IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "B", PUNE

Before Shri Shailendra Kumar Yadav, Judicial Member,
and Shri R.K. Panda, Accountant Member.

ITA.No.1680/PN/2011
(Assessment Year 2007-08)

DCIT, Circle-2,
C/o. Income Tax Office,
Old. B.J. Market, Jalgaon. .. Appellant

Vs.

Om Narayan Industries and Developer Pvt. Ltd.
Pratap Mill Compound,
Amalner - 425401. .. Respondent
PAN No.AAACO 5960E

Assessee by	:	Shri Sunil Ganoo
Revenue by	:	Shri K.K.Ojha
Date of Hearing	:	12-04-2013
Date of Pronouncement	:	29-04-2013

ORDER

PER SHAILENDRA KUMAR YADAV, JM:

This appeal has been filed by the Revenue on following grounds :

"1. On the facts and in the circumstances of the case, the CIT(A) erred in holding that Assessing Officer merely relied upon various accounting standards in disallowing the claim of the assessee.

2. On the facts and in the circumstances of the case, the CIT(A) has not appreciated the fact that assessee has shown the said land as work in progress and not as finished goods which itself indicates that the land was not ready for its use and therefore Accounting Standard-16 and Accounting Standard-2 would not applicable in assessee's case."

2. Brief facts of the case are that the assessee is a Pvt. Ltd. company and is engaged in the business of Purchase of lands, buildings, machinery. The assessee has filed original return of income on 12-11-2007 declaring total income at Rs.2,14,389/- which was subsequently revised on 11-09-2008 declaring total loss at Rs.1,72,55,135/-. The Assessing Officer had completed scrutiny assessment u/s.143(3) on 24-02-2008 determining total income at Rs.2,34,840/- disallowing the claim of assessee's loss of Rs.1,74,69,524/- towards the expenditure claim in revised return as capital

expenditure instead of revenue expenditure shown by the assessee. The Assessing Officer has given the following reasons for rejecting the assessee's claim.

(a) *"The issue is to be answered is whether in the case of Company which has bought a large textile mill at Amalner in 2001-02 and demolished it subsequently for development and to be used for residential purpose, whether interest can be included in the inventory cost or not after the Company has received permission from Collector stating that it can be used for residential purpose?"*

(b) *The Company has incurred various expenses like:*

Account Head	Amount
Development expenses	2,24,436/-
Development expenses Bungalow	17,74,470/-
Electrical repairs	5,96,218/-
Municipal Tax	93,560/-
N. A. Tax	46,323/-
Repairs and maintenance	1,18,348/-
Architect fees	50,000/-

(c) *Clause 12, of AS-2, states that interest and other borrowing cost are usually considered as non relating to brining the inventory to their present location and condition and are therefore usually not included in the cost of inventory. Here, one has to analyze the wording i.e. usually not included in the cost of inventory. The Company is required to comply the order of Collector along with the compliances of the condition laid down in the said order for the land before it is used for residential purpose.*

Thus, the AS-2, and AS-16, are not applicable in the case of assessee Company. The AS-7 is applicable to the assessee Company and therefore the interest claimed as revenue expenditure is not correct, the same is disallowed and added back to total income.

3. Matter was carried before the First Appellate Authority wherein various contentions were raised on behalf of the assessee and CIT(A) having considered the same allowed the claim of the assessee. Same has been opposed before us on behalf of revenue. The Ld. Departmental

Representative submitted that assessee in original return of income on 12-11-2007 declared total income of Rs.2,14,389/- which was subsequently revised on 11-09-2008 of loss of Rs.1,72,55,135/-. In revised return assessee claimed expenditure on account of interest of Rs.1,55,18,465/- and Rs.19,57,059/- on account of various expenses as revenue expenditure. While finalising the scrutiny assessment the Assessing Officer treated the expenditure of Rs.1,55,18,465/- and Rs.19,51,059/- as capital expenditure. According to Assessing Officer AS-7 is applicable to assessee. The AS-7 is applicable to the accounting for construction contract in financial statement of contractors whereas as per AS-2 interest cost does not form part of inventory and AS-16, of operating cost incurred till time or is ready for saleable condition should be capitalised. The Assessing Officer has wrongly claimed interest of Rs.1,55,18,465/- and amount of expenditure of Rs.19,51,059/- aggregating at Rs.1,74,69,524/- from work-in-progress of land and claimed as revenue expenditure. The Assessing Officer denied assessee's claim of revenue expenditure. CIT(A) deleted the addition by holding that assessee capitalised the expenditure including interest paid on borrowed funds till A.Y. 2006-07 and then claimed it as revenue expenditure when plots are available for sale after obtaining necessary approval from State authorities. During the year under reference, plots were ready for sale and some plots were infact sold out and assessee has shown sale proceeds of plots. In its return the assessee has purchased the plot as its stock in trade and has been showing the same under head "current assets". The assessee obtained loans from SBI for business purposes. Accordingly, CIT(A) allowed the same. Similar view was taken by the CIT(A) with regard to the expenditure of Rs.19,51,059/-. In this background Ld. Departmental Representative submitted that since assessee has shown the said land as work-in-progress and not as finished goods which itself indicates that land was not ready for its use and therefore assessee should have capitalised the expenditure of Rs.1,74,69,524/- instead of revenue expenditure claimed in revised return. Accordingly, order of the CIT(A) on this issue be set-aside and that of Assessing Officer be restored.

4. On the other hand the Ld. AR submitted that Assessing Officer was not justified in treating the assessee company as construction company and misplaced the AS-7 in this case. The Assessing Officer was not justified in non-acceptance of revised return of loss of Rs.1,72,55,135/-. The Assessing Officer was not justified in disallowing deduction of interest of Rs.1,55,18,465.48 being business expenditure which should have been fully allowed. The Assessing Officer was also not justified in disallowing expenditure to the tune of Rs.19,51,069/- being expenditure incurred for business purposes which can be fully allowed. According to the Ld. AR AS-7 is applicable to contractors and not to Developers. The assessee company is a Developer and not contractor, hence, AS-7 was not applicable to the assessee company. The Assessing Officer failed to appreciate the correct facts of the case. The Assessing Officer was not justified in disallowing claim of interest and other expenditure of assessee considering it a capital expenditure. The said expenditure was incurred in respect of interest and other expenditure exclusively for the purpose of business of assessee. Hence, it would certainly allowable u/s.36(1)(iii) and section 37 of the Income Tax Act, 1961. Ld. AR by detailed argument supported the order of the CIT(A).

5. After going through the rival submissions and material on record we find that the memorandum of association of assessee reveals that assessee company, i.e. Om Narayan Industries and Developers Pvt. Ltd. was incorporated for following main objects :

> *"To carry on business by acquiring by purchase, hire, lease land, buildings, structure, machinery including land estate or interest therein, and any right over or connected with land and buildings and develop in particular, by preparing sites and/or by constructing, reconstructing, altering, improving, furnishing and maintaining hotels, workshops, mills, factories, warehouse, cold storage, wharves, godowns, offices, hostels, gardens, swimming pools, play-grounds buildings, by hiring or disposing of the same"*

As stated above the assessee company has purchased one textile mill namely, Pratap Mill on 22-03-2002 from M/s. Pratap Spinning Weaving and Manufacturing Co. Ltd. The assessee company obtained clearance from State Government converting the land of said company from industrial zone to residential zone in 2006. The company had capitalized entire cost relating to development of land into plot till F.Y. ending 31-03-2006. The plot developed by assessee company on said land were ready for sale in A.Y. 2007-08. It is undisputed fact that the first sale deed was executed on 15-05-2006. Therefore, the assessee revised its return on 11-09-2008 claiming expenditure incurred on development of land in A.Y. 2007-08 including interest on part capital as revenue expenditure during the year under appeal. The records reveals that assessment for A.Y. 2006-07 was completed u/s.143(3) of Income Tax Act on 30-10-2008 in which AO has accepted capitalization of the expenditure. In the previous year relevant to the assessment year under consideration the assessee has claimed deduction of expenditure including interest u/s.36(1)(iii) and section 37 of the Act. It is not in dispute that assessee's return for A.Ys. (i.e. 2002-03, 2003-04 and

2004-05) have been filed in time. As per the sequence of events from purchase of land to sale of plot is as under :

(a) The company has purchased one textile mill named Pratap Mill on 22/03/2002 from the Pratap Spg. Wvg and Mfg. Co. Ltd. This is duly reflected in our account as a business income.

(b) The said property was under Industrial Zone. Therefore unless and until the zone of the property was changed from Industrial zone to Residential Zone our company could not have developed the property. Under circumstances our company moved an application to Amalner Muncipal Council for change of zone from Industrial to Residential.

(c) After completion of all formalities, Government of Maharashtra was pleased to pass an order on 19/11/2003 changing the zone from Industrial Zone to Residential.

Thereafter, a layout of the property was prepared by dividing that land into small residential saleable Plots and the same was submitted to Amalner Municipal Council which was forwarded to Assistant Director of Town planning for suggestion. After complete scrutiny of the proposal Assistant Director of Town planning passed the order on 15/02/2005.

Thereafter, the chief officer of Amalner Municipal Council passed the order and granted the approval for the layout on 10/06/2005. Further, our company had filed the NA application to collector, Jalgaon for changing the purpose of land and collector, Jalgaon was pleased to sanction the order and granted NA permission on 27/01/2006. Meanwhile, after approval of layout from Amalner Municipal Council, an advertisement was published in the renowed newspaper such as Likmat and Sachoti for the booking purposes and booking of the plot was started on 08/07/2005. The first sale deed was executed on 01/03/2006 in favour of Jagdish C. Agrawal. Further, Amalner Municipal Council had also given building permission on 15/05/2006.

Thus the assessee revised its return on 11-09-2008 giving following reasons :

> *"The concern is engaged in in Real Estate Business. The concern has purchased one Textile Mill named Pratap Mill at Amalner in the F.Y.2001-02.z The main activity of the concern was to develop residential colony in the premises. The concern has demolished major structure and machineries. The concern has developed layout and the said layout was available for intended sale from March 2006. The permission of the collector for developing and selling land was also received on 17/02/2006 i.e. to say that the concern has capitalized interest cost from the period F.Y. 2001-02 to F.Y. 2005-06. But when the goods were ready for intended sale then the concern could not have capitalized interest cost. Considering the provisions of section 36(l)(iii) of the Income Tax Act 1961 and Accounting Standard 2 and 16 issued by the Institute of*

> *Chartered Accountant of India (As per section 211(3)(C) of the Companies Act 1956 it is mandatory for the companies to comply with the accounting standard issued by The Institute of Chartered Accountant of India). Company cannot capitalize the interest amount to the land account. During the year company has capitalized the interest amount to Land Account. The said wrong valuation of stock was rectified and revised return was filled".*

6. The assessee in its revised computation has revised value of closing stock (work-in progress from Rs.12,95,56,432/- to 11,20,86,908/-) the difference i.e. Rs.1,74,69,522/- was on account of interest of Rs.1,55,18,465/- on borrowed funds and Rs.19,51,059/- on account of expenditure (after adjusting sale and cost of plots) inter alia on development, electric repairs, Municipal taxes, N.A. Tax, repairs and maintenance of Architect fees etc. The issue before us is whether above amount of Rs.1,74,66,524/- is to be treated as revenue expenditure as claimed by the assessee u/s.36(1)(iii) and section 37 (1) of the Act or capital expenditure as held by the AO in his assessment order. We find that the assessee has borrowed funds for the purpose of business and paid interest thereon. The assessee has capitalized the expenditure including interest paid on borrowed funds till A.Y. 2006-07 and then claimed it as revenue expenditure when plots were available for sale after obtaining necessary approval from State authorities. During the previous year relevant to the A.Y. 2007-08 plots were ready for sale and some plots were infact sold out and assessee has shown sale proceeds of said plots in its return of income. In this background assessee has claimed interest and other expenditure as revenue expenditure under the provisions of section 36(1)(iii).

The narrow issue before us is whether interest paid on borrowed capital used for business was a revenue expenditure once plots were ready for sale and infact some plots were sold during the previous year relevant to the assessment year under consideration. The AO is not justified in disallowing the entire expenditure of interest without cogent reasoning. The assessee has purchased the plot as its stock in trade and has been showing the same under the head "current assets" in its balance sheets since inception. The assessee has borrowed the funds for the purpose of business. Accordingly, interest paid on the funds borrowed for business purposes was to be allowable as revenue expenditure. The assessee as a Developer has used the borrowed funds for the business and claimed payment of interest as revenue expenditure u/s.36(1)(iii) of the Act. The AO was not justified in disallowing the same at the strength of some accounting standards. The litmus test for disallowance of interest as deduction is that borrowed found should be for purpose of business. In view of the above, the AO was not justified in ignoring the revised return of income and CIT(A) has rightly allowed deduction of Rs.1,74,69,524/- including expenditure amounting to Rs.19,51,059/- on various accounts. Same is upheld.

7. In the result, the appeal filed by the Revenue is dismissed.

Pronounced in the Open Court on this the 29th day of April, 2013.

Sd/-	Sd/-
(R.K. PANDA)	**(SHAILENDRA KUMAR YADAV)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

satish
dated the 29th April 2013.

Copy of the order is forwarded to:

1. The Assessee
2. The Department
3. The CIT(A)-II, Nashik
4. The CIT-II, Nashik
5. The DR "B" Bench, Pune.
6. Guard File

By Order

// True Copy //

Private Secretary,
Income Tax Appellate Tribunal, Pune.