Income-tax issues relating to builders including income on unsold stock

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Synopsis

- Introduction / General Background
- Section 43CA – some issues
- Taxation of annual value of units held as stock-in-trade
  - CIT v. Neha Builders (P.) Ltd. {(2007) 164 Taxman 342 (Guj)}
  - CIT v. Ansal Housing Finance & Leasing Co. Ltd. {(2012) 83 CCH 046 (Del)}
  - Mangla Homes (P) Ltd. v. ITO {(182 Taxman 55)(Bom)}
  - CIT v. Sane & Doshi Enterprises (Bom) {ITA No. 375 of 2013; order dated 9.4.2015}
  - Chennai Properties & Investments Ltd. v. CIT (SC) {Civil Appeal No. 4494 of 2004; order dated 9.4.2015}
  - C. R. Developments Pvt. Ltd. v. CIT (Mum ITAT) {ITA No. 4277/Mum/2012; Mumbai `C' Bench; AY 2009-10; Order dated 13.5.2015}
  - Insertion of section 23(5)
- Amendments by the Finance Act, 2017 affecting builders / developers –
  - S. 80IBA
  - Section 194IC
- Are any of the Income Computation and Disclosure Standards applicable to Builders / Developers
  - Issues arising out of ICDS IX – Borrowing Costs
- Can addition be made to the total income on account of differential selling price of units sold
- When do profits accrue in respect of land held as stock-in-trade?

Synopsis

Accounting Pronouncements (This portion would be relevant for period prior to applicability of 2012 Guidance Note)

- Accounting Standard 7 (AS 7)
- Revised Accounting Standard 7 (Revised AS 7)
- Opinion issued by Expert Advisory Committee (EAC) on 16.7.2003
- Guidance Note on Recognition of Revenue by Real Estate Developers issued in 2006 (GN 2006)
- Guidance Note on Accounting for Real Estate Transactions issued in 2012 (GN 2012)

- Is PCM acceptable and recognized method?
- Is revised AS-7 applicable to builders / developers?
- Decisions relied upon by the Department to substantiate Percentage Completion Method.
- Decisions where Project Completion Method has been accepted.
- Allowability of provision for purchase of TDR and other expenses.
- Are advances to be considered for computing turnover limits u/s 44AB in case of an assessee following Project Completion Method?
- Disallowances u/s 40(a).
- Year of credit of TDS in case of an assessee following Project Completion Method.
- Conversion of Capital Asset into Stock-in-trade – some Issues

Synopsis…

What is not covered?

- Issues arising out of revised guidance note applicable to projects commencing on or after 01.04.2012.
- 80IB (10) / 80IBA and issues thereunder.
- Allowability of interest and administrative expenses as a period cost in case of an assessee following project completion method.
- Impact of payments on account of fungible FSI.
- Premiums paid to BMC and other payments for regularisation of constructions.
- Joint Development Agreement – whether it constitutes an AOP?
- Allowability of depreciation on assets held as stock-in-trade (see Annual Accounts of DLF).
- Issues u/s 56(2)(vii)(b).

Introduction / General

Introduction - General

- The topic for today's discussion is very wide. We shall first begin with the two common methods of computing profits by builders / developers. At the outset, we need to understand certain basic propositions –
  1. Nature of business in case of builders / developers is different from the manufacturing concerns as far as time period is concerned. The operating cycle in the case of builders / developers is much larger than the operating cycle in case of a manufacturing concern.
  2. The builder / developer while he is constructing the building enters into agreements with persons willing to buy units in the buildings so being constructed and under such agreements various amounts are received. In case of a manufacturer normally there are no orders when the goods are being manufactured. Even if there are orders, the amounts are not received when the goods are being manufactured. Even if the amounts are received the customer does not generally have a contractual / statutory right to get money back.

Introduction – General...

- Profits can be computed and offered for taxation only when they accrue. One can say that the profits accrue when the following conditions are fulfilled –
  a there is a sale;
  b the sale consideration is known and is likely to be realized;
  c the cost of what has been sold is known or can be ascertained with reasonable certainty;
  d for a sale to take place the thing / property being sold must be in existence.
- There are two main methods of computing profits which are commonly being followed by builders / developers viz. Percentage Completion Method and Project Completion Method.
- The term 'Accrual' has been explained in Accounting Standard-1 on 'Disclosure of Accounting Policies', as under :

  "Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate."
- Accrual basis of accounting, thus, recognises that the buying, producing, selling and other economic events that affect enterprise's performance often do not coincide with the cash receipts and payments of the period. The goal of accrual basis of accounting is to relate the accomplishments (measured in the form of revenue) and the efforts (measured in terms of cost) so that reported net income measures an enterprise's performance during a period instead of merely listing its cash receipts and cash payments. Therefore, for a builder it is obligatory to accumulate receipts from customers and the expenses incurred on the project till the time construction is substantially complete and thereafter compare the two and declare the net result — profit or loss.

Introduction – General...

- The 'Guidance Note on Accrual Basis of Accounting' issued by the Institute of Chartered Accountants of India, states that revenue from sale or service transactions should be recognized when the following conditions are satisfied provided that at the time of performance it is not unreasonable to expect ultimate collection:
- The seller of goods has transferred to the buyer the property in goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership and no significant uncertainty exists regarding the amount of consideration that will be derived from the sale of goods.
- In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished.
- Before proceeding further it would be worthwhile to understand the difference between a contractor / builder or developer.

Introduction – General...

- **What are the activities of the builders and developers?**

Activities of the builders and developers as narrated in the decision of the Mumbai Bench of ITAT in the case of ACIT v. Prerna Premises (P) Ltd. 7 SOT 288 (Mum) are as under –

"The builder forms a project of constructing a building and to sell it out in the open market and to earn profit. It is a composite profit of construction of the building and its sale in the market. In order to achieve this target, the builder purchases the plot and gets the plan sanctioned from the appropriate authority and start construction thereon. In this line of business two methods of accounting are followed - (1) Project completion method (2) Percentage completion method. In a Percentage completion method, a builder is required to estimate the profit in each assessment year and offer it to tax. But in the case of a project completion method the builder/assessee shows the investment in the building as work-in-progress and carries it over to a next succeeding assessment year. He finally works out the profit of the entire project on its completion."

Special provision for full value of consideration for transfer of assets other than capital assets in certain cases – Section 43CA.

Section 43CA

- **Section 43CA - Special provision for full value of consideration for transfer of assets other than capital assets in certain cases.**
- The Finance Act, 2013 has with effect from 1.4.2014 inserted S. 43CA in the Income-tax Act, 1961 ("the Act"). This section deems value adapted or assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty (stamp duty value) of an asset (other than capital asset) being land or building or both to be the full value of consideration, received or accruing as a result of transfer thereof, by the assessee, in the event consideration received or accruing is less than the stamp duty value of the asset so transferred. The provisions of this section are broadly identical to the provisions of S. 50C and the two provisos to S. 56(2)(vii)(b)(ii).
- The Memorandum explaining the provisions of the Finance Act, 2013 states as under –

  "E. WIDENING OF TAX BASE AND ANTI TAX AVOIDANCE MEASURES

  Computation of income under the head "Profits and gains of business or profession" for transfer of immovable property in certain cases

  Currently, when a capital asset, being immovable property, is transferred for a consideration which is less than the value adopted, assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, then such value (stamp duty value) is taken as full value of consideration under section 50C of the Income-tax Act. These provisions do not apply to transfer of immovable property, held by the transferor as stock-in-trade.

Section 43CA

It is proposed to provide by inserting a new section 43CA that where the consideration for the transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the value so adopted or assessed or assessable shall be deemed to be the full value of the consideration for the purposes of computing income under the head "Profits and gains of business of profession".

It is also proposed to provide that where the date of an agreement fixing the value of consideration for the transfer of the asset and the date of registration of the transfer of the asset are not same, the stamp duty value may be taken as on the date of the agreement for transfer and not as on the date of registration for such transfer. However, this exception shall apply only in those cases where amount of consideration or a part thereof for the transfer has been received by any mode other than cash on or before the date of the agreement.

These amendments will take effect from 1st April, 2014 and will, accordingly, apply in relation to the assessment year 2014-15 and subsequent assessment years. [Clause 8]"

The section is introduced as a tax avoidance measure. The Memorandum states that this provision is intended to apply to stock-in-trade since the provisions of S. 50C are applicable only to capital asset. This objective will have to be kept in mind while interpreting the provisions in case two interpretations are possible due to ambiguity in the language of the provisions.

Section 43CA

- The text of the section is as under –

Special provision for full value of consideration for transfer of assets other than capital assets in certain cases.

"43CA. (1) Where the consideration received or accruing as a result of the transfer by an assessee of an asset (other than a capital asset), being land or building or both, is less than the value adopted or assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall, for the purposes of computing profits and gains from transfer of such asset, be deemed to be the full value of the consideration received or accruing as a result of such transfer.

(2) The provisions of sub-section (2) and sub-section (3) of section 50C shall, so far as may be, apply in relation to determination of the value adopted or assessed or assessable under sub-section (1).

(3) Where the date of agreement fixing the value of consideration for transfer of the asset and the date of registration of such transfer of asset are not the same, the value referred to in sub-section (1) may be taken as the value assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer on the date of the agreement.

(4) The provisions of sub-section (3) shall apply only in a case where the amount of consideration or a part thereof has been received by any mode other than cash on or before the date of agreement for transfer of the asset.".

Section 43CA

- **Analysis of S. 43CA**
- **Conditions precedent**
  1. There is an assessee.
  2. There is a transfer by the assessee.
  3. The transfer is of an asset as defined in this section.
  4. There is consideration received or accruing as a result of such transfer.
  5. The value adopted or assessed or assessable by any authority of a State Government (stamp duty value) for the purpose of payment of stamp duty in respect of such transfer is greater than the consideration mentioned in 4 above.
- **Consequence –**
  1. For the purpose of computing profits and gains from transfer of such asset, stamp duty value shall be deemed to be full value of consideration received or accruing as a result of such transfer.
- **Exception:**
  1. The asset (i.e. land or building or both) is a capital asset of the assessee.
  2. Where the date of agreement of sale and the date of registration of transfer are not the same, the stamp duty value on the date of agreement shall be taken in place of stamp duty value on the date of registration provided the conditions mentioned in sub-sections (3) and (4) are satisfied (see notes later).
- **Definition:**

Asset means land or building or both. However, such asset should not be capital asset.

Section 43CA

- **Commentary:**
- **Assessee:** The section applies to any assessee. For the section to apply legal status and / or residential status of the assessee are not relevant. Therefore, the section applies to an assessee being individual, hindu undivided family, firm, LLP, company, association of persons, body of individuals, trust, co-operative society, etc.

- **Transferee**: The transferee / buyer could be any person. Legal status and residential status of the buyer is not relevant. The transferee could even be a relative of the assessee or a wholly owned subsidiary, etc.

- **`Profits & Gains"** : The section applies while computing income under the head `Profits & Gains of Business or Profession'. The deeming fiction created by this section is for the purpose of computing "profits and gains" from transfer of such asset. The term "profits & gains" has been used and not `income'. It appears that the term "profits and gains" is used to signify the head under which the income is to be computed.

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- **Consideration received or accruing**: The section postulates comparison of consideration received or accruing as a result of the transfer of an asset with the stamp duty value thereof. The section does not cover transfers without consideration. Therefore, if the asset is transferred by the assessee without consideration by way of gift or otherwise then the section would not apply. The section may not even apply when the asset held as stock-in-trade is given without consideration as a part of scheme / sales promotion activity eg. a flat in a project being given free by way of lucky draw.

  The term `consideration' is not defined. The Courts, in the context of the provisions under the Direct Tax Laws have explained the word 'consideration' as follows:

- In the context of the provisions of the Indian Income-tax Act, 1922, Patna High Court in ***RaiBahadur H.P. Banerjee* v.*CIT* [1941] 9 ITR 137** explained it as follows :

  > "In my judgment the word 'consideration' appearing in this sub-section is used in its legal sense as it is used in connection with the transfer of assets. A transfer of assets may be gratuitous or wholly without consideration or it may be with consideration, that is for some return moving from the transferee to the transferor. The word 'consideration' is not defined in the Transfer of Property Act, and in my judgment it must be given a meaning similar to the meaning which it has in the Indian Contract Act. Section 2(*b*), Indian Contract Act, defines 'consideration' in these words 'When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise".

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- In the context of the provisions of the Gift-tax Act, 1958 the Full Bench of the Kerala High Court in ***CGT* v.*Smt. C.K. Nirmala*** **[1995] 215 ITR 156, 160, 161** explained it as follows:

  "Within the framework of the above finding what is required to be decided by this court is whether the transfer of property involved in this case would come within the meaning of the word 'gift' in section 2(*xii*) of the Act. One of the essential ingredients constituting the gift under this provision is that the transfer of property by one person to another must be 'without consideration in money or money's worth'. However, the word 'consideration' is not defined in the Act and, therefore, it must carry the meaning assigned to it in section 2(*d*) of the Indian Contract Act, 1872. In *Keshub Mahindra* v.*CGT* [1968] 70 ITR 1, the Bombay High Court, in a similar situation, adopted the said course.

- Section 2(*d*) of the Indian Contract Act is thus :

  "When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing **or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise."**

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- There is nothing to show in the definition of the term 'consideration' that the benefit of any act or abstinence must 'directly' go to the promisor. A contract can arise even though the promisee does or abstains from doing something for the benefit of a third party and the promisor can treat the benefit to a partnership firm where he is also a partner as consideration. Sir William R. Anson said : 'The consideration may be of benefit to the promisor, or to a third party, or may be of no apparent benefit to anybody, but merely a detriment to the promise.' (Principles of the English Law of Contract).... ...But the cardinal issue in this case has to be solved within the framework of the provisions contained in section 2(*xii*) of the Gift-tax Act read with section 2(*d*) of the Indian Contract Act..."

- Consideration may be in cash or in kind. Consideration need not be monetary consideration. The Bombay High Court has in the case of I. Chatterji v. CGT (53 Taxman428)(Bom) held that promise to marry was a valid consideration. Consideration may flow from a third party.

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- Agreements without consideration are void (Section 25 of the Indian Contract Act). S. 25 further provides for following three cases where agreement made without consideration is not void. i.e. following are cases of agreements without consideration which are not void.
  - It is expressed in writing and registered under the law for the time being in force for the registration of documents, and is made on account of natural love and affection between parties standing in a near relation to each other; or unless
  - It is a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, or something which the promisor was legally compellable to do; or unless
  - It is a promise, made in writing and signed by the person to be charged therewith, or by his agent generally or specially authorised in that behalf, to pay wholly or in part a debt of which the creditor might have enforced payment but for the law for the limitation of suits.

- The provision contemplates comparison of consideration received or accruing as a result of the transfer with the stamp duty value of the asset transferred. The provision uses the term for a consideration which is less than the stamp duty value …. of the asset. They do not use the terms `monetary consideration' as was the case in the provisions of erstwhile Gift Tax Act.

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- The consideration need not always be monetary consideration. In the context of S. 56(2)(v)/(vi)/(vii), the Tribunal has in the following cases held –
  a. That the amount received by a beneficiary from a trustee on dissolution of a trust cannot be said to be without consideration - Mumbai Bench of ITAT in the case of Ashok C. Pratap v Addl. CIT (2012) 23 Taxmann.com 347 (Mum) held
  b. That the amount received by the assessee, from her ex-husband, representing accumulated monthly installments of alimony constitutes consideration for relinquishing all her past and future claims. The Tribunal held that since there was sufficient consideration in getting the said amount, S. 56(2)(vi) was not applicable – Delhi Bench of ITAT in the case of ACIT v. Meenakshi Khanna (143 ITD 744).
  c. That abstaining from contesting the will was consideration for the amount received by the assessee and therefore the amount so received was not covered u/s 56(2)(v) – Mumbai Bench of ITAT in the case of Purvez A. Poonawalla v. ITO (2011-TIOL-262-ITAT-MUM).

- Since the language of S. 43CA and that of S. 56(2)(v) / (vi) / (vii) is identical reliance can be placed on the ratio of the abovementioned decisions for the proposition that section 43CA does not envisage only monetary consideration.

Section 43CA

- In cases where the consideration is not monetary consideration but is received in kind possibly the value of the property / thing received may have to be compared with the stamp duty value of the asset but in cases where it is not possible to do so e.g., in case where a person gives up a personal legal right (eg right to file a suit to contest the will of the parent of the assessee) and receives the asset in lieu thereof, it cannot be said that the receipt is without consideration. Also S. 43CA may not apply since it requires comparison of the consideration with the stamp duty value. Since the consideration in such case is not capable of measurement it can be argued that the charge fails on the ground that the computation machinery does not contemplate such a situation. Illustrations of consideration not being capable of measurement could be giving up of a right to contest a will, inconvenience / hardship suffered in the course of redevelopment.

- The consideration could even be a detriment to the giver or a promise not to do a certain act. The applicability of the section in such cases may be doubtful since the consideration is not capable of being received / accrued eg promise not to enter a refuge area in a building.

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- **An Asset (other than capital asset)**: The section applies to transfer by the assessee of an asset provided –
  - The asset is land or building or both; and
  - The asset is not a capital asset.
- The section applies to transfer of land or building or both which are stock-in-trade of the assessee. Rights in land or building may not be covered by the provisions of this section. In the context of S. 50C of the Act where similar language is used, the Tribunal has, in the following cases, held that the section 50C does not apply to rights in land or building.
  - DCIT v Tejinder Singh (2012) (50 SOT 391) (Kol) - Transfer of leasehold righs in a buildiing do not attract provisions of S. 50C.
  - Atul G. Puranik v. ITO (132 ITD 499)(Mum) - Leasehold rights in plot of land is not `land or building or both'.
  - Kishori Sharad Gaitonde v. ITO ((ITA No. 1561/M/09), BCAJ Pg. 28, Vol 41 B Part 5, February 2010)
- It is also relevant to note that in the following cases, the Tribunal has held that the provisions of S. 50C apply to transfer of development rights.
  - Chiranjeev Lal Khanna v. ITO (132 ITD 474)(Mum) – S. 50C applies to Transfer of Development Rights
  - Mrs. Arlette Rodrigues v. ITO (ITA No. 343/Mum/2010) (Assessment Year 2006-07) order dated 18.02.2011 – S. 50C applies to Transfer of Development Rights.

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- Smt. Myrtle D'Souza v. ITO (ITA No. 3168/Mum/2011) (Assessment Year 2006-07) order dated 20.06.2012 – follows Mrs. Arlette Rodrigues and holds that S. 50C applies to Transfer of Development Rights.

- Recently, the Mumbai Bench of ITAT has in the context of s. 50C held that the provisions of s. 50C do not apply to transfer of development rights with respect to land owned by the assessee –
  - Voltas Ltd. v. ITO [2016] 74 taxmann.com 99 (Mum Trib)

- Earlier, the Mumbai Bench of the Tribunal had similarly held in the case of Shakti Insulated Wires Pvt. Ltd. v ITO (Mum)(URO) (ITA No. 3710/Mum/07. Assessment Year 2003-04; Mumbai E-1 Bench, Order dated 27.4.2009)

- It appears that the ratio of the said decisions will apply with equal force to S. 43CA as well.

- The section may not apply when the assessee transfers 100% of the shares of a company in which immovable property is the only asset. However, the section may be held to apply to transfer of shares with occupancy rights.

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- **What is covered is only land or buildings or both**. Part of building is not covered by the section. Similar is the language in S. 50C / S. 56(2)(vii). However, it needs to be noted that the legislature has in S. 27, S. 194IA, S. 194LA, S. 194LAA and S. 269AB made a specific reference to part of a building. This could mean that the section applies only when the building as a whole is transferred and does not apply to transfer of a part of a building and / or that the section applies only when 100% interest in the building is transferred. If this interpretation is correct then the section may not apply to transfer of flat (because a flat is a part of a building) and section may not apply to transfer of an undivided interest in a building eg transfer of 50% interest in a building. However, considering the intent with which this section is introduced, it is quite likely that such literal interpretation may not be acceptable to Courts.

- A building under construction may not be covered by this section because a building under construction is certainly not a building. The Hon'ble Punjab & Haryana High Court has in the case of CWT v. Smt. Neena Jain (189 Taxman 308)(P & H) held that an incomplete building does not fall within ambit of `assets' as defined in section 2(ea) of the wealth-tax Act as it does not fall within definition of `building' nor does it fall within purview of `urban land'.

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- **`Transfers'**: For the section to apply the assessee should transfer the asset. S. 2(47) defines the term `transfer'. However, the said definition is in relation to a capital asset. S. 43CA applies to an asset which is not a capital asset and therefore, the definition of the term `transfer' as defined u/s 2(47) may not be relevant. Normally, an immovable property being land or building is transferred only by way of a conveyance. Gujarat High Court has in the case of CIT v. Ashaland Corporation (133 ITR 55)(Guj) held that the transfer of stock-in-trade happens only when title is transferred to the buyer. It held that till such time as the sale is complete the amount received constitutes an advance. An advance received cannot be taxed as income. The Court has even observed that handing over of possession in part performance of the contract may be a good defense to the buyer against the seller yet it does not confer any title on the buyer. Also, the Apex Court has in the case of Alapati Venkataramiah v. CIT (57 ITR 185)(SC) held that for determining the year of chargeability, the relevant date is not the date of the agreement to sell but the date of the sale i.e., effective transfer of title as contemplated by the parties. To the same effect is the ratio of the decisions of Chidambaram Chettiar v. CIT [1936] 4 ITR 309 (Mad); CIT v. Motilal C. Patel & Co. (173 ITR 666)(Guj)(HC) and CIT v. Moghul Builders & Planners (252 ITR 488)(AP). However, it would be relevant to note that the Bombay High Court has in the case of Estate Investment Co. Ltd. v CIT (121 ITR 580)(Bom) rejected the contention made on behalf of the assessee that until a conveyance is executed by the vendor

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in favour of the purchaser, the purchaser cannot be regarded as the owner of the property held that the assessee had done everything within its power to carry out its obligations with the purchasers viz. possession was given and price was received. The Court even noticed that the price had been stated to have been received in the Balance Sheet and was carried to reserve fund. It appears that the decision rendered by the Bombay High Court was on typical facts of the assessee.

- Also, **for the transfer to happen the asset has to be in existence**. For the proposition that the transfer can happen only when property is in existence, a useful reference may be made to the provisions of S. 5 of the Transfer of Property Act, 1882 (TOPA) which defines the term `Transfer of property' as under –

  "5. "**Transfer of property' defined**. – In the following sections "transfer of property" means an act by which a living person conveys property, in present or in future, to one or more other living persons, or to himself, or to himself and one or more other living persons : and "to transfer property" is to perform such act.

  In this section "living person" includes a company or association or body of individuals, whether incorporated or not, but nothing herein contained shall affect any law for the time being in force relating to transfer of property to or by companies, associations or bodies of individuals."

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- The following passage from the book by C. L. Gupta, titled Law of Transfer of Property, which has been revised by Justice S. D. Agarwala (Third Edition, 2002) throws light on the proposition that for a transfer to happen the property has to be in existence.
  - Significance of **Conveyance of property "in present or in future"** - A transfer of property may take place not only in the present, but also in future {Sumsuddin v. Abdul Hussein, ILR (1909) 31 Bom 165 (172)}; but the property must be in existence {Jugalkishore Saraft v. Raw Cotton Co. Ltd., AIR 1955 SC 376 : (1955) 1 SCR 1369 : 1955 SCJ 871 : 1955 SCA 440 ; Chief Controlling, Revenue Authority v. Sudarsanam Picutre, AIR 1968 Mad 319 (FB) : 81 Mad LW 75 : ILR (1968) 1 Mad 600 : (1968) 2 Mad LJ 1}. It has been observed by Bhagwati J. in Jugalkishore Saraf v. Raw Cotton Co. Ltd., {AIR 1955 SC 376 : (1955) 1 SCR 1369 : 1955 SCJ 871 : 1955 SCA 440; Chief Controlling, Revenue Authority v. Sudarsanam Picutre, AIR 1968 Mad 319 (FB) : 81 Mad LW 75 : ILR (1968) 1 Mad 600 : (1968) 2 Mad LJ 1} that the words "in present or in future", in Section 5, qualify the word "conveys" and not the word "property". **A transfer of property not in existence operates as a contract to be performed in the future which is specifically enforceable as soon as the property comes into existence. An assignment of future or non-existent property is quite valid and the transfer becomes operative as soon as the property comes into existence** {Purna Chandra Bhowmick v. Barna Kumari Devi, AIR 1939 Cal 715 (DB) : 43 CWN 953 : ILR (1939) 2 Cal 341}. Transfers of non-existent, or as it is conveniently called after-acquired property, provided they are not of the nature contemplated in Section 6(1), Transfer of Property Act, are perfectly valid. **The transfer would be regarded, in a Court of justice, as a**

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contract to transfer after the vendor has acquired title and would fasten upon the property as soon as the vendor acquires it {Holroyd v. Marshall, (1864) 10 HLC 191 ; Coollyer v. Issacs, (1882) 19 Ch D 342 ; Taiby v. Official Receiver, (1888) 13 AC 523 ; Prem Sukh Gulgulia v. Habib Ullah, AIR 1945 Cal 355 (358) (DB) : 49 CWN 371}. Therefore, a contract for sale of non-existent property, that is, of property which is not of the vendor's at the time of the contract, but which the vendor thinks of acquiring by purchase later on, is not bad in law. There is nothing in the Contract Act or in any other law which makes it invalid {Prem Sukh Gulgulia v. Habib Ullah, AIR 1945 Cal 355 (358) (DB) : 49 CWN 371}.

Section 5, Transfer of Property Act, makes it clear that a transfer of property can effectively take place not merely where a person conveys property in present, but also when a living person conveys property in future, and this aspect has to be borne in mind, while considering the operation of Section 33(1)(b), Bombay Tenancy and Agricultural Lands Act, 1948 {Ganpati Joti v. Jayasingrao Abasaheb, AIR 1956 Bom 749 (751) (DB)}."

- Therefore, S. 43CA may not apply to a flat under construction since the subject matter of transfer is not in existence. However, upon the flat coming into existence the section may apply.

Section 43CA

- **Value adopted or assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer**: The section contemplates comparison of consideration for transfer of an asset with the value adopted or assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer. Therefore, in case the State Government levies stamp duty not on market value but on the consideration stated in the agreement then in such cases the section shall not apply. Also, in Union Territories, where the value of the property is adopted or assessed by an authority of a Central Government then this section may not apply. It appears that the Legislature has consciously kept areas where value is not adopted or assessed by any authority of State Government out of purview of this section. This is evident if one looks at the definition of "stamp duty value" in Explanation (f) to S. 56(2)(vii) which makes a mention of authority of a Central Government as well. Also, the section will not apply to transfer of an asset situated outside India because in such cases there will not be stamp duty value. It may be noted that S. 43CA and S. 50C make a mention of only authority of State Government whereas S. 56(2)(vii) makes a mention of authority of Central Government as well.

Section 43CA

- **Provisions of sub-section (2) and sub-section (3) of S. 50C shall apply in relation to determination of the stamp duty value:** Sub-section (2) of S. 43CA provides that the provisions of sub-section (2) and sub-section (3) of S. 50C shall apply in relation to determination of stamp duty value. The implication of this is as under –

1. In case the assessee has accepted the stamp duty value and claims before the AO that the value adopted or assessed or assessable by the stamp valuation authority exceeds the fair market value of the asset on the date of transfer then the AO may refer valuation of such asset to the DVO. Though the section uses the term `may', in the context of S. 50C, in the following cases, the Tribunal has held that the AO is bound to make a reference to the DVO.
   i. M/s Fortuna Structures Pvt. Ltd. v ACIT (2008)(60 itatindia 886)(Lucknow)
   ii. Meghraj Baid v ITO 23 SOT 25 (Jodh)
   iii. Kalpataru Industries v ITO (Mum)(41-B BCAJ 32)(ITA No. 5540/Mum/2007, Mum H Bench, Asst Year 2005-06, Order dated 24.8.2009)
   iv. Abbas T. Reshamwala v ITO (41-B BCAJ 33)(Mum)(ITANo. 3093/Mum/2009)(AY 2006-07)(Decided on 30.11.2009)

   Upon a reference being made certain provisions of the Wealth-tax Act, 1957 shall apply in relation to such reference as they apply in relation to a reference made by the AO u/s 16A(1) of the Wealth-tax Act, 1957.

Section 43CA

2 In case the DVO determines the fair market value of the asset transferred to be less than the value adopted or assessed or assessable by the stamp valuation authority, the value determined by DVO shall be considered by the AO to be full value of consideration received or accruing as a result of such transfer. In other words, the computation of profits and gains arising on such transfer will be with reference to value determined by DVO and not the stamp duty value. However, if the DVO determines the fair market value of the asset transferred to be more than the value adopted or assessed or assessable by the stamp valuation authority, the stamp duty value shall be deemed to be full value of consideration received or accruing as a result of such transfer. In other words, the valuation done by the DVO in excess of stamp duty value needs to be ignored and computation of profits and gains is to be made with reference to stamp duty value.

3 In case the assessee has disputed the value adopted or assessed or assessable by the stamp valuation authority in any appeal or revision or reference has been made before any other authority, court or the High Court then the AO shall not be bound to make a reference to the DVO. In such cases, the value upheld in an appeal or revision or reference shall be deemed to be full value of consideration received or accruing as a result of the transfer of such asset.

Section 43CA

4 The term `assessable' is used in S. 43CA(1) but the same is not defined. The expression `assessable' is defined in Explanation 2 to S. 50C. The term `Valuation Officer' is defined in Explanation 1 to S. 50C. Both the Explanations to S. 50C clearly state that the meanings therein are for the purpose of the said section i.e. S. 50C. S. 43CA makes sub-sections (2) and (3) of S. 50C applicable to S. 43CA but not the Explanations. However, since sub-sections (2) and (3) of Section 50C use the terms defined in Explanations to S. 50C it may be possible to contend that the said Explanations are also applicable to S. 43CA.

Section 43CA

- **Cases where date of agreement fixing value of consideration for transfer of the asset and the date of registration of such transfer are not the same {S. 43CA(3) and S. 43CA(4)}** - Sub-section (3) of S. 43CA deals with cases where date of agreement fixing value of consideration for transfer of the asset and the date of registration of such transfer are not the same. The language of this sub-section is identical to the language of first proviso to S. 56(2)(vii)(b)(ii) with the only difference being that this sub-section uses the expression `value of consideration' whereas the first proviso to S. 56(2)(vii)(b)(ii) uses the expression `amount of consideration'. The provisions of sub-section (3) apply when the following conditions are cumulatively satisfied –
  1. There is an agreement;
  2. The agreement is dated;
  3. The agreement is for transfer of the asset;
  4. The agreement fixes value of consideration;
  5. The date of agreement and date of registration of such transfer are not the same;
  6. The amount of consideration or a part thereof has been received by any mode other than cash;
  7. The amount referred to in 6 above is received on or before the date of the agreement.
- If all the above mentioned conditions are cumulatively satisfied the consequence is that the stamp duty value of the asset on the date of agreement shall be deemed to be full value of consideration received or accruing as a result of such transfer.

Section 43CA

- The term `agreement' has not been defined in the Act. Therefore, a useful reference can be made to the definition in S. 2(e) of The Indian Contract Act, 1872 which defines the term `agreement' as:

  "Every promise and every set of promises, forming the consideration for each other, is an agreement. (Indian Contract Act (9 of 1872), S. 2(e))"
- Dictionaries have explained the meaning of the term `agreement' as under:
  1. the fact of being of one mind; concurrence in the same opinion. {**Casell Concise Dictionary (Revised Edition, P. 29)}**
  2. 1. The act of agreeing or of coming to a mutual arrangement. 2. The state of being in accord. 3. An arrangement that is accepted by all parties to a transaction. ……. 8. Law. A. ***an expression of assent by two or more parties to the same object. B. the phraseology written or oral, of an exchange of promises.*** { **Websters Unabridged Dicttionary (P. 40)}**
  3. AGREEMENT ranges in meaning from mutual understanding to binding obligation.
- The following observations lucidly explain the meaning of the term `agreement'.

  "An `agreement' is an instrument between the parties who willfully agree to perform certain acts or refrain from doing something. The parties to the instrument should be agreed about the subject matter at the same time and in the same sense. The two or more parties which are agreed must communicate with each other." [Felthouse v. Bindley, (1862) 142 ER 1037]

Section 43CA

- A question could arise as to whether letter of allotment is an agreement for transfer and therefore for the purpose of computing the difference between stamp duty value and consideration, the stamp duty value of the asset on the date of letter of allotment be considered. A letter of allotment which is dated and is for transfer of specific asset and is accepted by the purchaser and which fixes the value of consideration for transfer of the asset would be regarded as an agreement for transfer for the purposes of sub-section (3) of section 43CA provided the condition mentioned in sub-section (4) of section 43CA is satisfied viz. that consideration or part thereof has been received on or before the date of letter of allotment. However, if such a letter of allotment is not specific in terms of the property to be transferred / allotted but only mentions the area (i.e. size) without identifying the property it may be difficult to contend that such a letter of allotment constitutes an `agreement for transfer'. It could be a debatable question as to whether a letter of allotment which grants an option to the buyer to buy or not to buy the property but take interest on the amount given by him to the assessee would be regarded as an agreement for transfer. In my opinion, even such a letter of allotment would be regarded as an agreement for transfer envisaged by sub-section (3) of section 43CA if the property is specific and other conditions as stated earlier are satisfied.

Section 43CA

- For the proposition that the letter of allotment constitutes an agreement for transfer reliance can be placed on the ratio of the decision of the Supreme Court in the case of DLF Universal Ltd. v Appropriate Authority & Another (243 ITR 730)(SC) and also the following observations from the decision of the Division Bench of Delhi High Court in the case of Ansal Properties & Industries Ltd. v. Appropriate Authority which have been quoted by the Delhi High Court in the case of R. N. Soin and Sons (P) Ltd. v Appropriate Authority & Others (330 ITR 455)(Del).

  "27.1 The parties may enter into any private agreement for transfer. They must wait for arrival of the day on which the property has assumed the shape in which it is proposed to be transferred. On that day they must enter into the proforma agreement (Form 37-I) and file the same seeking no objection from the Appropriate Authority. It was submitted that this interpretation may put the parties to the agreement in a disadvantageous position. The initial private agreement may have been made in the year 1990. The property may take the shape in which it is to be transferred in the year 1998. The price would be one agreed upon between the parties in the year 1990. The value as shown on the date of proforma agreement in Form 37-I would appear to be undervalued persuading the Appropriate Authority to direct the purchase of the property by the Central Government. This is a misapprehension which has to be dispelled. The proforma agreement of the year 1998 would be accompanied by the private agreement entered into in the year 1990 and that will be a relevant fact to be kept in view by the Appropriate Authority while exercising its jurisdiction under Chapter – XXC."

Section 43CA

- One may therefore conclude that the letter of allotment which is dated and is accepted by the buyer and which is specific in terms of the property to be transferred, the consideration therefor, the dates of payment of consideration agreed between the parties can be regarded as the agreement for transfer of asset.

Section 43CA

- **Can the agreement of transfer contemplated by sub-section (3) of section 43CA be an oral agreement?** While, in law, an agreement may be an oral agreement, it appears that the section does not contemplate oral agreement because the section refers to date of the agreement fixing the value of consideration for the transfer of asset. Also, sub-section (4) of section 43CA contemplates that the consideration or part thereof has been received by any mode other than cash on or before the date of the agreement for the transfer of such asset. The use of the word `date of the agreement' gives an impression that the section contemplates a written agreement. Also, in the absence of a written agreement, it may be difficult to establish the date of the agreement except that the payment of consideration or part thereof may be one of the factors indicating the earliest date on which the agreement could have been entered. However, if the assessee is in a position to lead impeccable evidence to substantiate the date on which such oral agreement was entered into the Courts may accept such oral agreement as well as an agreement contemplated by sub-section (3) of section 43CA since this is a provision which is charging fictional amount to tax and sub-section (3) is intended to dilute the rigors of this provision.

Section 43CA

- **Significance of the word `may' in sub-section (3) of section 43CA –** Sub-section (3) of section 43CA " ……., the stamp duty value on the date of the agreement *may* be taken for the purposes of this sub-clause". What is the significance of the word `may'? Does it mean that the AO has discretion not to consider stamp duty value on the date of the agreement? It appears that for the following reasons the answer is in the negative.
- Sub-section (3) carves out an exception to the main provision contained in sub-section (1) viz. sub-section (3) deals with a situation where there is an agreement for transfer of an asset; such agreement fixes the value of consideration for the transfer of asset and the date of registration and date of the agreement are not the same. Once these conditions are satisfied sub-section (3) contemplates that the stamp duty value on the date of agreement may be taken for the purpose of comparison with the amount of consideration. The issue is whether the use of the word `may' signifies discretion to the AO to consider or not to consider the stamp duty value on the date of the agreement. It appears that the legislature has used the word `may' because this sub-section has to be read along with sub-section (4). Sub-section (4) states that sub-section (3) shall apply only in a case where the amount of consideration or a part thereof has been received by any mode other than cash on or before the date of the agreement for transfer. Therefore, if this condition is not satisfied then the AO will be justified in not considering the stamp duty value on the date of the agreement. However, if this condition is satisfied then the AO will have to mandatorily consider the stamp duty value on the date of the agreement.

Section 43CA

- It is relevant to note that the Legislature is conscious of the fact that there is a time gap between the booking of a property and its receipt by the purchaser on registration and there can be a considerable value difference between the two dates. Finance Act, 2009 had w.e.f. 1.10.2009 inserted S. 56(2)(vii) so as to interalia provide that when an individual or hindu undivided family receives an immovable property for a consideration less than its stamp duty value, the difference between the stamp duty value and the consideration is chargeable. Realizing that timing difference can give rise to a tax liability the Finance Act, 2010 deleted the portion of cl. 56(2)(vii)(b) dealing with receipt of immovable property for a consideration which is less than its stamp duty value with retrospective effect from 1.10.2009 for the following reasons stated in the Explanatory Memorandum.

  > "C. In several cases of immovable property transactions, there is a time gap between the booking of a property and the receipt of such property on registration, which results in a taxable differential. It is, therefore, proposed to amend clause (vii) of section 56(2) so as to provide that it would apply only if the immovable property is received without any consideration and to remove the stipulation regarding transactions involving cases of inadequate consideration in respect of immovable property."

Section 43CA

- Finance Act, 2013 reintroduced the same provision but with two provisos which are identical to sub-section (3) and (4) of section 43CA. The Memorandum to the Finance Bill, 2013 clearly states as under –

  "Considering the fact that there may be a time gap between the date of agreement and the date of registration, it is proposed to provide that where the date of the agreement fixing the amount of consideration for the transfer of the immovable property and the date of registration are not the same, the stamp duty value may be taken as on the date of the agreement, instead of that on the date of registration. This exception shall, however, apply only in a case where the amount of consideration, or a part thereof has been paid by any mode other than cash on or before the date of the agreement fixing the amount of consideration for the transfer of such immovable property."

- Thus, the Legislature has through the first proviso to S. 56(2)(vii)(b)(ii) carved out an exception which shall apply if the conditions mentioned in subsequent proviso are satisfied viz. that the consideration or a part thereof has been paid on or before the date of the agreement by any mode other than cash. Exactly identical to the two provisos are sub-sections (3) and (4) of section 43CA. If a view is taken that the first proviso to S. 56(2)(vii)(b)(ii) or sub-section (3) of section 43CA is discretionary then it would defeat the purpose of introduction of these provisions.

Section 43CA

- **Can the benefit of sub-section (3) be denied in a case where the initial amount is received by cash but subsequent amounts are received by cheque**: Sub-section (4) of section 43CA states that the provisions of sub-section (3) shall apply only when the consideration or part thereof has been received by any mode other than cash on or before the date of agreement for transfer of asset. In a given case the assessee may have entered into an agreement for transfer of asset say on 1.7.2013 and on that date received a sum of Rs 1,00,000 in cash towards part of consideration under the said agreement and two days later received further sum of Rs. 2,00,000 by cheque under the same agreement. Can the benefit of sub-section (3) be denied on the ground that the conditions prescribed by sub-section (4) are not satisfied. It appears that the Court in such case may take a liberal view and hold that if it is otherwise evident that the assessee is entitled to benefit of sub-section (3) the same may not be denied only on the ground that the initial amount was received by cash. Possibly the assessee may have to explain the reason for receiving the amount by cash. The intention of prescribing that the consideration should be received by mode other than cash appears to be to ensure that the assessee is gets the benefit only in genuine cases and therefore it the Court is convinced that the assessee's case is bonafide it may hold that the benefit should not be denied only for the reason that initial amount was received by cash.

Section 43CA

- **Can the assessee opt not to be covered by sub-section (3)**: In a case where the stamp duty value on the date of registration of transfer of asset has fallen as compared to stamp duty value on the date of agreement fixing value of consideration for the transfer of the asset it would be beneficial to the assessee to contend that since the provisions of sub-section (3) are intended to grant a benefit, he does not seek to avail of the same and therefore the stamp duty value on the date of agreement fixing the value of consideration for the transfer of the asset be ignored and the computation be done with reference to stamp duty value on the date of registration of transfer of asset. It appears that the assessee does not have any option in this regard. If the conditions of sub-section (4) are satisfied then the application of sub-section (3) would be mandatory. Also, the intention of the legislature appears to be that the value of consideration on the date it was fixed should have been equal to or greater than the stamp duty value of the asset.

Section 43CA

- **Is S. 43CA a computation provision or a charging provision?** : The section appears to be a computation provision and not a charging provision. Therefore, the section will apply when there is a charge created by the charging provision. The view that the section is a computation provision and not a charging provision is supported by the language of sub-section (1) which says that **for the purposes of computing** profits and gains from transfer of such asset. The stamp duty value of the asset is deemed to be full value of consideration received or accruing as a result of the transfer. The words `full value of consideration' are used in the context of computation of capital gains where section 48 states that capital gains are computed by subtracting from full value of consideration the cost of acquisition of the asset transferred, expenditure incurred in connection with transfer, etc. While computing income under the head `Profits and Gains of Business or Profession' the sales turnover, gross receipts are considered on the credit side of profit & loss account. The Memorandum states that section 50C applies to transfer of capital asset being land or building or both but when these assets are transferred by an assessee holding them as stock-in-trade, the provisions of S. 50C are not applicable. S. 43CA has been introduced so as to cover cases where land or building or both transferred by the assessee are held as stock-in-trade.

Section 43CA

- **Is the section retroactive?**

  While the section is not retrospective a question will arise as to whether the section is retroactive eg. In case the property is received (i.e. registration / possession of the property is received by the assessee) for a consideration which is less than its stamp duty value after the section was introduced i.e. in the year 2014-15 but the agreement for its transfer was entered into 3 years earlier i.e. in the year 2011-12 when the section was not applicable and the stamp duty value of the property was more than the consideration, will the provisions of the section apply in such a situation. In the context of S. 50C, the Tribunal has held that the provisions of S. 50C are not applicable where agreement fixing consideration was entered prior to enactment of S. 50C and the transfer takes place in a period after the provisions of S. 50C are effective provided the delay in completion of transfer is beyond the control of the assessee and the circumstances are documented. (M. Siva Parvathi & Ors. V. ITO (2011)(7 ITR 468)(Vish); Administrator of Estate of Late Mr. F. E. Dinsha v. ITO (2013-TIOL-831-ITAT-MUM).

Issues under section 43CA

- Is the section retroactive?
- Is the section a computation provision or a charging provision?
- Does the section apply to transfer of a flat under construction?
- In the case of an assessee following percentage completion method of offering profits, in which year is the difference between the stamp duty value and consideration for transfer chargeable to tax?
- Is letter of allotment an agreement for the purposes of sub-section (3) of section 43CA?
- In the event that the flat allotted to a buyer is cancelled and subsequent thereto the same flat is allotted to another buyer, is the section applicable even to a subsequent allotment?
- While applying this section is consideration for transfer of each flat to be compared with its stamp duty value or is the consideration of all the flats in the building to be compared with the aggregate of stamp duty value of all the flats.
- Sub-section (2) of section 43CA makes sub-sections (2) and (3) of section 50C applicable for determination of value adopted or assessed or assessable under sub-section (1) of section 43CA. Is Explanation 2 to section 50C also applicable.
- Are service tax, VAT, society charges, etc. part of consideration?
- Is the section applicable to grant of development rights in respect of land held as stock-in-trade?

Issues under section 43CA …

- Is the section applicable to an assessee following percentage completion method where part of the revenue has been recognized before the section became effective? If yes, how does the section apply in such a case?
- Can the agreement referred to in sub-section (3) be an oral agreement?
- Will the benefit of sub-section (3) be denied in the following cases –
  - Initial amount is paid by cash at the time of agreement and all subsequent payments are by cheque;
  - The first payment is made subsequent to the agreement;
  - The initial payment is made by way of a journal entry;
  - Initial payment is made by cheque but all subsequent payments are made by cash

Rental income in respect of let out / vacant flats held as stock-in-trade.

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'.

- A very common issue is whether annual value / notional income in respect of flats / units held as stock-in-trade, is chargeable to tax under the head `Income from House Property'.

- S. 22 which is the charging section for the head `Income from House Property' charges annual value of the property being buildings or land appurtenant thereto to tax under the head `Income from House Property'. However, it carves out an exception in respect of property occupied for the purposes of the assesssee's business. For ready reference, section 22 is reproduced hereunder:

> "22. The annual value of property consisting of buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property ***as he may occupy for the purposes of any business or profession carried on by him*** the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head `Income from house property'."

- Section 22 charges to tax annual value of the property. Section 23 lays down the manner of determination of annual value. Section 23(1) interalia states that for the purposes of section 22, the annual value of any property shall be deemed to be the sum for which the property might reasonably be expected to let from year to year; or …….

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'.

- The question, really, is whether rental income in respect of units held as stock-in-trade is chargeable to tax under the head `Income from House Property'. If one comes to a conclusion that rental income needs to be charged to tax under the head `Income from house property', another question which arises is whether in the case of builders, the annual value of vacant unsold units, held as stock-in-trade, is also chargeable to tax.

- A question therefore, arises as to whether flats / shops held as stock-in-trade can be said to be occupied by the assessee for the purposes of his business, profits of which are chargeable to tax under the head `Profits and Gains of Business or Profession'?

- In this connection it is relevant to note that the Finance Act, 2017 has, w.e.f. 1.4.2018, inserted sub-section (5) in section 23 of the Act which reads as under –
  - *"(5) Where the property consisting of any building or land appurtenant thereto is held as stock-in-trade and the property or any part of the property is not let during the whole or any part of the previous year, the annual value of such property or part of the property, for the period up to one year from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority, shall be taken to be* nil*."*

- In this connection, ratio of the following decisions needs to be noted:

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'.

- In this connection, ratio of the following decisions needs to be noted –

- **CIT v. Neha Builders (P.) Ltd. {(2007) 164 Taxman 342 (Guj)}**
- The question referred to the Court for its opinion was as under –
- "Whether, on the facts and in the circumstances of the case, the rental income received from any property in the construction business can be claimed under the head `Income from House Property' even though the said property was included in the closing stock and expenses on maintenance were debited to the P & L A/c?"

- In this case, the assessee company, engaged in the business of construction of property, let out one of its properties which was held by it as its stock-in-trade. The rental income there from was offered for taxation in the revised return of income under the head `Income from House Property'. The AO taxed it under the head `Income from Business'. The CIT(A) confirmed the action of the AO but the Tribunal allowed the appeal filed by the assessee by observing interalia that any dividend received on the shares or any interest received from the bank would be taken to be income from other sources, therefore, any income derived under the head of `Rent' would also become income from property.

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'....

- While deciding the appeal filed by the Revenue, the High Court held as under:
  - "From the order passed by the learned CIT(A), it would clearly appear that the case of the assessee was that the company was incorporated with the main object of purchase, take on lease, or acquire by sale, or let out the buildings constructed by the assessee. Development of land or property would also be one of the businesses for which the company was incorporated.

  - True it is, that **income derived from the property would always be termed as 'income' from the property, but if the property is used as 'stock-in-trade', then the said property would become or partake the character of the stock, and any income derived from the stock, would be 'income' from the business, and not income from the property. If the business of the assessee is to construct the property and sell it or to construct and let out the same, then that would be the 'business' and the business stocks, which may include movable and immovable, would be taken to be 'stock-in-trade', and any income derived from such stocks cannot be termed as 'income from property'**. Even otherwise, it is to be seen that there was distinction between the 'income from business' and 'income from property' on one side, and 'any income from other sources'. **The Tribunal**, in our considered opinion, **was absolutely unjustified in comparing the rental income with the dividend income on the shares or interest income on the deposits**. Even otherwise, this question was not raised before the subordinate Tribunals and, all of sudden, the Tribunal started applying the analogy.

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'....

- While in the case of Neha Builders, the Court was dealing with let out flats, the issue which came up for consideration of Delhi High Court in the case of CIT v. Ansal Housing Finance & Leasing Co. Ltd. {(2012) 83 CCH 046 (Del)} was whether the annual value of vacant unsold flats held as stock-in-trade could be charged to tax under the head `Income from house property'?
- **CIT v. Ansal Housing Finance & Leasing Co. Ltd. {(2012) 83 CCH 046 (Del)}**
  The assessee company engaged itself in the business of development of mini-townships, construction of house property, commercial and shop complexes etc. The AO assessed the ALV of flats which the assessee had constructed, but were lying unsold under the head "Income from house property". The assessee however, contended that the said flats were its stock-in-trade and therefore the ALV of the flats could not be brought to tax under the head "Income from house property". The AO however did not accept the stand of the assessee, and therefore, added the notional value of unsold flats to the total income of the assessee. On appeal by the assessee, the CIT(A) however set aside the addition made by the AO. The revenue's appeal to the Tribunal was unsuccessful.
- The Court held as under –
  In the present case, the assessee is engaged in building activities. It argues that flats are held as part of its inventory of stock in trade, and are not let out. The further argument is that unlike in the other instances, where such builders let out flats, here there is no letting out and that deemed income –

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'....

which is the basis for assessment under the ALV method, should not be attributed. This Court is of the opinion that the argument, though attractive, cannot be accepted.

As repeatedly held, in East India, Sultan, and Karanpura, the levy of income tax in the case of one holding house property is premised not on whether the assessee carries on business, as landlord, but on the ownership. **The incidence of charge is because of the fact of ownership.** Undoubtedly, the decision in Vikram Cotton indicates that in every case, the Court has to discern the intention of the assessee; in this case the intention of the assesse was to hold the properties till they were sold. **The capacity of being an owner was not diminished one whit**, because the assessee carried on business of developing, building and selling flats in housing estates. **The argument that income tax is levied not on the actual receipt (which never arose in this case) but on a notional basis, i.e. ALV and that it is therefore not sanctioned by law, in the opinion of the Court is meritless**. ALV is a method to arrive at a figure on the basis of which the impost is to be effectuated. The existence of an artificial method itself would not mean that levy is impermissible. Parliament has resorted to several other presumptive methods, for the purpose of calculation of income and collection of tax. Furthermore, application of ALV to determine the tax is regardless of whether actual income is received; it is premised on what constitutes a reasonable letting value, if the property were to be leased out in the marketplace. **If the assessee's contention were to be accepted, the levy of income tax on unoccupied houses and flats would be impermissible – which is clearly not the case.**

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'....

As far as **the alternative argument that the assessee itself is occupier, because it holds the property till it is sold, is concerned, the Court does not find any merit in this submission**. While there can be no quarrel with the proposition that **"occupation" can be synonymous with physical possession, in law, when Parliament intended a property occupied by one who is carrying on business, to be exempted from the levy of income tax was that such property should be used for the purpose of business. The intention of the lawmakers, in other words, was that occupation of one's own property, in the course of business, and for the purpose of business, i.e. an active use of the property, (instead of mere passive possession) qualifies as "own" occupation for business purpose.** This contention is, therefore, rejected. Thus, this question is answered in favour of the revenue, and against the assessee.

The **Calcutta High Court in Azimganj Estate (P) Ltd. v CIT (ITA No. 242/2003, decided on 13.9.2011)** was dealing with a case of an assessee who was a builder and had vacant flats, which were let out, the Court held that rental income was assessable not under the head `Profits and Gains of Business or Profession' but is properly assessable under the head `Income from House Property'.

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'....

The Hon'ble Delhi High Court has while rendering its decision in the case of Ansal Housing Finance and Leasing Co. Ltd. not considered the decision of the Gujarat high Court in the case of Neha Builders nor has it considered the decision of the Orissa High Court in the case of M. P. Bazaz.

This decision of the Delhi High Court was followed by the Delhi High Court in the case of CIT v. Ansal Housing & Construction [2016] 72 taxmann.com 254 (Delhi). Aggrieved by the decision of the Delhi High Court in this case, the assessee has filed an SLP to the Supreme Court which SLP has been admitted – Ansal Housing & Construction v. CIT [2016] 74 taxmann.com 245 (SC).

It also needs to be noted that the Delhi High Court has while deciding the case of Ansal not considered the earlier Full Bench decision of the Delhi High Court in the case of ***CIT v. Modi Industries Ltd. (210 ITR 1)(Del-FB)***. The Full Bench of the Delhi High Court has in this case dealt with the meaning of the term `occupy'. Following observations are relevant in this connection –

> "… the point for consideration is whether to avail of exemption under section 22, the property must necessarily be : (i) in direct occupation of the assessee company, and (ii) used as such for transaction of assessee's business or profession. This would depend on the scope of the term `occupy'."

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'....

Thereafter, the Court after discussing a few decisions states as follows –

> "….. To fall within the ambit of exemption in section 22, it is not necessary that the property must as such be in the occupation of the assessee-company itself or necessarily used for carrying on its business activity and not used for residential purposes."

The Gujarat High Court has in the case of Neha Builders held that rental income in respect of flats held as stock-in-trade is chargeable to tax under the head `Profits and gains of business or profession' and not `Income from House Property'. The only distinction between the facts of the decision of Gujarat High Court and Delhi High Court is that the Gujarat High Court was dealing with a situation where the flats held as stock-in-trade were let out whereas Delhi High Court was dealing with a case where the flats held as stock-in-trade were not actually let out but their notional annual value was sought to be taxed.

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'....

Mangla Homes (P) Ltd. v. ITO {(182 Taxman 55)(Bom)}

The assessee was a company incorporated with the object of dealing and investment in properties, flats, warehouses, leasing, hire purchase, renting, selling, reselling , etc. The assessee purchased flats for trading purposes at a cost of Rs. 4 crore. At the time of purchase, the building needed major repairs and the assessee expected the price would go up after completion of repairs.

Subsequently, due to recession in the market, the flat could not be sold hence the assessee let out the flat on leave and licenses basis and earned rental income.

The assessee treated rental income as business income.

The AO, CIT(A) and the Tribunal, all held that the rental income was chargeable to tax under the head `Income from House Property'.

The Tribunal based its decision on the decision of the Supreme Court in the case of East India Housing & Land Development Trust Ltd. v. CIT (1961) 42 ITR 49 (SC). The Supreme Court, in the case of East India relied upon its earlier judgment in the case of United Commercial Bank Ltd. v. CIT (1957) 32 ITR 688 (SC) wherein the apex Court had explained after exhaustive review of authorities that under the scheme of the Act the heads of income, profits and gains enumerated in the different clauses are mutually exclusive and specific head covering items of income arising from a particular source.

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'....

Mangla Homes (P) Ltd. v. ITO {(182 Taxman 55)(Bom)}

The Court held that the assessee's case is covered by the judgment in the case of East India Housing & Land Development Trust Ltd on which reliance has been rightly placed by the authorities below in reaching the conclusion that the rental income earned by the assessee was an income from house property.

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'....

CIT v. Sane & Doshi Enterprises [(2015) 58 taxmann.com 111 (Bom.)[ITA No. 375 of 2013; order dated 9.4.2015]

The assessee, a partnership firm, was engaged in construction business and had constructed a commercial property known as May Fair Tower. The unsold portion of the property was let out and assessee earned rental income there from. The rental income earned was offered for taxation under the head `Income from House Property' and deduction u/s 24(a) was claimed.

The AO was of the view that receipts from this property were on account of exploitation of commercial assets and as such rent was business profit of the assessee. He further observed that the assessee is engaged in the business of construction of building with a view to sell the same and not leasing it. Thus, leasing of unsold units is an integral part of its business. He, accordingly, taxed rental income as `Business Income'.

The CIT(A) held that the rental income should be charged to tax under the head `Income from House Property'.

The Tribunal, relying upon the decision of the Apex Court in the case of East India Housing and Land Development Trust Ltd. v. CIT (1961) 42 ITR 49 (SC), upheld the view of the CIT(A) and dismissed the appeal filed by the Revenue.

Aggrieved, the revenue preferred an appeal to the High Court.

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'....

CIT v. Sane & Doshi Enterprise (Bom) {ITA No. 375 of 2013; order dated 9.4.2015}

Held: The underlying test and as evolved throughout is whether the income has been derived from property. The treatment given in the books of account as stock-in-trade would not, therefore, alter the character or the nature of the income as held by the Supreme Court. If there is a test and which is in the field and emerging from repeated judgments rendered either by the Hon'ble Supreme Court or by other High Courts, then a different conclusion cannot be reached.

Aggrieved by the aforesaid decision of the Bombay High Court, Department has filed a SLP to the Supreme Court, which has been admitted – CIT v. Sane & Doshi Enterprise [2017] 77 taxmann.com 288 (SC). The Department's case is that the rental income, in this case, ought to be taxed under the head "Profits & Gains of Business or Profession".

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'....

Chennai Properties & Investments Ltd. v. CIT (SC) [2015] 56 taxmann.com 456 (SC) - [Civil Appeal No. 4494 of 2004; order dated 9.4.2015]

The main object of the assessee company as per its Memorandum of Association was to acquire and hold the properties known as "Chennai House" and "Firhavin Estate" both in Chennai and to let out those properties as well as make advances upon the security of lands and buildings or other properties or any interest therein.

In the return of income filed by the assessee, the rental income from these properties was shown as income from business. The AO, however, refused to accept this income as `Business Income' but taxed it as `Income from House Property'.

The CIT(A) allowed the appeal filed by the assessee and held that the rental income be charged to tax as Business Income. The Tribunal upheld the order passed by the CIT(A). The Department approached the High Court. The High Court allowed the appeal of the Department i.e. it held that the rental income is chargeable to tax as `Income from House Property'.

The High Court rested its decision primarily on the judgment of the Apex Court in the case of East India Housing and Land Development Trust Ltd. v. CIT (1961) 42 ITR 49 as well as the Constitution Bench judgment of the Apex Court in the case of Sultan Brothers (P) Ltd. v. CIT (1964) 51 ITR 353 (SC).

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'....

Chennai Properties & Investments Ltd. v. CIT (SC) [2015] 56 taxmann.com 456 (SC) – [Civil Appeal No. 4494 of 2004; order dated 9.4.2015]

The Apex Court noted the main object as per Memorandum of Association and emphasised that the main object of the company was holding the aforesaid properties and earning income by letting out those properties. The court also noted that the entire income was through letting out of the aforesaid two properties viz. Chennai House and Firhavin House. There was no other income of the assessee other than income from letting out of these two properties.

The Court observed that in the case of East India Housing and Land Development Trusts Ltd., the company was incorporated with the object of buying and developing landed properties and promoting and developing markets. Thus, the main objective of the company was to develop the landed properties into markets. It so happened that some shops and stalls, which were developed by it, had been rented out and income was derived from the renting of the said shops and stalls. In those facts, the question arose for consideration was: whether the rental income that is received was to be treated as income from the house property or the income from business. This court while holding that the income shall be treated as income from house property rested its decision in the context of the main objective of the company and took note of the fact that letting out of the property was not the object of the company at all.

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'....

Chennai Properties & Investments Ltd. v. CIT (SC) [2015] 56 taxmann.com 456 (SC) – [Civil Appeal No. 4494 of 2004; order dated 9.4.2015]

The court was therefore, of the opinion that the character of that income was from the house property had not altered because it was received by the company formed with the object of developing and setting up properties.

The Court observed that the Constitution Bench in the case of Sultan Bros. had pointed out that the deciding factor is not the ownership of land or leases but the nature of the activity of the assessee and the nature of the operations in relation to them. It was highlighted and stressed that the objects of the company must also be kept in view to interpret the activities. In support of the aforesaid proposition, number of judgments of other jurisdictions, i.e. Privy Council, House of Lords in England and US Courts were taken note of.

The Court finally held that in this case, letting of the properties is in fact the business of the assessee, The assessee therefore, rightly disclosed the income under the head `Income from Business'. It cannot be treated as `Income from House Property'.

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'.

- In the case of Rayala Corporation (P.) Ltd. v. CIT **[2016] 72 taxmann.com 149 (SC), the assessee relying on the** decision of the Apex Court in Chennai Properties & Investments Ltd. contended that in its case also the rental income needs to be taxed under the head Income from Business.

- The argument of the Revenue in the High Court was that leasing and letting out of shops and properties was not the main business of the assessee-company as per Memorandum of Association and, therefore, the income earned by the assessee-company should be treated as income earned from house property.

- In the Supreme Court, the revenue submitted that the rent should be the main source of income or the purpose for which the company is incorporated should be to earn income from rent, so as to make the rental income to be the income taxable under the head 'Profits and Gains of business or profession'.

- The Court having noted that the assessee-company has only one business and that is of leasing its property and earning rent therefrom held that the judgment relied upon by the assessee squarely covers the facts of the case involved in the appeals. The business of the company is to lease its property and to earn rent and, therefore, the income so earned should be treated as its business income.

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'.

- The question for consideration now is whether the amendment to section 23(5) makes any difference to the legal position?

- Assuming that the amendment does make a difference, will the amendment affect the cases which are pending at various levels.

- Is the amendment creating a charge or is it granting an exemption.

- Will the amendment be effective without the charging section viz. section 22 being amended?

Is annual value of stock-in-trade chargeable to tax under the head `Income from House Property' or `Income from Business'....

C. R. Developments Pvt. Ltd. v. CIT (Mum ITAT) {ITA No. 4277/Mum/2012; Mumbai `C' Bench; AY 2009-10; Order dated 13.5.2015}

In this case, the AO had charged notional income in respect of 3 unsold shops shown as stock-in-trade under the head `Income from House Property'. The action of the AO was confirmed by the CIT(A).

Before the Tribunal, on behalf of the assessee, reliance was placed on the decision of Mumbai Bench of the Tribunal in the case of M/s Perfect Scale Company Pvt. Ltd. (ITA Nos. 3228 to 3234/Mum/2013; order dated 6.9.2013) wherein it has been held that in respect of assets held as business, income from the same is not assessable u/s 23(1) of the Act.

The Tribunal applying the analogy of the decision of the SC in the case of Chennai Properties stated that it can held that the assessee is engaged in the business of construction and development, which is the main object of the assessee company. The three flats could not be sold at the end of the year were shown as stock-in-trade. Estimating rental income by the AO for these three flats as income from house property was not justified in so far as these flats were neither given on rent nor the assessee has intention to earn rent by letting out the flats. The flats not sold were its stock-in-trade and income arising on its sale is liable to be taxed as business income. Accordingly, we do not find any justification in the order of AO for estimating rental income from these vacant flats under section 23 which is assessee's stock-in-trade as at the end of the year.

Can ratio of decision of Supreme Court be distinguished?

A possible way out ?

- A practical suggestion which can be given to builders having unsold inventory in such case could be to let out at least some of the flats in the building and then contend that the provisions of section 23(1)(c) are applicable and therefore, only the amount received is chargeable to tax. Possibly, this way the charge on vacant unsold flats can be avoided.

- **Income from house property.**

  22. The annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head "Income from house property".

A possible way out ?

- Section 23(1)(c) of the Act w.e.f. Assessment Year 2002-03 reads as under –

- **Annual value how determined.**

  23. (1) For the purposes of section 22, the annual value of any property shall be deemed to be—

  (*a*) the sum for which the property might reasonably be expected to let from year to year; or

  (*b*) where the property or any part of the property is let and the actual rent received or receivable by the owner in respect thereof is in excess of the sum referred to in clause (*a*), the amount so received or receivable; or

  (*c*) where the property or any part of the property is let and was vacant during the whole or any part of the previous year and owing to such vacancy the actual rent received or receivable by the owner in respect thereof is less than the sum referred to in clause (*a*), the amount so received or receivable:

A possible way out ?

- In view of the language employed by section 22 it can be argued that what section 23 envisages to be covered by the word property is any buildings or lands appurtenant thereto of which the assessee is the owner. Section 22 uses plural form of buildings and lands. Whether some importance should be given to use of plural form by the Legislature in section 22.

- It can be argued that all the flats constitute a property and when some of the flats in the building are let out it is part of the property which has been let out and in a case where part of the property is let out and part is vacant, the rent received in respect of the part let out needs to be considered as the annual value of the property in view of the provisions of section 23(1)(c) of the Act.

Amendments by the Finance Act, 2017 affecting builders / developers – Ss. 80IBA and 194IC

Amendment to s. 80IBA

- With effect from AY 2017-18, Section 80IBA of the Act grants deduction in respect of profits derived from the business of developing and building housing projects. The deduction is 100% of the profits derived from such business and is subject to satisfaction of conditions mentioned in the section.

- The Finance Act, 2017 has made certain amendments to the conditions required to be satisfied for claiming deduction under this section. These are –

- (i) the section, before its amendment by the FA 2017, required that the housing project should be completed within a period of three years from the date of approval by the competent authority. The time period of 3 years has been increased to 5 years by the FA 2017 w.e.f. 1.4.2018.

- The question is whether this extended time period is applicable even in respect of projects which were approved and which commenced construction before the amendment by FA 2017?

Amendment to s. 80IBA

- (ii) the section provided the maximum size of a residential unit in the project area. This size was stated in terms of built-up area. The Finance Act, 2017 has substituted the reference to built-up area by "carpet area". This affects interalia the following conditions viz. –
  - (a) the condition that the built-up area of the shops and other commercial establishments included in the housing project does not exceed three per cent of the aggregate built-up area; [s. 80IBA(2)(c)]
  - (b) the built-up area of the residential unit was not to exceed 30 sq. mts where the project is located within the cities of Chennai, Delhi, Kolkata or Mumbai.
  - (c) the size of the residential units in a project located within a distance, measured aerially, of twenty five kilometres from the municipal limits of the cities of Chennai, Delhi, Kolkata or Mumbai was to be 30 sq. mts. built-up area. As a result of the amendment by the Finance Act, 2017, the size of residential units in these areas can be sixty sq. mts. carpet area.
  - The term "carpet area" is defined in s.80IBA(6)(a) as under –
    - "carpet area" shall have the same meaning as assigned to it in clause (k) of section 2 of the Real Estate (Regulation and Development) Act, 2016.

Amendment to s. 80IBA

- Section 2(k) of RERDA defines carpet area as –
  - "carpet area" means the net usable floor area of an apartment, excluding the area covered by the external walls, areas under service shafts, exclusive balcony or verandah area and exclusive open terrace area, but includes the area covered by the internal partition walls of the apartment.
  - Explanation. – For the purpose of this clause, the expression "exclusive balcony or verandah area" means the area of the balcony or verandah, as the case may be, which is appurtenant to the net usable floor area of an apartment, meant for the exclusive use of the allottee; and "exclusive open terrace area" means the area of open terrace which is appurtenant to the net usable floor area of an apartment, meant for the exclusive use of the allottee;"

Amendment to s. 80IBA

- The question for consideration is whether the increased areas will apply to the projects which have been approved before the amendment as well or will the benefit of increased areas be available to the projects which are approved after the amendment –
  - **CIT v. Arif Industries Ltd. [2017] 80 taxmann.com 374 (Allahabad)**
  - ***CIT* v. Anriya Project Management Services (P.) Ltd. [2013] 353 ITR 12 (Kar.)** – the Karnataka High Court held that the definition of 'built-up area' inserted by Finance No. 2 of 2004 which came into effect from 1-4-2005 is only prospective in nature. It has no application to the housing projects which were approved by the local authority prior to that date. Prior to 1-4-2005, in calculating the 1,500 sq. ft. of a residential unit, the area covered by a balcony was excluded.

Amendment to s. 80IBA

- One more amendment made by the FA, 2017 to this section which may be relevant in this context is -
  - the project located within a distance, measured aerially, of twenty five kilometres from the municipal limits of the cities of Chennai, Delhi, Kolkata or Mumbai was required to utilize 90% of the floor area ratio permissible in respect of the plot of land under the rules to be made by the Central Government or the State Government or the local authority, as the case may be. As a result of the amendment by the Finance Act, 2017, the projects located in these areas can now utilize 80% of the floor area ratio permissible in respect of the plot of land. The definition of the term floor area ratio defined in s. 80IBA(6)(c) is unchanged."

- Here also, a question arises as to whether the projects approved before the amendment will be required to utilize 90% of the floor area ratio or can they now utilize 80% of the floor area ratio.

Amendment to s. 80IBA

- (ii) the section provided the maximum size of a residential unit in the project area. This size was stated in terms of built-up area. The Finance Act, 2017 has substituted the reference to built-up area by "carpet area". This affects interalia the following conditions viz. –
  - (a) the condition that the built-up area of the shops and other commercial establishments included in the housing project does not exceed three per cent of the aggregate built-up area; [s. 80IBA(2)(c)]
  - (b) the built-up area of the residential unit was not to exceed 30 sq. mts where the project is located within the cities of Chennai, Delhi, Kolkata or Mumbai.
  - (c) the size of the residential units in a project located within a distance, measured aerially, of twenty five kilometres from the municipal limits of the cities of Chennai, Delhi, Kolkata or Mumbai was to be 30 sq. mts. built-up area. As a result of the amendment by the Finance Act, 2017, the size of residential units in these areas can be sixty sq. mts. carpet area.
  - The term "carpet area" is defined in s.80IBA(6)(a) as under –
    - "carpet area" shall have the same meaning as assigned to it in clause (k) of section 2 of the Real Estate (Regulation and Development) Act, 2016.

Section 194IC inserted by the FA, 2017

Section 194IC

- The Finance Act, 2017 has, with effect from 1.4.2017, inserted s. 194IC which reads as under-
- **"[Payment under specified agreement.**
  - **194-IC.** *Notwithstanding anything contained in section 194-IA, any person responsible for paying to a resident any sum by way of consideration, not being consideration in kind, under the agreement referred to in sub-section (5A) of section 45, shall at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to ten per cent of such sum as income-tax thereon."*
  - *Explanation (ii) to section 45(5A) defines "specified agreement" as –*
    - *"(*ii) *"specified agreement" means a registered agreement in which a person owning land or building or both, agrees to allow another person to develop a real estate project on such land or building or both, in consideration of a share, being land or building or both in such project, whether with or without payment of part of the consideration in cash;"*
- Therefore, the section applies to any person provided –
  - (a) the section applies to any person irrespective of his legal status and irrespective of his residential status;

Section 194IC

- The following are the features of section 194IC –
  - (a) the legal status and/or residential status of the payer is not important as the section applies to any person;
  - (b) the payee should be a resident;
  - (c) the payment is under a specified agreement;
  - (d) the payment is of a sum of money towards consideration;
  - (e) the deduction is without any threshold i.e. even if the payment is of Rs. 5,000 it will still require deduction of tax under this section if other conditions are satisfied;
  - (f) the provisions of this section are notwithstanding the provisions of s. 194IA, Therefore, it cannot be contended that the provisions of s. 194IA have been complied with and therefore, the provisions of this section are not required to be complied with.
- Non-deduction will interalia attract disallowance under s. 40(a)(ia) in addition to assessee being treated as an assessee in default and being held liable to pay interest and penalty.

Accounting Standards / Pronouncements

Accounting Standards / Pronouncements

- **Accounting Standard 7, Construction Contracts – Issued in 1983**
  - Issued in December 1983.
  - Applicable to enterprises undertaking construction activities as contractors as well as enterprises undertaking construction activities on their own account as a venture of commercial nature.
  - Provided for two methods :
    - Percentage Completion Method
    - Project Completion Method
- **Accounting Standard 7 (Revised), Construction Contracts – Issued in 2003**
  - Issued in 2003.
  - Supercedes old Accounting Standard 7
  - Applicable to all contracts entered into from the accounting periods commencing on or after 01.04.2003.
  - Applicable only to enterprises undertaking construction as Contractors and not to enterprises undertaking construction on their own account.
  - Prescribes only one method - Percentage Completion Method
  - Objective is to prescribe accounting treatment of Revenue and Cost associated with Construction Contracts.

Difference between AS-7 and Revised AS-7

AS-7	Revised AS-7
Applied even to enterprises undertaking construction activities not as contractor but on their own account as a venture of commercial nature where the enterprise had entered into agreement for sale, eg : builders, developers.	Does not apply to enterprises undertaking construction activities not as contractor but on their own account as a venture of commercial nature where the enterprise has entered into agreement for sale, eg : builders, developers.
Permitted both the Percentage Completion Method and Completed Contract Method.	Permits only POCM. Also permits in uncertain situations another form of accounting, which is a surrogate of the erstwhile completed contract method. Once the uncertainity disappears, POCM is applied.
Stated that profit is not recognised in fixed price contract unless the work on the contract has progressed to a reasonable extent. This test was ordinarily considered as not having being satisified unless 20 to 25% of the work is completed.	Does not prescribe the extent of work which should be completed, but it recognises that in early stages of contract it is often the case that the outcome of the contract cannot be estimated reliably. In such situations contract revenue (i.e. turnover) is recognised equivalent or below the cost incurred on the contract as appropriate. Consequently, in early stages of the contract, profit is not recognised but loss is recognized.
Required evidence of final acceptability for recognising claims.	Claim is recognised when it is probable that the customer will accept the claim and that such an amount can be estimated reliably.

Opinion issued by EAC on 16.07.2003 (Volume XXIII – Query No. 15).

Facts :

- The Querist, a company – a joint sector enterprise promoted jointly by West Bengal Housing Board and another private sector company was engaged in the business of developing mass scale housing projects undertook development of small commercial complexes.
- The activities were undertaken on own account and not on contractual basis i.e. on project being conceived, designs and drawings are finalised, land is procured, some initial developmental activities are carried out by the company, and thereafter flats / commercial spaces are offered to the public for booking / sale through advertisements follwed by allotment of the same usually by way of lottery to the successful allottees (eventual owners). Allotment is documented by way of an allotment letter to each allottee. The letter bears reference to the brochure (i.e., offer documents), which, inter alia, contains various terms and conditions. Consideration for a flat /commerical space is payable in a phased manner normally linked to various stages of completion of construction. Major construction activities pertaining to buildings are usually undertaken after allotment process as aforesaid is over. After completion of construction possession of flats/commercial spaces is handed over to the respective allottees followed by execution of deeds/other legal documents in their favour evidencing ownership of properties.

Opinion issued by EAC on 16.07.2003 (Volume XXIII – Query No. 15)...

- The Company was recognising revenue under POCM and was valuing WIP in its books of accounts as per AS-7 issued in December 1983.
- Consequent to revision of AS-7, which came into effect in respect of all contracts entered into during accounting periods commencing on or after 01.04.2003, which is silent about its applicability to construction activities undertaken by enterprises on their own account and not as contractors.

Opinion issued by EAC on 16.07.2003 (Volume XXIII – Query No. 15)...

- Queries and Response :

Query	Response
Whether the revised AS 7 would be applicable to the company for accounting for new housing projects, which may be undertaken by the company on or after 01.04.2003 on the same business model as mentioned in the facts of the case.	The revised AS 7 would not be applicable to the company for accounting for new housing projects, which are undertaken by the company during the accounting periods commencing on or after 01.04.2003.
In case revised AS 7 is not applicable to the company, whether the company can value its inventories in accordance with Accounting Standard (AS) 2, 'Valuation of Inventories', issued by the Institute of Chartered Accountants of India, considering the definition of inventory as 'an asset in the process of production for the purpose of sale', i.e., whether the activity of developing housing projects on its own account as a commercial venture by the company can be construed as a production activity.	The activity of developing housing projects on its own account as a commercial venture by the company is of the nature of production activity and, therefore, should be construed as such. The inventories should be valued by the company in accordance with AS 2 as explained in paragraph 9 above.

Opinion issued by EAC on 16.07.2003 (Volume XXIII – Query No. 15)...

- Queries and Response :

Query	Response
If the activities of the company cannot be considered as a production activity and consequently AS 2 is also not applicable, which Accounting Standard should be followed for recognition of revenue and valuation of its construction work-in-progress ?	AS 2 is relevant for valuation of inventories including construction work-in-progress and not for recognition of revenue. AS 9 would be relevant for recognition of revenue.

Para 9 of EAC Opinion
The Committee notes that the activities carried on by the company under consderation as explained in paragraphs 1 and 2 above (refers to first two bullet points under facts), cannot be construed as rendering of services. The construction activities carried on by the company are of the nature of production activities. Accordingly, in terms of the above definition of the term 'inventories', the Committee is of view that the company should value the completed projects as inventories held-for-sale in the ordinary course of business; the semi-finished housing projects as inventories in the process of construction for such sale; and materials and supplies held for use in the housing projects as inventories in the form of materials or supplies to be consumed in the construction process.

Guidance Note on Recognition of Revenue by Real Estate Developers issued in 2006.

- This GN recommended principles for recognition of revenue arising from Real Estate Sales by enterprises engaged in such activities.
- In case of real estate sales, all significant risks and rewards of ownership are normally considered to be transferred when legal title passes to the buyer (e.g., at the time of the registration, with the relevant authorities, of the real estate in the name of the buyer) or when the seller enters into an agreement for sale and gives possession of the real estate to the buyer under the agreement. All significant risks and rewards of ownership are **also** considered to be transferred, if the seller has entered into a legally enforceable agreement for sale with the buyer and all the following conditions are satisified even though the legal title is not passed or the possession of the real estate is not given to the buyer:
  (a) The significant risks related to real estate have been transferred to the buyer. In case of real estate, price risk is generally considered to be one of the most significant risks.
  (b) The buyer has a legal right to sell or transfer his interest in the property, without any condition or subject to only such conditions which do not materially affcect his right to benefits in the property.
- If the above condtions were satisfied then the GN provided for recognition of revenue by applying principles of percentage of work completion method as provided in AS 7.
- The only disclosure requirements were disclosure of accounting policy regarding recognition of revenue arising from real estate sales, including the timing of transfer of significant risks and rewards of real estate which is the subject matter of sale.

Guidance Note on Accounting for Real Estate Transactions issued in 2012

- Foreword to the GN-2012 states –
  "With the fast growth of this sector, the volume and the number of transactions in this sector have also grown significantly. In the recent past, **different practices followed by the various real estate developers** in recognising their revenue has also been amongst the favourite headlines in the news across the country. **Considering this**, ICAI felt that the **revision** of the Guidance Note **is necessary**".
- This GN applies to all projects in real estate which are commenced on or after 01.04.2012 and also to projects which have already commenced but where revenue is being recognized for the first time on or after 01.04.2012.
- An enterprise may choose to apply this GN from an earlier date provided it applies this GN to all transactions which commenced or were entered into on or after such earlier date.
- Supercedes GN-2006 when this GN is applied as above.
- Much more detailed than GN-2006
- Drafted in simple manner.
- GN-2012 is clearer in terms of applicability. This would ensure uniformity and comparability.
- POCM is to be applied when nature of contract is similar to construction contract i.e. it is a construction type contract. In other cases AS 9 is to be applied.
- The manner in which POCM is to be applied is further elaborated:
  - Trigger criteria is different from revenue recognition criteria.
  - Land and borrowing costs are to be excluded for calculating trigger criteria but while calculating revenue to be recognised the same should be included.

Guidance Note on Accounting for Real Estate Transactions issued in 2012…

- This GN has introduced additional conditions for revenue recognition eg % of area sold, % of consideration realised, approvals obtained, etc.
- Additional disclosure requirements prescribed.
- GN-2012 could in certain cases result in volatility of earnings.
- There could, however, be several implementation issues.
- Arguable that several requirements of this GN conflict with the accounting standards notified under the Companies (Accounting Standards) Rules.
- Outline of the GN-2012
  1. Objective and Scope
  2. Definitions
  3. Accounting for Real Estate Transactions
  4. Application of principles of AS 9 in respect of sale of goods to a real estate project.
  5. Application of percentage completion method
  6. Accounting for sale of land or plots – (A) Sale of plots of land without any development and (B) Sale of developed plots.
  7. Transferable Development Rights.
  8. Transactions with multiple elements.
  9. Disclosure
- As per illustrations given in the GN-2012, while construction cost is considered pro-rata based on percentage of work done at the end of the reporting period, land cost based on area sold is charged off fully without prorating it for the % of work done at the end of reporting period.

Method of Accounting

- The profits arising from a building construction project can be estimated in both ways i.e. by showing profit each year by applying certain percentage of profit to work in progress of the year and (ii) by showing entire profits only in the year in which the project is completed, the method called “completed project” method of accounting. Completed Project method is also a recognized / accepted method of accounting. To reject the completed project method consistently followed by the assessee the AO has to state that fair and true profits cannot be deduced / estimated. It is the assessee’s prerogative to follow any one of the two methods. Mumbai `E’ Bench of ITAT in the case of Rajesh Construction ITA No. 3592/Bom/95 has for AY 1991-92 vide order dated 5.9.2003 has upheld as correct the declaring of profit on the completion of contract / project by following completed contract method of accounting. Further, Mumbai Bench of ITAT vide decision dated 20.2.1995 in the case of CIT v Nahalchand Lalchand Pvt. Ltd and the decision dated 31.12.1996 in the case of Billimoria Construction Co. Ltd. has upheld the change of method to Project Completion Method and the RA against the same stands rejected by the Hon’ble Bombay High Court.
- The Karnataka High Court has in the case of ITRC Nos. 19 to 21 of 1993, in the case of CIT v Khoday Distilleries Ltd., Bangalore, dated 12.9.1995 held that the completed contract method was a recognized method of accounting.

Does Revised AS 7 apply to Builder / Developer ?

- **In the following decisions it has been held that revised AS 7 applies to contractors and does not apply to builders / developers**
  - DCIT v. Omega Shelters Pvt. Ltd. (2011-(ID2)-GJX-3005-THYD)
  - ACIT v. National Builders (137 ITD 277)(TAhd)
  - Prem Enterprises v. ITO (2012)(54 SOT 367)(TBom)
  - Unique Enterprises v. ITO (2010-TIOL-737-ITAT-Mum)
  - ITO v. Bhadrasen Construction Pvt Ltd. (2010-TIOL-421-ITAT-Mum)
  - DCIT v. Shiv Construction Consortium (2012-(ID2)-GJX-1296-TAhd)
  - ITO v. Elixir Infrastructures (2011-(ID2)-GJX-2678-TIND)
- Opinion dated 16.07.2003 issued by Expert Advisory Committee

Project Completion Method v. Percentage Completion Method

Cases relied upon to substantiate %CM

- **Which are the cases relied upon by the Department to substantiate Percentage Completion Method.**
- The cases on which the Department relies upon for the proposition that Percentage Completion Method should be followed are :
  - Sri Sukhdeodas Jalan v CIT (26 ITR 617)(Patna)
  - Tirath Ram Ahuja v CIT (103 ITR 15)(Del)
  - P. M. Mohammed Meerakhan v CIT (73 ITR 735)(SC)
  - CIT v. Nandram Hunatram (103 ITR 433)(Ori)
  - Uttam Singh Duggal & Co. Pvt. Ltd. v. CIT (127 ITR 21)(Del)
  - Champion Construction Co. v. ITO (5 ITD 495)(Bom)
  - S K Estates (P) Ltd. v. ACIT (60 ITD 621)(TBom)

Decisions where PCM has been accepted

- **Decisions where Project Completion method has been accepted**
  - CITv. Bilahari Investment P. Ltd (299 ITR 1)(SC)
  - CIT v Khoday Distilleries Ltd (Kar HC) (ITRC Nos. 19 to 21 of 1993, dated 12.9.1995)
  - Mumbai Bench of ITAT vide decision dated 20.2.1995 in the case of CIT v Nahalchand Lalchand Pvt. Ltd and the decision dated 31.12.1996 in the case of Billimoria Construction Co. Ltd. has upheld the change of method to Project Completion Method and the RA against the same stands rejected by the Hon'ble Bombay High Court.
  - CIT v. V. S. Dempo & Co. Pvt. Ltd. (131 CTR 203)(Bom)
  - CIT v. Vikas Oberoi (165 Taxation 7)(Bom HC)
  - Awadhesh Builders v. ITO (2010)(37 SOT 122)(Mum)
  - Malka Construction Co. in ITA No. 4068-4069/Bom/85 dt. 7.3.1989;
  - Super Builders & Developers P. Ltd. in ITA 2080/Bom/1986 dt. 5.6.1990;
  - P.D.R. Pvt. Ltd in ITA 2704/B/82 dt. 22.1.1983;
  - D. K. Enterprises in ITA 9618/B/1990 dt. 17.7.1991 reported in 39 ITD 394;
  - Flowmore (P) Ltd. (1989) 33 TTJ (Del) 17
  - Davy Power Gas Ltd. in ITA No. 819/Bom
  - ACIT v. Rajesh Builders (2004-TIOL-88-ITAT-MUM)
  - Rajesh Constructions (ITAT No. 3592/Bom/95, Order dated 05.09.2003)(Bom ITAT)
  - Maitri Developers v. ITO (2011-TIOL-472-ITAT-Mum)

Decisions where PCM has been accepted ...

- The Mumbai `E; Bench of ITAT in the case of **CIT v. Manju Gupta (R.A. No. 756/Bom/94 and R.A. No. 757/Bom/94, order dated 10th February, 1995, Assessment Year 1990-91)**, the Revenue required the Tribunal to refer the following question to the Bombay High Court for its opinion.

1 Whether on the facts and in the circumstances of the case and in law, the Tribunal was justified in deleting the income estimated @ 15% of the surplus generated over receipts either by way of sale or advances received after the cost / expenditure is recouped thereon;

2 Whether on the facts and in the circumstances of the case and in law, the Tribunal was justified in holding that the **completion of the project is an absolute and necessary pre-condition to determine the profit earned by a builder** year after year before the completion of such projects, in the light of the Apex Court judgment in the case of British Paints India Ltd. (188 ITR 44)".

Decisions where PCM has been accepted ...

- In this case the assessee filed her return of income declaring income on the basis of project completion method. The AO rejected project completion method and estimated income @ 15% of the net sale proceeds. The addition was supported by him on the basis of ratio of the decision of the Tribunal in the case of Champion Construction Co (5 ITD 495) and by the judgment of Supreme Court in British Paints Ltd (188 ITR 44) to estimate the profits even without completion of the project. The assessee contended that there are several decisions of the Tribunal in favor of the assessee as well as judgments of the Orissa High Court and Bombay High Court. The CIT(A) sustained the order passed by the AO. Aggrieved the assessee preferred an appeal to the Tribunal. The Tribunal reversed the order of CIT(A) and deleted the addition made by the AO on estimated basis and held that –

"(i) project completion method is universally accepted method of accounting and is recognized by the ICAI and Orissa High Court supported such a view in 197 ITR 66; (ii) that deposits and advances do not give rise to any income unless it takes the form of sale proceeds; (iii) that the ratio of Champion Construction Co. reported in 5 ITD 495 (Bom) was not applicable in the assessee's case; (iv) that as a matter of fact profit from each project was disclosed by the assessee for the years 1993-94 and 1994-95. "

Decisions where PCM has been accepted ...

- The Revenue was of the view that the Tribunal's findings are not acceptable for the reason that (a) project completion method is not an absolute and necessary pre-condition to arrive at the profit earned by a builder who takes a number of years to complete his project and the IT Act does not prescribe that charging of income should await till such project completion period; (b) that non-returnable deposits received by a builder from prospective buyers is nothing but trading receipts and from such receipts trading profit can definitely be ascertained and income determined, since every assessment year is independent irrespective of being completely or partially sold out; (c) that the ratio of Champion Construction Co. (5 ITD 495) is very much applied in the assessee's case since in that case too project was not fully completed during the year under review; and (d) that whether profit or loss returned by the assessee for 1993-94/1994-95 is not at all material or relevant for the year 1990-91 which is under review.
- It was also contended that profits of one year are likely to be shifted to another year which would be an incorrect method of computing profits. Each year being a self contained unit and the taxes of a particular year being payable with reference to the income of that year as computed under the Act, the Tribunal misdirected itself and should not have accepted the assessee's claim of showing the profits on the basis of project completion method.

Decisions where PCM has been accepted ...

- In paras 9 and 10 of the order it was held as under:

"9. Since we have held that the non-refundable deposits were trading receipts and that the cost of construction had to be deducted there from for ascertaining the trading profits, it follows logically that the whole exercise could be carried out only upon the completion of the transaction and the allotment of floor space area, since that event occurred only in the accounting year relevant to the assessment year 1969-70, the tribunal was justified in holding that the profits with reference to the trading receipts accrued in the said assessment year and deleting the addition of Rs. 40,07,676 and Rs. 31,61,218 for assessment years 1967-68 and 1968-69. Question No. 4 would have to be answered in the affirmative.

10. The Tribunal also followed its own orders in the case of (1) Malka Construction Co. in ITA No. 4068-4069/Bom/85 dt. 7.3.1989; (2) Super Builders & Developers P. Ltd. in ITA 2080/Bom/1986 dt. 5.6.1990; (3) P.D.R. Pvt. Ltd in ITA 2704/B/82 dt. 22.1.1983; (4) D. K. Enterprises in ITA 9618/B/1990 dt. 17.7.1991 reported in 39 ITD 394; (5) Flowers Pvt. Ltd. (1989) 33 TTJ (Del) 17 and (6) Davy Power Gas Ltd. in ITA No. 819/Bom/78-79. Thus, the Tribunal was fortified in its view to hold that the project completed method would be the proper method and accepted the method of accountancy and therefore estimation of profits should be on that basis. Since this has been followed and even the Bombay High Court has supported such a view in the case of Nirmal Builders (supra); and therefore we are of the opinion that the questions as proposed have been already answered and they are not referable."

Ratio of Champion Construction Co.

- **Ratio of Champion Construction Co. (5 ITD 495)**
- The Bombay Tribunal in the case of Champion Construction Co. v. ITO (5 ITD 495), has taken a view that no profits be offered for tax if :
  - Construction is incomplete;
  - Not even half portion of the building was sold (43%); and
  - The net sale proceeds are much less than the total expenditure.

  However, in the same judgement, for a subsequent year, when 80% work was complete, the Tribunal held that proportionate profits must be charged to tax.

- In the case of ITO v. Peter Fernandes (2010-(ID1)-GJX-2839-TBOM). The Tribunal has observed that estimation of income on the basis of Champion Construction Co. will arise only when the assessee has completed substantial part of the project. .

Extension Project – part of original project or independent project?

- **Guidelines to decide whether the extension project forms part of an original project or its an independent project**.
- **ACIT v. Prerna Premises (P) Ltd 7 SOT 288 (Bom)**
- Guidelines to resolve all possible controversies with regard to the year of completion of project in a case where the additional FSI is sanctioned and the same are as under :
  1. As held in the case of Champion Construction Co. (5 ITD 495), a project is deemed to have been completed in that assessment year in which 80% of the constructed area is sold and occupied by the purchaser, irrespective of the fact that minor construction work is going on, on the project.
  2. In a case when additional FSI is sanctioned and the builder/assessee starts construction thereon before the project is deemed to have been completed in terms defined as above, the construction of the additional FSI is an extension of the original project and is deemed to have been completed in that assessment in which 80% of the total constructed area of the entire project (original project + construction of additional FSI) is sold and occupied by the buyer.

Extension Project – part of original project or independent project?...

3. In a case, where the original project is deemed to have been completed as per clause (1) and thereafter additional FSI is sanctioned on which construction is required to be raised. The construction of the additional FSI will be an independent project and it will not extend the period completion of the original project. It would be an independent project and it would be deemed to have been completed in the same manner, as the original project is deemed to have been completed i.e., on the sale of 80% of the constructed area.
4. In a case where assessee/builder gets the sanction of the additional FSI before the project is deemed to have been completed as defined above in clause (1), but construction has been started after the completion of project. If the gap between the completion of original project and the start of the construction of Additional FSI is reasonable, that is less than six months, it amounts to an extension of the original project and the entire project is deemed to have been completed in terms indicated above. But, if the gap between the completion of project and the start of the construction is unreasonable i.e., about more than six months, the construction of the additional FSI is entirely an independent project and it would not extend the period of completion of the original project. It would be treated as an independent project. The year of completion would be worked out independently in a manner as defined in clause (1).

Reply to reliance by Revenue on Champion

- **When Revenue relies on decisions of various High Courts other than Bombay High Court and also on the ratio of the Mumbai Bench of ITAT in the case of Champion Construction Co. is there any argument available to the assessee?**
- In the case of ACIT v Rajesh Builders (2004-TIOL-88-ITAT-MUM) the Tribunal was faced with a situation where the assessee followed project completion method consistently when it offered for taxation profits when all the sales were completed. The AO held that revenue cannot wait indefinitely for collection of its revenue and that the scheme of the Act is such that assessee will have to be taxed on the profit of the year. He accordingly estimated profit @ 8% of the work-in-progress during the year. The Tribunal in this case has interalia observed as under –

  "As regards the judicial decisions of various High Courts other than the Jurisdictional (Bombay) High Court, we are bound by the judgment of the Jurisdictional High Court, which accordingly we need follow in preference to the judgment of other High Courts. As regards Mumbai Tribunal's order in Champion Construction Co.'s case (supra) there is another subsequent order dated 5-9-2003 of ITAT, Mumbai in I.T.A. No. 3592/Bom./95, referred to above which we need preferably follow for the reason that this order is based on Hon'ble Jurisdictional High Court's judgment in Dempo & Co. (P.) Ltd.'s case (supra)."

Reply to reliance by Revenue on Champion..

- As such, considering all the facts and circumstances of the case as also the legal position and respectfully following Dempo & Co. (P.) Ltd.'s case (supra) and order dated 5-9-2003 of ITAT, Mumbai in ITA No. 3592/Bom./95 in the case of Rajesh Construction, we are of the considered opinion that the Assessing Officer having not drawn any finding that the accounts of assessee suffer from any defect nor that from the method of accounting followed by assessee, true/correct profits of assessee cannot be deduced and the assessee having been following the "Completed Project" method consistently, which being a recognized method of accounting, the assessee's method of accounting cannot be rejected nor is there any justification for estimating assessee's profits of the year from the assessee's business activity of building construction by resorting to applying of percentage of profit to the work-in-progress of the year.

Can method be changed in respect of on going project?

- **In respect of an ongoing project where project completion method has been accepted, the AO cannot change the method and compute the profits by dividing net profit year wise in proportion to the yearly gross receipts.**
- **CIT v Guttofnungasghutto Serkrado (197 ITR 66)(Ori HC)**

  In respect of an ongoing project where project completion method has been accepted in the past for certain years, the Tribunal was justified in its opinion that the profit of the assessee's business can only be properly deduced year wise from the method employed by the assessee by maintaining its accounts on complete work basis and not by the method of dividing the net profit year wise in proportion to yearly gross receipts.

Issues on PCM

- **Under the project completion method can the recognition of profits be delayed on the ground that the sale deeds are not registered?**

  When flats have been sold, price received and purchasers are put in possession there is no justification, even where the assessee follows project completion method to postpone the declaration of income is the ratio of the decision of the Bangalore Bench of ITAT in the case of Pratima Builders v ITO (**2009-TIOL-95-ITAT-BANG**).

- **Is it correct to state that only the gross profit can be estimated by the AO and not the net profit?**

  No it is not correct to state that only the gross profit can be estimated by the AO. The AO may even estimate the net profit. In the case of **Pratima Builders v ITO (2009-TIOL-95-ITAT-BANG)**, the counsel of the assessee argued that the AO could only estimate the gross profit and not the net profit..

- **In a case where 94% of the project has been sold but profits not offered to tax, the AO charges to tax 12% of the receipts as income of the project – is it correct to contend that it is only 12% of the receipts for the year which can be charged and not 12% of the entire receipts since the commencement till the end of the previous year?**

Issues on PCM…

In the case of ITO v Savoy Real Estate Developers Pvt. Ltd. (2010-TIOL-399-ITAT-MUM), the assessee was a builder who constructed a building which had attained 94% completion level but did not offer any income from the said project for taxation. The AO following the ratio of the Mumbai Bench of ITAT in the case of Champion Construction Co. v ITO 5 ITD 495 estimated the profits to be 12% of the receipts and charged them to tax in AY 2003-04. The CIT(A) upheld the action of the AO in principle, but held that only 12% of the receipts during the year and not the entire receipts of the project need to be taken into account. On an appeal by the Revenue Tribunal held as follows :

The short issue that we have to thus decide is **whether 12% of entire project receipts are to be brought to tax or only such receipts, as pertained to the relevant assessment year are to be taken into account**. **The question of taxability arises only in the year in which project is completed or is substantially completed. Therefore, the taxability cannot be confined to the receipts of that year alone as there may or may not be revenue receipts in that year. The profits are to be ascertained in respect of the work that is completed and to the extent it is completed, in the year of such completion – provided the threshold of "substantial completion" is achieved**. In this view of the matter, in our considered view, **revenues to be taken into account are revenues pertaining to such work and it is immaterial whether or not the said revenues are actually received in that year.** We, therefore, see no merits in relief granted by the learned CIT(A).

Relevance of OC in PCM

- **When Occupancy Certificate is issued in financial year ended 31.3.2007, electricity connection was received in financial year 2006-07, possession was given to flat purchasers in this financial year, certificate of architect was filed stated that as on 31.3.2005 RCC work upto 6th floor was completed, WIP which was Rs 553 lakhs as on 31.3.2005 increased to 675 lakhs on 31.3.2006 and Rs 736 lakhs as on 31.3.2007 can it be said that project was completed in an earlier year specially when assessee was consistently following project completion method and same was confirmed by CIT(A) in an earlier year and against which the Department had not preferred an appeal?**
- **Important to note that in spite of receipt of sale consideration of all the flats and registration of agreements of some of the flats the Tribunal upheld project completion method.**

  No. In ITO v Bhadrasen Construction Pvt. Ltd (2010 – TIOL – 421 – ITAT- MUM) this was the fact pattern before the Tribunal. The assessment order for AY 2005-06 was under appeal.

Relevance of Possession / receipts of TDR

- **Handing over possession of a few flats does not necessarily mean that the project has been completed. Expenditure incurred on construction of a club house could not be denied merely on the ground that club house was not mentioned in the agreements though the same was mentioned in the construction plans as approved by BMC.** (ITO v. Juhu Construction Co. Ltd (2009-TIOL-497-ITAT-MUM))

- **In a case where assessee follows project completion method, as per AS 7, the assessee is entitled to set off receipts from sale of TDR against cost of WIP.** (ACIT v Skylark Build (2011-TIOL-400-ITAT-MUM))

Can an addition be made on the ground that different units / flats have been sold by the assessee at different prices.

Addition on account of sale at differential prices

- Now a days it is quite common that different units / flats in the same building are often sold at varying prices. Invariably the AO comes to a conclusion that the cases of sale at lower price are on account of the fact that the assessee has received the differential amount in cash. The argument of the assessee that the sale is at a price greater than the Stamp Duty Value of the flat / unit is not accepted. The difference in the price is added to the total income of the assessee. In the case of **DCIT v. Sumer Ville Investments (2011-(ID2)-GJX-3587-TBOM)** the Tribunal was dealing with a similar situation where the assessee had sold commercial unit in the project in the year 1995 at a very high rate between Rs 8000 to Rs. 11000 per sq. ft. but sold some units in the year 2004-05 at a much lower rate (Rs. 3340 to Rs. 4729 psf) the assessee contended that there was a boom in the real estate market in the year 1995 and that most of the buyers were international companies. It was also argued that the AO has conveniently discarded some sale transactions of 1995 where the assessee charged between Rs. 2,450 to Rs. 4,500 per sq. feet. It was also argued that except for presumption and assumption nothing has been brought on record by the AO to establish that assessee had received higher sale price than that declared in the agreement and recorded in the books of accounts. On behalf of the Department it was argued that it is in the same project some of the units were sold in 1995 at high price whereas the others have been sold in 2004-05 at a lower price. The Tribunal held as under :

Addition on account of sale at differential prices...

- **Though there is some logic in the argument of the Ld. CIT, D.R. at the same time the Assessing Officer has not taken any pain to bring on record at least few independent sale transactions to support his conclusion and findings. It is well settled principle by different judicial pronouncements that the burden is on the Assessing Officer to prove that the assessee has received more than what is recorded in the books of accounts. In our opinion, the Assessing Officer could have taken some pain and made some enquiry to prove that the assessee had charged more price but lesser amount is recorded.** Moreover, the Ld. counsel submits that **the sale price declared by the assessee is higher than valuation adopted for the purpose of stamp duty and hence the same also cannot be discarded**. In this case, **even the Assessing Officer has not made reference to the Departmental Valuation Officer u/s. 142A of the Act**. After giving utmost consideration and keeping in view of the totality of the facts, we find no reason to interfere with the order of the Ld. CIT(A). Accordingly, the Ground No. 3 in the Asst. Year 2005-06 is dismissed."

Case for discussion

- In a particular case, XYZ, an assessee sold a flat to ABC at an abnormally high price. The AO considering this as a benchmark made an addition to the total income of the assessee. The sale of other flats though at a price lower than sale of this flat was for a value higher than the stamp duty value of the flats. There was a search / survey and no incriminating material was found by the department.. You are required to consider the arguments which can be advanced to support the case of the assessee.

Decisions relevant for the case for discussion

- DCIT v. Sumer Ville Investments (2011-(ID2)-GJX-3587-TBOM)
- D.N. Kamani (HUF) v. DCIT (1999) 70 ITD 77 (Pat) (TM)
- ITO v. W.D. Estate (P.) Ltd. (1993) 45 ITD 473 (Bom)
- Sri Ramalinga Choodambikai Mills Ltd. v. CIT (1955) 28 ITR 952 (Mad.)
- CIT v. A. Raman & Co. (1968) 67 ITR 11 (SC)
- CIT v. Calcutta Discount Co. Ltd. [1973] 91 ITR 8 (SC)
- Patiala Biscuit Manufacturers (P.) Ltd. v. CIT (1976) 103 ITR 208 (Punj. & Har.)
- Md. Umer v. CIT (1975) 101 ITR 525 (Pat.)
- R.B. Bansilal Abirchand Spinning & Weaving Mills v. CIT (1970) 75 ITR 260 (Bom.)
- ITO v. Dr. Kailash Sharma & Sons (2004) 4 SOT 857 (Jodh.)
- Sree Shanmugar Mills Ltd. v. CIT (1974) 96 ITR 411 (Mad.)
- Dhakeswari Cotton Mills Ltd. v. CIT (1954) 26 ITR 775 (SC)
- International Forest Co. v. CIT (1975) 101 ITR 721 (J. & K.)
- ACIT v. Kanhiya Lal Choudhary (2012) 20 taxmann.com 368 (Jaipur)
- ITO v. Hitesh Kumar Panchori (2008) 113 TTJ 357(Jodh)
- Abhishek Corporation v. DCIT (1999) 63 TTJ (Ahd) 651
- CIT v. President Industries (2002) 258 ITR 654 (Guj)
- V. R. Textiles v. JCIT (2012) 20 taxmann.com 154 (Ahd.)

When do profits accrue in respect of sale of land held as stock-in-trade?

When do profits accrue in respect of sale of land held as stock-in-trade?

- **In respect of land held as stock-in-trade when does the transfer take place? Is S. 53A of the Transfer of Property Act relevant to come to the conclusion that the transfer has taken place and the profits have accrued.**
- The Gujarat High Court has in the case of CIT v. Ashaland Corporation held that in respect of land purchased by the assessee as its stock-in-trade the assessee would continue to be the owner of the land which it has purchased and which is part of its stock-in-trade, till it is divested of the ownership by completion of the sale transaction. The business deal in respect of a land owned by the assessee would be complete only when it executes a registered sale deed. It is only on completion of the sale transaction in respect of the land owned by the assessee that the assessee could be said to have earned profit or suffered loss, as the case may be, and sale would not be complete unless it executes a registered sale deed. The Court rejected the argument of the assessee that since the business of the assessee is to purchase and sell land, it is immaterial as to when the sale deeds in respect of the land agreed to be sold are executed. Whatever it receives in advance towards the sale price between the agreement to sell and execution of the registered sale deeds is nothing but trading receipt. On behalf of the assessee it was further contended that such trading receipts represent the assessee's income earned on the date on which they are received. The Court held that all receipts are not income. In order to partake of the character of income, receipt must be part of the profits earned by the assessee. In other words, the receipt must assume the character of income before it becomes exigible to

When do profits accrue in respect of sale of land held as stock-in-trade?

income-tax. As regards the applicability of the doctrine of part performance, the Court held that Doctrine of part performance embodied in s. 53A of the Transfer of Property Act has a limited application and it affords only a good defense to the person put in possession under an agreement in writing to protect his possession to the extent provided in the said s. 53A of the Transfer of Property Act; but, in any case, the agreement in writing to sell, coupled with parting of possession, would not confer any legal title on the purchaser and take the land out of stock-in-trade of the seller if he is a dealer in land. The Court went on to hold that The real test in deciding whether the receipt is the assessee's income or not, is whether the assessee continues to be the owner of the land, or whether he is divested of such ownership. The land of which the assessee is the owner is its stock-in-trade and the land which is sold, i.e., the land of which the ownership or title is transferred, ceases to be its stock-in-trade only when the transaction is complete. As regards the method of accounting the Court held that, even assuming for the sake of argument that the method of accounting which the assessee follows is the cash method, it would have a bearing only in respect of completed business transactions. If the method followed is the cash method, only amounts which the assessee has received will form part of its income, but that would be so only after the transaction in respect of which the amounts are received are really completed. Such amounts cannot be treated as trading receipts till the title passes to the purchaser and the land for which the amount is received goes out of the stock-in-trade of the assessee. The Court further mentioned that a similar question in a

When do profits accrue in respect of sale of land held as stock-in-trade?

different context had arisen before it in the case of CIT v. Shah Doshi & Co. (Income Tax Reference No. 232 of 2976 decided on March 24/25, 1981. **The question which arose before us in that case was whether as a result of the agreement with M/s. Shah & Co., the assessee had acquired any stock-in-trade**. This court took the view that, **since the assessee was a dealer in land, only such land which it acquired in the course of its business would form part of its stock-in-trade. It was observed that a mere agreement to purchase land would not confer any title on the assessee and the land until the sale transaction was complete. The stock which the assessee had contracted, but the property in which has not passed to the assessee, cannot be regarded as the assessee's stock-in-trade**. The Court held that land doesnot ceased to be stock-in-trade of the assessee unless and until the sale is completed.

- Support for similar proposition can be had from the decision of Madras High Court in the case of Chidambaram Chettiar (4 ITR 309)(Mad).
- In the case of CIT v. Motilal C Patel & Co. (173 ITR 666)(Guj) The Court held that the money received by the assessee in the earlier year would become profit in the hands of the assessee only on completion of the sale in favour of the Society. Till such time as the sale was completed the amount received was to remain only an advance towards the price or consideration.

When do profits accrue in respect of sale of land held as stock-in-trade?

- **Relevant decisions :**
  - CIT v Ashaland Corporation (133 ITR 55)(Guj)(HC)
  - CIT v. Shah Doshi & Co. (Income-tax Reference No. 232 of 2976, decided on March 24/25, 1981)
  - Chidambaram Chettiar v. CIT [1936] (4 ITR 309)(Mad)
  - Kunjamal and Sons [1941] (9 ITR 358)(All)
  - CIT v. Motilal C. Patel & Co. (173 ITR 666)(Guj)(HC)
  - Estate Investment Co. Ltd. v. CIT (121 ITR 580)(Bom) ⇨
  - Madgul Udyog v. CIT (184 ITR 484)(Cal)
  - CIT v. Moghul Builders & Planners (252 ITR 488)(AP) ⇨

Allowability of provision for purchase of TDR and other expenses.

Allowability of provision for purchase of TDR and other expenses.

- **ACIT v. Leela Creators & Others (2012-(ID1)-GJX-0461-TBOM)**
- For the assessment year 2007-08, the Revenue came up in appeal against the order of CIT(A) allowing claim for deduction on account of provision for TDR while computing income from the projects.
- The assessee, was engaged in business as builder and developer, was executing building projects and was following project completion method for computing and offering profits for taxation. BMC had issued commencement certificate as per which assessee had approval for construction of A and B wing with stilt plus 4 upper floors. The assessee completed construction of stilt plus 8 upper floors. The building was completed on 31.3.2007 and assessee had sold all the flats during the year. Profits for the project were computed and offered for taxation. While computing the profits, the assessee made a provision of Rs. 1,78,70,000 on account of provision for cost of TDRs.
- The AO did not allow the provision on the ground that it was claimed on the basis of estimate as per Architect Certificate and the expenses were not ascertained liabilities but were in the nature of contingent liability also the approval for TDR from Municipal Authorities was not obtained even after a lapse of 2 years from the date of sale of most of the flats. CIT(A) allowed the claim of the asseessee on the ground that the assessee was under contractual obligation to purchase TDR and the liability on account of TDR was an ascertained liability though quantification may have to be done later. On an appeal by the revenue, the Tribunal held as follows :

Allowability of provision for purchase of TDR and other expenses...

- In case of Leela Estate (ITA No. 141/M/2010 dated 11.5.2011) an assessee from the same group, in which case also approval had been granted for construction of stilt level plus 1st floor but the assessee had made construction up to 7th floor after using TDRs without getting approval from BMC. In that case also, assessee was following mercantile system of accounting and **project completion method**. The assessee like in these cases had also claimed provision for TDR Rs. 3,44,59,100/- which had been disallowed by the AO but in appeal the same had been allowed by CIT(A) aggrieved by which revenue was in appeal before the Tribunal. The Tribunal after detailed examination observed that the **matching concept had to be applied** as per which if there is revenue, the cost incurred for such revenue if not paid during the year has to be allowed. However, the Tribunal also observed that **it was required to be examined whether there was any liability on account of TDR attached to the income offered by the assessee by way of sale of flats**. The Tribunal held that the issue had to be examined after careful consideration of the BMC Rules. **In case as per BMC Rules, purchasing of TDRs was permissible post construction and requisite conditions as laid down in such rules were satisfied, the deduction had to be allowed for the likely amount that may be required for the purchase of such TDR. In that case, quantum of provision for TDR has to be ascertained properly on the basis of some relevant evidence and certificate of architect could not be considered as sole basis of quantification of TDR**. The Tribunal also observed that **in case on, examination of BMC Rules, the AO found that there was no provision for purchase of TDRs post construction, in that case, it would mean that the assessee was not entitled to such TDR as per law and hence deduction can not be granted**. The Tribunal, therefore, set aside the order of CIT(A) and restored the matter to the file of AO for taking fresh decision after necessary examination.

Allowability of provision for purchase of TDR and other expenses...

The facts in case of present assessees are identical and therefore, respectfully **following the decision of the Tribunal (supra) we set aside the orders of CIT(A) and restore the matter to the file of AO for passing fresh orders after necessary examination** and after allowing opportunity of hearing to the assessee.

- The assessee had in the cross objections, raised a ground that income on account of sale of flats to the extent of TDR acquired did not accrue to the assessee. It was argued that the project could not be said to be completed until the obligation of loading of TDRs and regularisation did not take place. It was also submitted that the project should be considered as incomplete until TDRs were actually purchased and in such a situation income to that extent should not be recognized.
- The Tribunal held that the issue raised in Cross Objections is also covered by the decision of the Tribunal in case of Leela Estate (Supra) in which the Tribunal did not find any force in the contentions raised by the assessee. The Tribunal observed that the assessee was following **project completion method** and project had been completed and the entire sales had taken place during the year. Therefore, **once all flats were sold and possession of flats given to buyers and sale consideration received, there was no question of treating the project as incomplete to the extent of provision for TDR**. The Tribunal further observed that **there was no material to show that there was any liability on part of the assessee to refund any part of sale consideration in the event of non-purchase of TDRs**. The Tribunal therefore did not find any merit in the Cross Objections raised by the assessee and accordingly same were

Allowability of provision for purchase of TDR and other expenses...

dismissed. Facts in these cases being identical the Tribunal dismissed the Cross Objections raised by the assessee following the decision of the Tribunal (supra).

- **Manish Builders v. ITO (2012-TIOL-159-ITAT-MUM)**

  This decision is an authority for the proposition that in a case where the project is regarded as complete and all the receipts from the project are considered for taxation, provision for expenses which are yet to be incurred need to be allowed as a deduction while computing the profits chargeable to tax. If the same are not allowed the assessee will not be able to claim deduction in future when the expenses are actually incurred because in the said years the assessee will not have any receipts from the project to set them off against the expenditure.

- **Persepolis Construction Co. (P.) Ltd. v Addl CIT (99 TTJ 92)(Bom)**

  In a case where the developer has to hand over constructed area to the land lord and the profits are computed / offered for taxation before the completion of the entire project, the proportionate cost of the portion to be given free of cost needs to be considered as forming part of cost while computing the profits even though the same may not have incurred. Such a provision cannot be regarded as a contingent liability. In this case the Tribunal held as under :

Allowability of provision for purchase of TDR and other expenses...

The assessee is under a contractual obligation to construct two buildings and hand over them to the charitable trust free of cost. This liability could be discharged by the assessee-company only by incurring cost in constructing two free buildings. The cost incurred for the construction of the two buildings should be defrayed by the remaining six saleable buildings. Therefore, it is to be seen that the expenditure of constructing two free buildings, forming part of the total project cost runs concurrently with the income earned out of the project. **Income cannot be recognised at one point and the corresponding expenditure cannot be deferred to a later point**. **The construction of every saleable building is loaded with a proportionate cost attributable to the construction of the free buildings. Therefore, the assessee has rightly worked out the proportionate cost of the free buildings attributable to the building No. 1 constructed, completed and sold by it**.

Allowability of provision for purchase of TDR and other expenses…

- **Dy. CIT v. Rajgir Builders (70 ITD 226)(Mum)**

  In this case the assessee, a builder, entered into an agreement with another party for construction of flats and shopping centre. As per the agreement, the assessee was to take and appropriate the sale proceeds of 57 flats in consideration of constructing and handing over of free of cost, 39 flats and 24 shops to the other party. Construction and sale of 57 flats were completed in the period relevant to the assessment year under appeal and the construction of 24 flats to be handed over to the other party was not complete. While computing taxable income, the assessee estimated the cost of construction of 24 flats and claimed the same as deduction. The assessing authority disallowed the claim but the CIT(A) held that the construction and sale of flats were subject to the liability attached to it in the form of construction of other sets of flats and shopping complex, and the income of the assessee could be rightly worked out only if the expenditures towards construction of those flats and shopping complex also were taken into consideration. The above position of the CIT(A) was confirmed by the Tribunal in the said order holding that the liability was real and had to be deducted in computing the taxable income of the assessee.

- **Provision for expenses to be incurred needs to be allowed as a deduction – Aditi Developers v ACIT (2012)(49 SOT 664)(Bom).**

Are advances to be considered for computing turnover limits u/s 44AB in the case of an assessee following Project Completion Method.

Are advances to be considered for computing turnover limits u/s 44AB?

- **DCIT v. Gopal Krishan Builders (272 ITR 1)(91 ITD 124)(Luck.)**
- The words used in section 44AB of the Act "total sales", "turnover" or "gross receipt" have been used specifically and the scope of words "gross receipt" is quite wide, otherwise the legislature would have stopped after using the words "sales" or "turnover".
- The amount of advance was to be adjusted towards the cost of the flat booked by each customer and the amount of advance must be having cost of construction as well as element of profit, which may subsequently be bigger in proportionate when whole of the amount fixed for sale of flat is realized, but it cannot be said that the amount of advance received by the assessee will not be included in the scope of words "gross receipt".
- Object of section 44AB of the Act read with Rule 6G of Income-tax Rules is to safeguard against tax evasion and tax avoidance which will ensure that the economic system docs not result in concentration of wealth to the common detriment.
- The ld. CIT(A), while disposing off the appeal of the assessee, had referred to the guidelines issued by the Institute of Chartered Accountants. The same is quoted in para 6 of her order. The ld. counsel has not brought before me the said audit guidelines. Even if, for the sake of argument, the same may be treated as in existence, then the same will be against the very object behind section 44AB of the Act.
- It is against the very principle of section 44AB that in project completion assessee would get the books of account audited in the last year and not in earlier years when he is debiting the expenses and showing sundry debits and different types of receipts are also there.

Are advances to be considered for computing turnover limits u/s 44AB?...

- **Siroya Developers v DIT (2011-(ID1)-GJX-0335-TBOM)**

  The tribunal held as under :

  The advances received against booking of flats cannot be treated as sale proceeds or turnover or as part of gross receipt because the same was not received by the assessee firm unconditionally and hence the said advances received on booking of the flats cannot be treated as part of the turnover or gross receipts.

- **ACIT vs. B. K. Jhala & Associates (69 ITD 141)(Pune)**

  In this case the AO regarded the value of WIP as forming part of the amount for computing the limits mentioned u/s 44AB. The Pune Bench of the Tribunal held as follows :

  In case of work-in-progress, there is no buyer and accordingly, work-in-progress, cannot be considered as turnover. It only represents the current assets and it includes the cost of material, labour and other direct overheads incurred by the assessee. It is the cost of incomplete and unfinished work and hence, it is quite similar to stock-in-trade, the ownership of which remains vested with the assessee. The assessee could be said to have effected sales only in respect of those flats/shops construction of which is complete and the possession of which is given to the purchaser. The "Sale" or "Turnover" requires two parties to a contract, namely a seller and a buyer. In this case, in relation to work-in-progress, the assessee is the seller, but there is no buyer and hence again work-in-progress done cannot be considered as sale."

Are advances to be considered for computing turnover limits u/s 44AB?...

- Advances received against booking of flat are not part of total sales, turnover or gross receipts as the assessee was following **Project Completion Method** of accounting.
- **Note** : In this case in the submissions made on behalf of the assessee it is at one place stated that the assessee has not sold the flats by executing the documents and the person booking the flat is entitled to cancel the booking and ask for refund of advances given by him.

Disallowances u/s 40(a)

Disallowances u/s 40(a)

- **Disallowance u/s 40(a)(ia) – whether to be reduced from WIP?**
- **Savala Associates v ITO (35 SOT 148)(Bom)(ITAT)**
- In this case, the tribunal was dealing with an assessee who followed project completion method of accounting. The AO disallowed amounts u/s 40(a)(ia). The amounts disallowed were part of WIP in respect of projects which were not completed. The issue before the tribunal was -
- Whether the AO can make any addition to the total income on account of disallowing expenditure u/s 40(a)(ia) of the Act, in a case where assessee follows completed contract method. The Tribunal held as under –

  In principle we agree with above view of revenue in case of "completed contract method" the Assessing Officer is empowered to examine the expenditure incurred during the year which increases the opening work-in-progress or addition in work-in-progress. But we do not agree with the view of revenue that addition is to be made in total income, if some expenditure were found not allowable. The correct procedure in "completed contract method" is that instead of making addition, the Assessing Officer should correct the amount of work-in-progress by reducing or enhancing work-in-progress as the case may be. Such corrected WIP will be finally considered in profit and loss account/contract account for the year in which work is completed. The result of calculation of correct profit in case of "completed contract method" could be attained by this procedure. In the case under consideration, the Assessing Officer made addition in all the projects including incomplete projects, which is not warranted. Such addition in total income is warranted only in respect of project which is completed during the year.

Disallowances u/s 40(a)...

- **ITO v. P. C. Developers Pvt. Ltd (Del ITAT){2010-(ID1)-GJX-1133-TDEL}**
- The assessee was in the business of construction of residential flats. It followed project completion method of accounting. Since the project was in early stages, the expenditure incurred on construction was c/fd as WIP. A sum of Rs. 6,00,000 paid to Architects without deduction of tax at source was capitalized as WIP. Since there were no receipts, P & L was not prepared and no expenditure was claimed. The AO disallowed Rs. 6,00,000 u/s 40(a)(ia) and added it to total income. The CIT(A) following ratio of Bombay Tribunal in the case of Savala Associates allowed the assessee's appeal. Aggrieved, revenue preferred an appeal to the Tribunal. The Tribunal held as follows –

  "We see no infirmity in the order of CIT(A) in as much as the assessee has not claimed any revenue expenditure as no P&L A/c is prepared. The assessee capitalized this expenditure and claimed as work in progress stock. In any case the TDS has been deducted in the next financial year. Since no expenditure has been claimed in this year, the amount cannot be disallowed u/s. 40a(ia). We uphold the order of CIT(A)."

Year of credit of TDS in case of an assessee following Project Completion Method.

Year of credit of TDS - PCM

- In a case where assessee was following project completion method and TDS was deducted from the amounts received by it, can the credit for TDS be denied on the ground that the income of the project will be assessed in future.
- **Toyo Engineering India Ltd. v JCIT (2005-TIOL-234-ITAT-MUM)**
- The Assessing Officer found that the said amount of TDS has been claimed as credit by the assessee-company for the impugned assessment year even though the corresponding contracts were completed only during the previous year relevant to the assessment year 2000-01 and income accrued only for the said assessment year.
- Tax is deducted at source from every piece meal payment even though every such piece meal payment did not reflect 'income' as such. Earning of income is a continuous, indivisible process embedded in the business dynamics. The income is recognized for a particular period, statutorily for one year on the basis of the method employed by an assessee. The income or loss of an assessee is the cumulative result of the working carried on by the assessee and reasonably measured for that particular assessment year. Therefore, there is no immediate nexus between the income as such and the TDS made out of a particular payment. Tax deduction at source is basically a machinery provision for collecting tax on the potential income of the assessee. There is no such conclusive presumption that tax is invariably deducted always out of income; that is why the expression "tax deducted at source" has been used in the Act, rather than "tax deducted from income".

Year of credit of TDS – PCM…

- The pith and substance of the above discussion is that it may not be possible all the time to co-relate a specific amount of TDS with a specific amount of income earned by an assessee in a particular assessment year. If at all such a nexus is required, such nexus is rather notional or conceptual, rather than specific or immediate. When the law has used the words in section 199 of the Income-tax Act that "credit shall be given to the tax deducted at source" on production of the certificate for the assessment year for which such income is assessable; it implied that the nexus between TDS and the corresponding income element would remain rather notional/conceptual.
- When the present issue is viewed in the right perspective, we are bound to accept the contention of the learned senior counsel that the work-in-progress credited by the assessee-company every year in its books of account is impregnated with the element of income which would finally culminate into the summation of the profits on the completion of the projects which would be offered for assessment. Therefore, one is bound to take note of the expression "income" and the expression "profits" in its contextual perspective as explained by the learned senior counsel. The execution of a project is a continuing process. The income/loss arising therefrom also generates contemporaneously/simultaneously; even though such income/loss is finally measured as profit/loss only at the end of the project for the reason that the assessee is following project-completion method for the recognition of profit/loss. In this context it is always useful to remember that courts have held that 'income' also includes loss.

Year of credit of TDS – PCM…

- The set off of TDS would arise only when the income results in profits. Therefore, it is all the more clear that the income whether profit or loss impregnated in the value of work-in-progress is finally summed up to be the profit/loss of the contract which is answerable to the assessment to be made on the assessee. Therefore, we have to accept the proposition that in every assessment year, even though the final result is ascertained only on the completion of the project, an element of income is latent in the yearly working result. The distinction between the above conceptual profit and the ultimate de facto assessment of profit is because of the distinction exists between "income" and "profits".
- Therefore, in the facts and circumstances of the case we are of the considered opinion that the provisions of law contained in section 199 do not stand in the way of the claim made by the assessee-company for credits in respect of TDS made during the relevant previous year. As such, it is our finding that the Assessing Officer should give credit for the TDS amounting to Rs. 2,28,37,491. This issue is, therefore, decided in favour of the assessee.

Conversion of capital asset into stock-in-trade

Conversion of capital asset into stock-in-trade

- **ACIT v Tata Housing Development Co. Ltd. (45 SOT 9)(Bom)**

  The genuineness of the transaction or genuineness of conversion of assets from investment to stock-in-trade which has already been converted in an earlier year and not during the year, cannot be examined in the year of the sale of stock-in-trade. It can be examined only in the year when the asset was acquired or converted from investment into stock-in-trade.

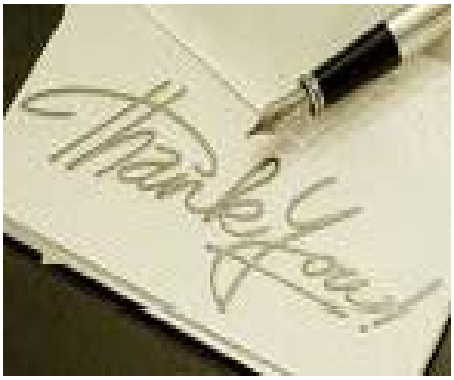
  In case of conversion of investment into stock-in-trade, there may three separate years involved as in the case under consideration; the first one is the year when the assets were purchased, second one is the year in which the investment was converted into stock-in-trade and third one is when stock-in-trade was sold. Since all years are separate years, and related assessment are also separate assessment years, the examination of the transaction is also subject to three assessment years but, for different purposes. The genuineness of the transaction can be examined only in the year of the purchase of assets, which in this case is financial years 31-3-1991, 31-3-1992 or say before the financial year relevant to assessment year 1993-94. The genuineness of conversion of assets from investment into stock-in-trade and calculation of capital gain by taking the fair market value of the capital assets on the date on which it was converted or treated as stock-in-trade as the same is to be deemed as full value of the consideration received as a result of the transfer of capital assets, can be examined only in the year of conversion, i.e., assessment year 1993-94. Now what is to see in the year of sale, assessment year 1997-98 is only chargeability of capital gain and business income.

Conversion of capital asset into stock-in-trade…

- The Assessing Officer has tried to examine the genuineness of transaction and its conversion from investment to stock-in-trade in the year when the asset was sold as stock-in-trade.
- The genuineness of the transaction or genuineness of conversion of assets from investment to stock-in-trade which has already converted in earlier year and not during the year, cannot be examined in the year of the sale of stock-in-trade. It can be examined only in the year when the asset was acquired or converted from investment into stock-in-trade.

- **DCIT v Crest Hotels Ltd. (78 ITD 213)(Bom)**
  When business profit on sale of such stock accrues to the assessee, tax on capital gain also will be levied in the same year as is envisaged by section 45(2). In such an event, all the arguments relating to conveyance, possession etc. which are generally related to transfer of capital asset, are rendered meaningless.
  The assessee itself having recognized business profits on sale of converted asset in the years under consideration, tax on capital gains on conversion will be levied in these years according to the area sold by the assessee in each year.

- The Bombay `H" Bench of ITAT in **ITA No. 7381/Mum/2004** has in the case of **DCIT v. Jehangir H C Jehangir** has held that profit arising on conversion of capital asset into stock-in-trade is assessable to tax in terms of S. 45(2) in the year of sale of stock-in-trade.



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