

IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 5TH DAY OF MAY, 2020

PRESENT

THE HON'BLE MR. JUSTICE ARAVIND KUMAR

AND

THE HON'BLE MR. JUSTICE SURAJ GOVINDARAJ

ITA NO.84/2010

BETWEEN:

- 1 . THE COMMISSIONER OF INCOME TAX
C.R. BUILDING, QUEENS ROAD
BANGALORE.
- 2 . THE DEPUTY COMMISSIONER OF
INCOME TAX
CENTRAL CIRCLE-1 (1)
C.R. BUILDING, QUEENS ROAD
BANGALORE.

...APPELLANTS

(BY SRI. K V ARAVIND, ADVOCATE)

AND:

M/S PRESTIGE ESTATE PROJECTS PVT. LTD.,
NO.1, FALCON HOUSE,
MAIN GUARD CROSS
ROAD, BANGALORE - 560 001.

...RESPONDENT

(BY SRI. ASHOK A KULKARNI, ADVOCATE)

THIS APPEAL IS FILED UNDER SECTION 260A OF INCOME TAX ACT, 1961 PRAYING TO FORMULATE THE SUBSTANTIAL QUESTION OF LAW STATED THEREIN AND ALLOW THE APPEAL AND SET ASIDE THE ORDERS PASSED BY THE ITAT BANGALORE IN ITA NO.218/BANG/2009, DATED:11.09.2009 CONFIRMING THE ORDER OF THE APPELLATE COMMISSIONER THE ORDER OF THE APPELLATE COMMISSIONER AND CONFIRM THE ORDER PASSED BY THE DEPUTY COMMISSIONER OF INCOME TAX, CENTRAL CIRCLE-1(1), BANGALORE, IN THE INTEREST OF JUSTICE AND EQUITY.

THIS APPEAL HAVING BEEN HEARD AND RESERVED COMING ON FOR PRONOUNCEMENT OF JUDGMENT THIS DAY, **ARAVIND KUMAR J.**, DELIVERED THE FOLLOWING:

JUDGMENT

The above appeal came to be admitted on 01.12.2010 to consider the following substantial question of law:

- “(1) Whether the Tribunal was correct in holding that the order of the Assessing Officer and the Appellate Commissioner holding that the Completed Contract Method of accounting followed by the assessee did not reflect the correct profits and percentage method of accounting as prescribed by accounting standard AS-

7 issued by ICAI after amendment to Section 145 of the Act, was erroneous?

Matter was taken up for final hearing on 04.12.2019 and during the course of arguments, we noticed that following two additional substantial questions of law would also arise for consideration:

- (2) Whether tribunal was correct in holding rental income received from Forum Mall should be considered as “Income from business” and not “Income from house property”, though agreement between landlord and tenant contemplating relationship of landlord and tenant and as such it would partake character of rental income.
- (3) Whether tribunal was correct in arriving at a conclusion that rental received is liable to be brought to tax under the head “income from other

sources” and not “income of house property”.

2. Asseessee is a private limited company carrying on the business of real estate. Return of income for the assessment year 2005-06 came to be filed on 29.10.2005 declaring total income of Rs.28,11,70,620/-. Return was processed under Section 142(1) of the Income Tax Act, 1961 (‘Act’ for short) on 19.06.2006 and rectified under Section 154 of the Act on 13.09.2006. During the course of assessment proceedings, Assessing Officer noticed that assessee has adopted ‘Completed Contract Method’ of accounting for all its real estate projects. On the ground that as per the provisions of accounting standard AS – 7, assessee was required to mandatorily follow ‘Percentage Completion Method’ and as such, a sum of Rs.7,33,13,640/- was added to the income. Assessing Officer has also recorded a finding that rental

income received from Forum Mall and rental income received from fit outs were 'income from business' and 'income from other sources' and not as income from house property. Accordingly, assessment order came to be passed on 31.12.2007 (Annexure-A).

3. Being aggrieved by the same, assessee preferred an appeal before Commissioner of Income Tax (Appeals)-VI, Bangalore in ITA No.397/DCIT Central Circle.1(1)/BLR/CIT(A)-VI/2007-08 and appellate authority, by order dated 07.01.2009 dismissed said appeal filed by the assessee. Hence, assessee filed an appeal before Income Tax Appellate Tribunal, Bangalore Bench 'B' in ITA No.218/Bang/09. Tribunal, by order dated 11.09.2009 partly allowed the appeal and held that assessing officer ought to have followed "Complete Contract Method" as claimed by the assessee and rental income received from Forum Mall should be brought to

tax under the head “profits and gains from business” and income from fit outs should be brought to tax under the head ‘income from other sources’. Hence, revenue is in appeal.

4. We have heard the arguments of Sri K.V.Arvind, learned Standing Counsel appearing for appellant-revenue and Sri Ashok Kulkarni, learned Advocate appearing for respondent-assessee. Perused the records.

5. It is the contention of Sri K.V.Aravind, learned Advocate appearing for appellant that Tribunal erred in arriving at a conclusion that Complete Contract Method of accounting was to be followed by the assessee, giving a complete go-by to the fact that Percentage Method of accounting as prescribed by accounting standard AS-7 which is the accounting procedure prescribed by Institute of Chartered

Accountants of India (ICAI) in the light of amendment brought to Section 145 of the Act.

He would further contend that Tribunal committed an error in holding that rental income received from Forum Mall should be treated as 'income from business' and not as 'income from house property' though agreement between landlord and tenant establish said relationship and the fact that rent was being paid every month. He would also contend that rentals received from fit outs namely, bare super structure of building was liable to be brought to tax under the head 'income from other sources' and not under the head 'income from house property'. Hence, he prays for allowing the appeal by answering substantial questions of law in favour of the revenue.

6. Per contra, Sri Ashok A. Kulkarni, learned Advocate appearing for assessee would support the order passed by Tribunal and contends that finding

recorded by Tribunal are questions of facts and even otherwise, substantial questions formulated by this Court be answered in favour of the assessee.

He would draw the attention of the Court to reply given by the Expert Committee on the queries raised by companies which resulted in the said committee opining that such enterprises undertake construction activities on their own account as a venture of commercial nature and as such, revised AS-7 was not required to be followed for the assessment year under reference. Hence, he prays for answering substantial questions of law in favour of the assessee and against revenue by dismissing the appeal.

RE: SUBSTANTIAL QUESTION OF LAW NO.1.

7. The assessee is engaged in the business of Builders and Developers. For the assessment year 2005-2006, the assessee had adopted Completed

Contract Method for all its real estate projects. The revenue did not accept the same on the ground that provisions of Accounting Standard AS-7 issued by Institute of Chartered Accountants of India was to be followed and thereby Percentage Completion Method was held to be the recognized procedure to be adopted. Hence, the assessing officer added back to the total income of the assessee a sum of Rs.7,33,13,640/- by adopting 'Percentage Completion Method' of accounting.

8. The appellate authority held that assessee is to be treated as a contractor because it enters into an agreement to construct the Mall in stages with others fund only. Hence, it came to be held that assessee cannot adopt Percentage Completion Method of accounting to arrive at its taxable income.

9. Section 145 of the Act would indicate as to how income is to be computed in accordance with either Cash or Mercantile system of accounting regularly employed by the assessee. Sub-section (2) of Section 145 empowers the Central Government to notify the Accounting Standards to be followed by any class of assessee or in respect of any class of income . In exercise of the said power conferred, Central Government has issued a notification No.S.O. 69 (E), dated 25.01.1996 whereunder the Accounting Standard-I relating to disclosure of accounting policies have been notified.

10. In the instant case, assessee entered into a Development Agreement with M/s.Karnataka Realtors Private Limited, under which agreement the assessee was to develop the property and after development of the property, the owner and the developer were entitled

to a specified percentage of super built area and both were free to sell the super built area allotted to their respective shares before construction of the built up area fallen to the share of the assessee, it (assessee) entered into agreement with the proposed buyer to construct the portion as per their specification. In other words, construction is undertaken by the assessee on behalf of the proposed buyer. However, for the purposes of stamp duty payable on the sale of undivided share of land sold to the buyer, only value of the land is taken and assessee had followed consistently this method of accounting to declare the profit namely, on project completion method as per the provisions of the Companies Act namely, Section 211(3A) the Profit and Loss Account and balance sheet of the company has to comply with the Accounting Standard. As per proviso to Section 211(3C), Standards of accounting specified by the ICAI are deemed to be Accounting Standard until

the Accounting Standards are prescribed by the Central Government. In other words, the companies are required to adopt and follow the Accounting Standards as prescribed by ICAI. In the event of such prescribed Accounting Standards are not being followed, then, such companies are required to disclose in its Profit and Loss Account and Balance sheet the reasons as prescribed under Section 211(3B) of the Companies Act. To put it differently, the Companies Act also provided for deviation from the Accounting Standards also. There is no dispute to the fact that AS-7 effective from 01.04.2003 is applicable to all construction contractors.

The objective of AS-7 reads:

“The objective of this Standard is to prescribe the accounting treatment of revenue and costs associated with construction contracts. Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different accounting periods. Therefore, the primary issue in

accounting for construction contracts is the allocation of contract revenue and contract costs to the accounting periods in which construction work is performed. This Standard uses the recognition criteria established in the Framework for the Preparation and Presentation of Financial Statements to determine when contract revenue and contract costs should be recognized as revenue and expenses in the statement of profit and loss. It also provides practical guidance on the application of these criteria.”

Thus, assessee – company which is required to follow Standard as prescribed by ICAI will have to necessarily take into account the reply furnished by the Institute for the Expert Committee, which reads as under:

- (i) the seller of the goods has transferred to the buyer the property in the goods for a specific price or on significant risks and rewards of ownership has been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership;
- (ii) no significant uncertainty exists regarding amount of consideration that has been derived from the sale of the goods.

In the instant case, it has been noticed by the appellate Tribunal that assessee was in the activity of projects and was not a construction contractor. Thus, the revised AS-7 would be applicable to an enterprise undertaking construction activities on their own account as a venture of commercial nature. Whereas, the assessee undertakes construction activities for those persons to whom it intends to sell super built area along with undivided share of land in a project which it is developing as a developer.

11. There cannot be any dispute to the fact that every assessee being entitled to arrange its affairs and follow the method of accounting, which the Department has earlier accepted. Under similar circumstances as obtained from the facts on hand, Hon'ble Apex Court in the case of **COMMISSIONER OF INCOME TAX vs**

BILAHARI INVESTMENT PRIVATE LIMITED reported
in **(2008)299 ITR 1 (SC)** has held:

“Recognition/identification of income under the 1961 Act is attainable by several methods of accounting. It may be noted that the same result could be attained by any one of the accounting methods. The completed contract method is one such method. Similarly, the percentage of completion method is another such method.

Under the completed contract method, the revenue is not recognized until the contract is complete. Under the said method, costs are accumulated during the course of the contract. The profit and loss is established in the last accounting period and transferred to the profit and loss account. The said method determines results only when the contract is completed. This method leads to objective assessment of the results of the contract.

On the other hand, the percentage of completion method tries to attain periodic recognition of income in order to reflect current performance. The amount of revenue recognized under this method is determined by

reference to the stage of completion of the contract.”

12. In the instant case, the Tribunal has rightly held that in case of revised AS-7 is to be applied, then the opening inventories is also to be valued as per revised AS-7. In fact, the revenue had accepted the method of accounting adopted by the assessee for the previous years and in the light of guidance note provided that AS-7 is applicable to real estate developers, assessee itself has changed the method of accounting and for the subsequent years, it has changed from Project Completion Method to Percentage Completion Method in the subsequent year and as such, there is revenue neutral in the assessment year in question. Hence, for the reasons aforesaid, we answer the substantial question of law No.1 in the affirmative i.e., in favour of the assessee and against the revenue.

RE: SUBSTANTIAL QUESTION OF LAW Nos.(2) and (3):

13. As said issue involved is no longer *res integra* in view of law laid down by this Court in the matter of **COMMISSIONER OF INCOME TAX-III VS. VELANKANI INFORMATION SYSTEMS (P) LTD.,** reported in **(2014) 265 CTR 250 (Karnataka),** whereunder it has been held if assessee is in the business of taking land, putting up commercial building thereon, letting out such building with all furniture as his profession or his business then notwithstanding the fact that he has constructed building and he has also provided other facilities and even if there are two separate rental deeds, it does not fall within the income from house property and as such, question Nos.2 and 3 are answered against revenue and in favour of the assessee.

For the reasons aforestated, we proceed to pass the following:

JUDGMENT

- (i) Appeal is hereby dismissed.
- (ii) The order dated 11.09.2009 passed by Income Tax Appellate Tribunal, Bangalore Bench 'B' in ITA No.218/Bang/09 for the assessment year 2005-06 is hereby affirmed.
- (iii) Costs made easy.

**SD/-
JUDGE**

**SD/-
JUDGE**

RU/DR/sp