proviso thereunder restricts the disallowance of amount of interest paid, in respect of the capital borrowed for acquisition of an asset for expansion of existing business or profession, for any period beginning the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use. The proviso under sub-section states that the interest relatable to such period is not allowable deduction. The provisions of the statute have to be read in entirety and the same cannot be given a meaning by way of reading the provisions in dis-jointed manner. No doubt, under the proviso, the reference is made to the borrowal of capital for acquisition of asset for expansion of existing business or profession, but the concluding para refers to an asset put to use i.e. for determining the period of disallowance of interest, is to start from the date on which the capital was borrowed till the date on which such asset was first put to use. In other words, the proviso makes a reference to

capital asset which is acquired by the assessee out of borrowed funds for the expansion of an existing business or profession, which is capitalized in the books of account or not, then the interest which is relatable to the period beginning from the date on which capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, is not to be allowed as deduction. Reading the proviso clearly establish that the said provisions are applicable to capital assets acquired by the assessee and are not relatable to current assets. In case, we accept the proposition offered by the Revenue authorities, then in order to work out the disallowance of interest in the hands of assessee in respect of current assets held by the assessee i.e. the investment in properties which has not been sold during the current year, then the date on which such asset was first put to use cannot be applied, because once the current assets held by the assessee is complete in all respects, the same will not be put to use, but would be sold in the market to the prospective buyers. In such circumstances, we hold that there is no merit in the observations of the Revenue authorities that the proviso is applicable both to the current and / or capital assets. In our opinion, the proviso is clearly applicable only to capital assets and has no relevance in respect of current assets. In other words, if the amount of capital borrowed by the assessee is utilized for acquisition of non-capital assets, then such interest is allowable in the hands of the assessee, in view of main substantive provisions of section 36(1)(iii) of the Act. The proviso restricts the disallowance of interest only for the period till which the asset is not put to use. Once the asset is put to use, then the interest relatable to acquisition of such capital asset is also allowable as deduction in the hands of assessee as the asset after being put to use is utilized for the purpose of carrying on the business.

24. The second aspect of the issue is the Accounting Standard 16 issued by ICAI. In the first instance, we agree with the proposition raised by the learned Authorized Representative for the assessee that where the deduction or otherwise of an expenditure is covered by the substantive provisions of the Act, there is no merit in referring to the accounting standards issued by ICAI for working out the disallowance in the hands of assessee. In this regard, we find support from the ratio laid down by the Hon'ble Bombay High Court in CIT Vs. M/s. Reliance Industrial Infrastructure Ltd. in Income Tax Appeal No.3611 of 2010, order dated 17.08.2015.

25. Under para 6 of accounting standards 16, it is prescribed that the borrowing costs which are directly attributable to acquisition, construction or production of qualifying asset, then the same should be capitalized as part of the cost of that asset. Undoubtedly, the assessee is engaged in the business of construction and had borrowed funds for carrying on the construction activities. The issue which arises before us is whether overriding provisions of section 36(1)(iii) of the Act, which entails that the interest cost attributable to borrowed funds utilized for the purpose of business are to be allowed as deduction, can the provisions of accounting standards 16 override the provisions of the Act. We find no merit in the stand of the authorities below in this regard, in view of the specific provisions of the Act i.e. section 36(1)(iii) of the Act, which covers the allowability or otherwise of the interest cost of capital borrowed by the assessee for the purpose of carrying on its business and no resort can be made to any accounting standards by way of any directions / rules / provisions of other statutes / bodies / regulators for disallowing the expenditure in the hands of the assessee. In this regard, we find the mandate of Hon'ble Supreme Court in Southern Technologies Ltd. Vs. JCIT (supra) being squarely applicable. Further, where the interest cost

is not attributable to the specific project undertaken by the assessee and constitute mixed funds in the hands of assessee, which in turn, were utilized for carrying on of the business in entirety, there is no merit in relying on Accounting Standard 16 to work out the disallowance of interest expenditure. Para 6 of Accounting Standard 16 clearly prescribed the borrowing costs which are directly attributable to acquisition, construction or production of qualifying asset, then the same is to be capitalized as part of the cost of assessee. The authorities below have failed to point out the borrowed finances were directly attributable to the construction of specific project, against which the disallowance is being made. In the absence of any identification of the finance costs being directly relatable to the so-called project under consideration, we find no merit in the reliance placed upon by the authorities below on the said Accounting Standards. In this regard, we find support from the ratio laid down by the Pune Bench of Tribunal in DCIT Vs. Thakkar Developers (supra).

26. Further, the issue before the Hon'ble Bombay High Court in CIT Vs. K. Raheja Pvt. Ltd. (supra) was as under:-

> *(i) whether on the facts and the circumstances of the case and in Law the Hon'ble ITAT was right in holding that claim made by the assessee for deduction of Finance Cost by way of interest is in conformity with the Accounting Standard-7 issued by the Institute of Chartered Accountants of India and the exemptions provided therein?*

27. The Hon'ble Bombay High Court held as under:-

> *"The finding of fact recorded by the Tribunal is that there is no identity between a particular borrowing and a particular line of business and there is no basis for coming to a conclusion that interest attributable to the loans should be appointed amongst the various business activities of the assessee and the portion attributable to the construction activity should be deferred and made a part of the work in progress to defer the interest expenditure till completion of the project. In our opinion, the issue raised in this appeal are squarely covered by the judgment of this Court in the case "Commissioner of Income Tax. Vs. Lokhandwalal Construction Inds. Ltd., reported at 260 ITR 579". In this view of the matter, therefore, we see no merit in the appeal, the appeal is dismissed.*

28. Following the above said proposition, we find no merit in the orders of authorities below in working out the interest attributable to the loans relatable to 12 projects under construction, has been not allowable as deduction in the hands of assessee. The assessee was following unit sale method of accounting, where revenue was recognized on sale of the units completed by it. The assessee was not following project completion method. Though the assessee was capitalizing the cost of projects which were under consideration, the revenue relatable to units of such projects was offered to tax as and when the units were sold by the assessee. Thus, in such circumstances, there is no merit in holding that the interest attributable to the alleged loans utilized for 12 projects under consideration is to be disallowed in the hands of assessee. We find no merit in the orders of authorities below in this regard.

29. We find another aspect on which the deduction claimed by the assessee under section 36(1)(iii) of the Act was rejected by the authorities below that in respect of 12 projects, which were in execution stage during the year, the expenses except the finance costs incurred were capitalized and shown as work-in-progress. The assessee was in the process of constructing the aforesaid 12 projects and the expenditure incurred for construction of the said projects was capitalized as work-in-progress and was to be claimed as deduction against the sales made of the units in the said projects. This method of accounting wherein the finance cost was not capitalized in proportion to the 12 projects undertaken by the assessee, as per the CIT(A) would result in distortion of profits in a particular year. Admittedly, where the assessee was using mixed funds and was accounting for the expenditure out of said mixed funds and where there is no basis for determining the funds utilized for the said projects, we find no merit in the orders of authorities below in this regard. Under the provisions of the Act, the

interest expenditure perse is allowable as deduction in case the same is incurred during the course of carrying on of the business. Where the assessee has conceptualized a project and started constructing the same implies that the assessee is engaged in carrying on of its business of construction activity. Merely because, the project has not been completed and the units were not sold does not mean that the business of the assessee is not being carried on. The business whether it results in profits in this year or next year is being carried on by the assessee and during the course of carrying on such business, it had incurred the finance cost, which is duly allowable as revenue expenditure in the hands of the assessee. The finance costs as such relates to various business activities of the assessee is to be allowed as deduction in the hands of assessee as the assessee had utilized the said funds for carrying on its business. As pointed out by us in the paras hereinabove, the business has commenced on the start of the project itself and there is no merit in holding that since no part of the 12 projects has been sold by the assessee, the business relatable to such projects had not commenced.

30. Now, coming to the alternate stand of the CIT(A) that allowance of such finance cost would result in distortion of profits in a particular year was based upon the ratio laid down by the Hon'ble Bombay High Court in Taparia Tools Ltd. Vs. JCIT (supra). The said proposition has been overturned by the Hon'ble Supreme Court in Taparia Tools Ltd. Vs. JCIT (2015) 372 ITR 605 (SC), wherein it has been held that *there is no concept of deferred revenue expenditure unless so specified in the Act.* Further, the Hon'ble Apex Court held as under:-

> *"18. Further, by no stretch of imagination closing stock or Work in Progress in case of real estate can be called as Qualifying Asset. It is an ongoing process which changes in accordance with specific business cycle. Take an example of manufacturing industry, trading whole sale & retail, consider service industries. Scenario of closing stock / work in progress is peculiar to class of industry.*

> 19. *The main reason for which the department has to stretch this position of capitalizing the period cost to WIP / closing stock by means of AS-16 is 'matching concept'. The AO as well as CIT(A) have heavily relied on the matching concept to change the basis for allowability of interest. Further, the learned CIT(A) had relied upon the decision of Jurisdictional High Court in the case of Taparia Tools Ltd. Vs. JCIT 260 ITR 102 (Bom) to justify the proposition of matching concept for the purpose of allowability of interest expenditure.*
>
> ….
>
> 22. *The Hon'ble apex court in certain terms has observed that matching concept is not embedded in law, unless the assessee himself applies matching concept in computation. The Hon'ble Apex Court has also considered the decision cited by the department in the case Madras Industrial Corporation case 225 ITR 802 (SC) for deferred revenue expenses. The court held that in that case the assessee itself chose to defer revenue expenses so the court allowed the same. Otherwise there is no doubt that under the Act the concept of deferred revenue is not in existence."*

31. Applying the said proposition laid down by the Hon'ble Supreme Court, we hold that the assessee is entitled to the claim of deduction of interest expenditure in the year of claim.

32. The CIT(A) has also applied the proviso to section 36(1)(iii) of the Act in respect of the interest relatable to 12 incomplete projects, which were in execution stage and as per the CIT(A), the said proviso came into play in respect of such projects. As held by us in the paras herein above, wherein we have held that the provisions of the proviso to section 36(1)(iii) of the Act are applicable to capital assets only and not to current assets, we find no merit in the proposition proposed by the CIT(A). The so-called 12 projects of the assessee are the current assets of the assessee, as the assessee is engaged in the business of construction activity and the said projects are not capital assets of the assessee, which have to be put into use, but have to be sold in the open market and allowance of interest relatable to such current assets cannot be curtailed by invoking the provisions of proviso to section 36(1)(iii) of the Act.

33. One more aspect which has to be taken note of that in addition to carrying on the activity of development of buildings, promoter and development of buildings, the assessee was also engaged in the development of plots out of bigger plots. The assessee for the year under consideration had shown profit on sale of plots i.e. plot shown by the assessee was business asset. The acquisition cost of which has been met out of the interest bearing funds, then the interest relatable to such secured / unsecured funds is allowable in the hands of assessee. In this regard, we find merit in the order of CIT(A) and find no merit in the ground of appeal raised by the Revenue.

34. We further find that Mumbai Bench of Tribunal in JCIT Vs. K. Raheja (P) Ltd. (supra) had held that the finance costs in the case of real estate developers is to be allowed for the year in which it was incurred or accrued, even though the assessee was following the completed contract method for returning its income.

35. In the totality of the above said facts and circumstances, we hold that where the assessee is engaged in the business of construction and development and the project undertaken by the assessee constitute stock in trade / work-in-progress and are not capital assets owned by the assessee, the proviso to section 36(1)(iii) of the Act do not apply and there is no merit in restricting the deduction on account of interest expenditure on loan availed for carrying on the business of the assessee. Accordingly, we direct the Assessing Officer to allow the expenditure of Rs.11,26,17,000/- in the hands of the assessee. At this juncture, we also want to refer to the alternate plea raised by the assessee before the Assessing Officer that at best disallowance of Rs.52,15,480/- can be made being attributable to qualifying assets. The said alternate contention was

without prejudice to the main contention and in view of our allowing the claim of the assessee in totality, we find no merit in the alternate plea raised by the assessee. Consequently, the grounds of appeal raised by the assessee are allowed and the grounds of appeal raised by the Revenue are dismissed.

36. In the result, the appeal of the assessee is allowed and the appeal of the Revenue is dismissed.

Order pronounced on this 29th day of January, 2016

Sd/-	Sd/-
(**R.K. PANDA**)	(**SUSHMA CHOWLA**)
लेखा सदस्य / ACCOUNTANT MEMBER	**न्यायिक सदस्य / JUDICIAL MEMBER**

पुणे / Pune; दिनांक Dated : 29th January, 2016

GCVSR

<u>आदेश की प्रतिलिपि अग्रेषित/Copy of the Order is forwarded to</u> :

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. आयकर आयुक्त(अपील) / The CIT(A)-III, Pune;
4. आयकर आयुक्त / The CIT – III, Pune;
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे "ऐ" / DR 'A', ITAT, Pune;
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

वरिष्ठ निजी सचिव / Sr. Private Secretary
आयकर अपीलीय अधिकरण, पुणे / ITAT, Pune