

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 05.10.2021

CORAM :

THE HON'BLE MR. JUSTICE T.S. SIVAGNAM

AND

THE HON'BLE MR. JUSTICE SATHI KUMAR SUKUMARA KURUP

Tax Case Appeal No.496 of 2021

The Commissioner of Income Tax,
Chennai.

... Appellant

Vs.

M/s.Ceebros Hotels P Ltd,
19/1, Sukriti, III Cross Road,
R.A.Puram,
Chennai – 600 028.

... Respondent

Tax Case Appeal filed under Section 260A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal, Madras "C" Bench, Chennai, dated 31.03.2021 passed in I.T.A.No.3372/Chny/2019.

For Appellant : Mr.T.Ravi Kumar
Senior Standing Counsel

For Respondent : Mr.A.S.Sriraman

J U D G M E N T

(Judgment was delivered by **T.S. SIVAGNANAM, J.**)

This appeal by the Revenue filed under Section 260A of the Income Tax Act, 1961 (“the Act” for brevity), is directed against the order, dated 31.03.2021, passed by the Income Tax Appellate Tribunal, Madras “C” Bench, (“the Tribunal” for brevity), in I.T.A.No.3372/Chny/2019, for the Assessment Year 2015-16.

2.The appeal has been filed by the Revenue, raising the following substantial questions of law :

“1. Whether on the facts and in the circumstances of the case, the Tribunal was right in deleting the additions made without appreciating the fact that the work in progress pertaining to MRC Nagar project is a qualifying project and therefore interest cost should have been capitalized and should have been reflected in the closing stock and shown in the profit and loss account which had not been done by the assessee and therefore the AO had rightly made the additions?”

2.Is not the finding of the Tribunal bad especially when the interest expenditure pertaining to MRC Nagar project is under-development and current year development expenses had been added to the closing work in progress which makes it a qualifying assets for the borrowing cost to be capitalized and since the same was not done by the Assessee, the AO had rightly disallowed the cost pertaining to MRC Nagar project? ”

3.The assessee filed its return of income for the Assessment Year under consideration, AY 2015-16, on 27.09.2015, admitting Nil Income. The case was selected for scrutiny and notice under Section 143(2) of the Act, dated 31.08.2015, was served on the assessee and thereafter, by another letter dated 25.04.2016, details were called for. The details were furnished and the assessment was completed by order dated 26.12.2017 under Section 143(3) of the Act.

4.The issue before the Assessing Officer was that the assessee was running a Hotel and Real Estate business and offered a total income of Rs.120.27 Crores from Rooms Revenue, Restaurants and Banquets Revenue,

Contract Profits recognized, Other Operating Revenues, Rental Revenue, etc. The major portion of the revenue was received from the Hotel business. For the Assessment Year 2015-16, the assessee had offered income from the Real Estate in respect of the project, namely, 'Atlantic' at Egmore. An amount of Rs.41,37,73,978/- was claimed towards "Interest Payable" at 13.75% p.a. on a loan amount of Rs.301.92 Crores, obtained from IFCI Limited, which was outstanding as on 31.03.2015.

5.The Assessing Officer observed that the said loan was obtained for the specific purpose of purchasing the land to an extent of 90.53 grounds in MRC Nagar. According to the Assessing Officer, the assessee had entered into the business of Real Estate for the first time during the Assessment Year 2015-16, in which, the assessee had offered some income from the Real Estate business. In addition to the Hotel business, the assessee had two residential projects and out of the two projects, in one project namely, 'Atlantic', Egmore, activities were commenced and so far as the MRC Nagar project is concerned, the Assessing Officer observed that the assessee had only purchased the land, and a perusal of the break-up of the Revenue from

operations shows that a sum of Rs.47.56 Crores was offered as Revenue from Real Estate business. Further, the Assessing Officer observed that the entire amount was on account of the contract receipts earned from the project, known as Atlantic, Egmore, and the assessee has shown the amount of Rs.94.23 Crores as advance received on account of the Atlantic Project and was shown under the head "Trade Payables". Thus, the Assessing Officer held that the amount of Rs.94.23 Crores shown in the Balance Sheet as "Trade Payables" related only to the 'Atlantic' project and the assessee has not even started the project in MRC Nagar during the year 2015-16 and had only purchased the land.

6.Thus, the question before the Assessing Officer was whether, the claim of interest expenditure of Rs.41.37 Crores on loan obtained for the purchase of land in MRC Nagar is allowable during AY 2015-16.

7.The Assessing Officer was of the view that the assessee, having not commenced the project in MRC Nagar and had not offered any income from the project, all the expenditures, which are specifically attributable to the

project, have to be accounted as 'Work-in-Progress' and only when the income is generated and offered from the project, the expenditure can be claimed. Further, the Assessing Officer observed that no income was offered from the MRC Nagar Project, therefore, any expenditure relating to the Real Estate project 'Atlantic', Egmore, could be allowed for AY 2015-16, and not the expenditure related to MRC Nagar Project.

8. Further, in the Assessment Order, the Assessing Officer has noted that the assessee accounted 'Property Development and Construction Work-in-Progress' under the head "Inventories". An amount of Rs.845.67 Crores was shown as 'Property Development and Construction Work-in-Progress', the break-up of which was relating to Atlantic project and MRC Nagar project. The assessee was called upon to explain and they have stated as to how the asset in MRC Nagar was put to use. The Assessing Officer did not agree with the submissions made by the assessee, since the assessee was following Mercantile System of Accounting. According to the Assessing Officer, as per the Accounting Standard 16 ("AS-16" for brevity), borrowing costs that are directly attributable to the acquisition, construction or

production of a qualifying asset should be capitalised as part of the cost of that asset and the amount of borrowing costs eligible for capitalisation should be determined in accordance with the AS-16, otherwise, borrowing costs should be recognized as an expense in the period in which they are incurred. Thus, the Assessing Officer held that the assessee is bound to capitalise the interest cost of Rs.41.37 Crores on the borrowal to the Work-in-Progress of MRC Nagar Project and instead of doing so, the assessee chose to claim the entire expenditure as revenue expenditure, when no income was offered for the MRC Nagar Project.

9.The Assessing Officer referred to the decision of the Special Bench of the Tribunal in *Wallstreet Construction Ltd. v. Joint Commissioner of Income Tax, Mumbai [Mumbai (2006) 101 ITD 156 (Mumbai) (SB)]*. Thus, the Assessing Officer disallowed the sum of Rs.41.37 Crores towards the loan obtained for the purchase of the land in MRC Nagar and added the same to Work-in-Progress of the Inventories and recomputed the interest expenditure by adding a part of the same to the total income and arrived at a Total Assessed Income for a sum of Rs.39,91,16,420/-.

10. Aggrieved by the same, the assessee preferred an appeal to the Commissioner of Income Tax (Appeals)-I, Chennai ("CIT(A)" for brevity). The said appeal was dismissed by order dated 05.12.2019. Aggrieved by the same, the assessee preferred an appeal before the Tribunal, which was allowed and challenging the said order, the Revenue is before us by way of this appeal, raising the above referred substantial questions of law.

11. We have elaborately heard Mr.T.Ravi Kumar, learned Senior Standing Counsel appearing for the appellant/Revenue and Mr.A.S.Sriraman, learned counsel appearing for the respondent/assessee.

12. The Revenue seeks to sustain the order passed by the Assessing Officer, as confirmed by the CIT(A), by contending that the entire amount of Rs.47.56 Crores offered as revenue from Real Estate business was on account of the contract receipts earned from Atlantic Project at Egmore and the assessee has shown the amount of Rs.94.23 Crores as advance received towards the Atlantic Project, which was shown under the head "Trade

Payables” for the year ended 31.03.2015 and the same relates only to the Atlantic Project and not to MRC Nagar Project. Further, it is submitted that the Tribunal committed an error in not considering the fact that, in the Balance Sheet for the year ended 31.03.2015, the assessee had accounted the 'Property Development and Construction Work-in-Progress' under the head “Inventories” and an amount of Rs.845.67 Crores was shown as 'Property Development and Construction Work-in-Progress', out of which, Nil profits were offered in MRC Nagar and Closing Work-in-Progress was shown, which clearly shows that the project at MRC Nagar had not even commenced. Further, it is submitted that, no distinction under Section 36(1)(iii) of the Act could be made between the capital borrowed for revenue purpose and capital borrowed for the purpose of business. Further, the Revenue seeks to rely upon the Director's Report and would submit that, in terms of the report, it has been stated that the MRC Nagar project had not commenced its operations during the relevant previous year and therefore, the expenses claimed by the assessee cannot be treated as inventory and ought to be treated as pre-operative expenses, which are required to be capitalised.

13.The learned counsel appearing for the respondent/assessee submitted that the Tribunal, on considering the facts which were placed before it, which is the Abstract of the expenses pertaining to the MRC Nagar project, on perusal of the same, came to the conclusion that the property at MRC Nagar was put to use. Further, the Tribunal has also taken note of the various documents that were filed by the assessee in the form of paper-book and held that the Real Estate Development should be treated as a segment of the assessee's business, wherein, the assessee executes several projects in different locations and if the same is done, then the segregation of the projects undertaken by the assessee, as done by the Assessing Officer, is incorrect. Further, the learned counsel submitted that the Tribunal had rightly held that AS-16 would have no application to the facts and circumstances of the case.

14.The facts which are not in dispute are that the assessee borrowed a loan from IFCI Limited for the purpose of purchase of land in MRC Nagar and claimed interest paid on such loan as a deduction under Section 36(1)(iii)

of the Act. The Assessing Officer disallowed the claim on the ground that the land purchased at MRC Nagar was not put to use in the business of the assessee and thus, the interest paid on loan borrowed for acquisition of any asset needs to be capitalised till such time the asset was put to use in the business of the assessee.

15. The Assessing Officer, though admits that the assessee is in the business of Real Estate Development, came to the conclusion that the MRC Nagar project should be treated as stand-alone project, since no activity had commenced in the MRC Nagar project and the expenditure including the interest paid on the loan borrowed for the purchase of the land, needs to be capitalised and added back to the Work-in-Progress account. In this regard, the Assessing Officer has referred to the Form AS-16 issued by ICAI and the principles of Matching Concept of accounting to support his findings and according to the Assessing Officer, unless revenue is recognized from the project, corresponding expenditure cannot be allowed.

16. Section 36 of the Act deals with “Other deductions”. Sub-Clause (1) of Section 36 states that the deductions provided for in the various clauses enumerated thereunder, shall be allowed in respect of matters dealt with therein, in computing the income referred to in Section 28 of the Act. For the purpose of the case on hand, Clause (iii) could be relevant, which states that the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession would be allowable as deduction. The proviso in Section 36(1) states that, 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 capitalised 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.

17. Therefore, the question which was examined by the Tribunal was the allowability or otherwise of the interest paid on the loan borrowed by the assessee from IFCI Limited and whether it would fall within the scope of

Section 36(1)(iii) of the Act.

18.As rightly noted by the Tribunal, the loan which was obtained by the assessee from IFCI Limited is for the purpose of business of the assessee and having accepted the said fact, the deduction of interest was disallowed only on the ground that the asset purchased by the assessee in MRC Nagar was not put to use in the Assessment Year under consideration for the purpose of business of the assessee. This appears to be factually incorrect, as could be seen from the material facts which were placed before the CIT(A) and noted by the CIT(A). When the appeal was being heard by the CIT(A), the assessee furnished an Abstract of Expenses pertaining to MRC Nagar project and the expenses were in the nature of advertisement expenses, architect fees, CMDA charges, consultancy charges, electricity charges, legal fees, rent, security charges, site expenses, various labour charges and purchase of materials. The assessee had also furnished the ledger accounts for these expenses and also the facts that they carried on major work of demolition of the existing structure which was newly built by the previous owner for Hotel business and this demolition was done by the assessee. This

factual position would go to show that the land was put to use in the Assessment Year under consideration. On this issue, the Tribunal had rightly noted that the term “put to use” in the proviso in Section 36(1)(iii) would be applied to capital asset/income earning apparatus/facilitating the business activity and therefore, the Statute envisages the importance of such capital asset should be put to use in the business in contra distinction to the inventory of the assessee.

19. Further, the Tribunal noted that the inventory in the business/holding of inventory in the business by itself is a business activity in the normal course and in continuation of business of construction pursued by the assessee. Therefore, it held that the attempt to apply the proviso to the case of the assessee would lead to wrong interpretation of law and therefore, the reasons given by the Assessing Officer to disallow the interest expenditure by applying the provisions of Section 36(1)(iii) is not in accordance with law. Further, the Tribunal noted that the assessee is into the business of Real Estate Development and in the process of executing two projects at different places and the Assessing Officer was not justified in

treating the two projects on stand-alone basis and also that the property in MRC Nagar was not put to use. Further, the Tribunal observed that the purchase of inventory in the course of carrying on business should be reckoned as continuation of same business activity in the normal course and cannot be equated or termed as extension of business activity. Furthermore, the Tribunal noted that the assessee has offered substantial income from the Atlantic project and the attempt to apply Matching Concept principle is misconceived.

20. So far as the decision of the Special Bench of the Tribunal in *Wallstreet Construction Ltd.* is concerned, the issue was whether, where the assessee has followed the Project Completion Method of accounting, the interest identifiable with that project should be allowed as deduction in the year when the project is completed and the income is offered from the project or it should be allowed on a year to year basis. In our considered view, the said question does not arise in the case on hand and therefore, the said decision cannot be applied to the facts before us.

21.Thus, we are of the view that the Tribunal was right in allowing the appeal filed by the assessee and holding that the term “put to use” applies to capital asset only because capital asset is held to facilitate the business activity and sometimes, it needs to be prepared after it is acquired for being used to facilitate the business activity and in the instant case, the assessee was able to establish that substantial activities had been done in the project, which would go to show that the property purchased has been put to use.

For all the above reasons, the Tax Case Appeal filed by the Revenue is dismissed. Consequently, the substantial questions of law are answered against the Revenue. No costs.

(T.S.S., J.) (S.S.K., J.)

05.10.2021

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Internet : Yes

Index : Yes / No

Speaking order / Nonspeaking order

To

1.The Income Tax Appellate Tribunal, Madras, "C" Bench

2.The Commissioner of Income Tax,
Chennai.



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T.S. SIVAGNANAM, J.
and
SATHI KUMAR SUKUMARA KURUP, J.

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