Pr. Cit -3 vs Dlf Ltd. (Fomerly Known As Dlf Universal ... on 6 March, 2025

Author: Yashwant Varma

Bench: Yashwant Varma

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* IN THE HIGH COURT OF DELHI AT NEW DELHI
+ ITA 926/2016
PR. CIT -3
Through:

versus

DLF LTD. (FOMERLY KNOWN AS DLF UNIVERSAL LTD. .....Respo
Through: Ms. Kavita Jha, Sr. Adv. w
Mr. Akash Shukla and Mr.
Aditya Bali, Advs.

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+ ITA 928/2016
PR. CIT -3
Through:

versus

DLF LTD. (FORMERLY KNOWN AS DLF UNIVERSAL LTD.) .....Res
Through: Ms. Kavita Jha, Sr. Adv. w
Mr. Akash Shukla and Mr.
Aditya Bali, Advs.

CORAM:
HON'BLE MR. JUSTICE YASHWANT VARMA
HON'BLE MR. JUSTICE HARISH VAIDYANATHAN SHANKAR
ORDER

% 06.03.2025

1. We had, by a detailed order of 23 September 2024 taken note of This is a digitally signed order.

 the principal question which was posited for our consideration and had on hearing learned counsels for respective sides ultimately identified „Question 3 alone as one which would survive for consideration. Our order of 23 September 2024 for purposes of completeness is reproduced in its entirety hereinbelow:

> "ITA 926/2016 & 928/2016
>
> 1. The Principal Commissioner impugns the order of the Income Tax Appellate Tribunal dated 11 March 2016. By order dated 24 August 2017 following questions of law were framed by this Court:
>
> "1. Whether in the facts and circumstances of the case, the revenue recognition under percentage completion method should commence in that previous year when expenses reach 25% against the threshold of 30% of budgeted cost?
>
> 2. Whether the Tribunal erred in the facts and circumstances of the case and prevailing law in holding that Internal Development Costs/ External Development Costs have to be included for the purposes of computing threshold limit for recognition Revenue under the POCM?
>
> 3. Whether the Tribunal erred in the facts and circumstances of the case and prevailing law in deleting the addition of Rs.91,70,13,955/- on account of capitalization of interest expense as per AS-16?
>
> 4. Whether the Tribunal erred in the facts and circumstances of the case and prevailing law in deleting the addition of Rs.8,15,68,758/- on account of reclassification if Income from House Property?"
>
> "1. Whether in the facts and circumstances of the case, the revenue recognition under percentage completion method should commence in that previous year when expenses reach 25% against the threshold of 30% of budgeted cost?
>
> 2. Whether the Tribunal erred in the facts and circumstances of the case and prevailing law in deleting the addition of Rs.27,45,00,000/- on account of capitalization of interests?"

2. We note that insofar as the issues emanating from the adoption of the Percentage Of Completion Method is concerned the Tribunal has while dealing with this aspect observed as follows:

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> The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 12/03/2025 at 21:31:03 "38. The brief facts of this ground are that during the year, assesse has changed its method of accounting in case of constructed properties from completed project method to percentage completion method. It was noted by the AO that despite change in method of accounting, the assesse has not recognized any revenue on Mangolia Project as well as Summit Project. Therefore, the AO worked out a profit chargeable to tax from Mangolia Project of Rs.26,55,94,049/-

and from Summit Project of Rs.11,45,52,376/-. The contention of the assesse is that construction of these two projects based on the percentage completion method has not reached threshold requirement of 30% as on 31.03.2006. It was submitted that profits of these projects are offered for taxation in subsequent years when the threshold yardsticks of 30% in terms of accounting policy of the assesse is achieved. Against this, AO was of the view that assesse has himself incurred expenses on land, such as, external development and construction cost on both these projects the revenue should have been recognized. Assesse further submitted that even the special auditor appointed by the revenue have also not recommended any recognition of revenue on Mangolia and Summit projects. The assesse submitted comparative data of other developers too where they are following threshold for starting of revenue recognition in development projects when 30% of the project is completed. However, the AO rejected all the contentions and held that Accounting Standard 9 issued by the ICAI and according to that Accounting Standard, there is no justification for the assesse to adopt a benchmark of 30% for recognition of the revenue and, therefore, made a total addition of Rs.72,32,38,796/- from Mangolia Project and Rs.30,52,54,713/- from Summit Project. The assesse carried the matter before the CIT (A) who in principle agreed with the contention of the assesse that internal development charges allocated to these projects have not been considered should be included in the cost of project and, therefore, upholding the addition on the principle restricting the addition to the extent of Rs.62,68,85,221/- on account of Mangolia Project and Rs.16,08,95,700/- from Summit Project. Aggrieved by this, the assesse is in appeal before us.

39. Before us, ld. AR submitted that assesse has correctly laid down a threshold limit of 30% which is in accordance with the principles laid down in the Guidance Note issued by the ICAI. He submitted that though the Guidance Note prescribes the percentage of threshold as 25%, however, the assesse based on the prevalent practices in the trade has adopted it @ 30% as threshold. For this, he submitted that assesse has given sufficiently large number of comparable developers' This is a digitally signed order.

The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 12/03/2025 at 21:31:04 case where identical practice is being followed and accepted by the revenue. His next argument was that there is no doubt about the correctness of the profit of these two projects merely revenue wants to prepone taxability of these projects from subsequent years to earlier year and this is a revenue neutral exercise. For this, he relied on the decisions of Hon'ble Supreme Court in the case of CIT vs. Billahari Investment Private Limited (supra). The next submission of the ld. AR was that in case of

special audit of the assesse for AY 2010-11, revenue itself has accepted the criteria of 30% of threshold completion for revenue recognition. He submitted that the special auditor has stated that those superficial yardstick of 30% of cost incurred has not been prescribed anywhere in the publication of the ICAI, however considering the spirit of the publication, it is accepted from every assesse to calculate the correct amount of revenue for recognition under the project completion method. However, assesse who is not in the business of construction is required to estimate reliably correct amount of revenue of the respective year. The auditor further went to state that the company has initially fixed the threshold limit of 30% effect from AY 2006-07 for recognizing revenue and its method has been consistently followed by the company every year thereafter. Thereafter, auditor stated that, according to him it is reasonable to adopt revenue under the Percentage of completion (POC) Method where the level of expenditure incurred is 30% or more of the estimated project cost. Hence, auditor was of the view that the assesse company has adopted the threshold limit of 30% going by the industry claims, prudence and followed the same consistency and, therefore, there is no postponement of tax. In nutshell, the ld. AR argued that it is an opinion of the expert on accounting practices for AY 2010-11 which has been accepted by the revenue that 30% threshold limit is as per the industry norms, provisions and consistency, same should not be disturbed in this year.

40. Against this, ld. DR submitted that the CIT (A) as well as the AO has correctly decided the issue and threshold limit of 30% is rejected by both the lower authorities. However, he fairly agreed that fixing such threshold limit is required in case of projects of such scale and if the total expenditure on those projects has not crossed the threshold limit of 30% of the total cost of the project, the revenue should not be recognized. He submitted that as the AO has not examined that whether these projects have crossed the threshold limit of 30% or not, this ground of appeal should be set aside to the file of the AO for determination of income accordingly.

41. To this argument, the ld. AR submitted that it has been accepted by the lower authorities that both the projects have not exceeded the threshold of 30% for the purpose of revenue recognition and, therefore, he stated that the revenue cannot be recognized. However, he also fairly agreed that though data available at page 69 to 71 of the assessment order, according to which both the projects are at the very primitive stage i.e. Mangolia Project at approximately 10- 12% and Summit Project is also less than 20%. However, he agreed that there is no objection from the assesse side to determine the threshold limit of 30% of the total project cost for the purpose of revenue recognition."

3. As is evident from the above, the assessee appears to have urged that the 30% threshold is one which has been adopted by the industry as a whole had also been consistently followed by the assessee itself in subsequent years. The threshold of 30% as adopted was also accepted by the Commissioner of Income Tax (Appeals) in proceedings for the subsequent year.

4. It is on an overall conspectus of the aforesaid, that the Tribunal while taking into account the stage of the two projects held that the 30% percentage as adopted would be in accordance with law for the purposes of recognition of revenue. It further held that the Accounting Standards only spoke of a minimum threshold and that consequently, it was permissible for an assessee to bear in consideration a higher threshold taking into consideration the stage of completion that may have been reached as well as the expenditure incurred. It further held that since in any case the aspect of whether it was taken into consideration in a particular Financial Year or subsequently would give rise to no additional tax implications. It ultimately held that since the issue was rendered revenue neutral it was liable to be laid to rest. The conclusions of the Tribunal in this respect are reproduced below:-

> "42. We have carefully considered the rival contentions and also given a careful thought to the offer of ld. DR for setting aside this ground of appeal to the file of the AO for determination of threshold limit of 30% of the total project cost incurred up to this year or not. Before that we would like to address the issue of threshold percentages determined by the assesse of 30 % instead of 25 % provided in the guidance note on accounting for real estate transactions issued by ICAI in 2012. Firstly assesse has submitted the instances where in the identical facts and circumstances there is trade practice of adopting threshold of 30 % of the achievement of total project cost for commencement of recognising of revenue. According to that guidance note it is provided that "(a) All critical approvals necessary for commencement of

 the project have been obtained. These include, wherever applicable:

> (i) Environmental and other clearances.
>
> (ii) Approval of plans, designs, etc.
>
> (iii) Title to land or other rights to development construction.
>
> (iv) Change in land use
>
> (b) When the stage of completion of the project reaches a reasonable level of development. A reasonable level of development is not achieved if the expenditure incurred on construction and development costs is less than 25 % of the construction and development costs as defined in paragraph 2.2 (c) read with paragraphs 2.3 to 2.5.

(c) At least 25% of the saleable project area is secured by contracts or agreements with buyers.

(d) At least 10% of the total revenue as per the agreements of sale or any other legally enforceable documents are realised at the reporting date in respect of each of the contracts and it is reasonable to expect that the parties to such contracts will comply with the payment terms as defined in the contracts. To illustrate - If there are 10 Agreements of sale and 10 % of gross amount is realised in case of 8 agreements, revenue can be recognised with respect to these 8 agreements"

According to the above guidance note the revenue of the project can be recognised only when the above conditions specified therein. According to one of the conditions specified there in is reasonable level of development is not achieved if the expenditure incurred on construction and development costs is less than 25 % of the construction and development costs as defined in paragraph 2.2 (c) read with paragraphs 2.3 to 2.5. Therefore the threshold suggested by ICAI is the minimum threshold and it is not prohibited that looking to the business conditions assesse cannot fix up higher threshold. More so when the assesse has stated that many identical companies are also following similar threshold of 30 % of the total project cost, no fault can be found with the estimate made by the assesse. It is also undisputed that in subsequent years the special auditor appointed by revenue has accepted the threshold of 30 % adopted by assesse and AO has accepted the same. In view of above we are of the opinion that assesse has rightly accepted the threshold of 30 % of achievement of total project cost for commencement of revenue recognition. Further the working of the total project should also include all types of development charges required to be included in the same. Ld. AR has stated that the details of percentage of completion of This is a digitally signed order.

The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 12/03/2025 at 21:31:04 project are available in the assessment order itself. However after careful consideration and agreed by both the parties, we set aside this issue to the file of the AO to determine with respect to Magnolia Project and Summit Project following :-

(i) To determine the total project cost of both these projects including the cost of internal and external development charges of the project.

(ii) To determine whether the actual cost of expenditure incurred up to 31.03.2006 is less than 30% of the total project cost estimated by the assessee;

(iii) If the threshold limit of 30% is crossed then to determine the income of both these projects on percentage completion method in this year;

(iv) To give appropriate relief in subsequent years, if any income is taxed on these projects in these years;

(v) If the project cost incurred up to this year has not crossed threshold of the total project cost estimated then to delete the addition of Rs. 1,02,84,93,509/-.

While deciding this issue AD may however keep in mind the principle laid down by honourable Supreme court in case of CIT v. Excel Industries Ltd. [2013] 358 ITR 295, if AD is satisfied that issue is revenue neutral the matter may be set at rest.

Therefore, ground no. 8 of the appeal is allowed with the above direction"

5. We thus find no justification to interfere with the view as expressed by the Tribunal.

6. The second aspect which was sought to be canvassed for our consideration pertained to the treatment of Internal Development Charges and External Development Charges and whether they were liable to be included for the purposes of computation of the threshold limit for recognizing revenue under the POCM. While dealing with IDC the Tribunal has ultimately observed as under:

"111. We have heard the rival contentions of the parties. Regarding taxability of these two projects was also the ground no 8 of the appeal of the assesse. While this ground of appeal on the request of both the parties we have set aside the issue of determining threshold of 30% of incurring the total project cost of these projects for commencement of revenue recognition. Therefore the parties also requested to set aside this issue to the file of the AO as this is a connected issue. Therefore in the interest of justice we set aside this ground of appeal of the revenue to the file of the AO and to decide afresh according to our directions This is a digitally signed order.

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7. In light of the fact that the matter has merely been remitted to the Assessing Officer for the purposes of verification, we find no justification to entertain the appeal on that score.

8. Similarly, and with respect to EDC the Tribunal has while dealing with the aforesaid ground observed as under:

"126. We have carefully considered the rival contentions. The brief facts of the case are that there is construction account with respect of 13 projects which has a credit balance of Rs.37,81,33,632/- tabulated at page 123 of the assessment order. The assessee explained before the AO that these credit balances are not appearing in the books of accounts of the assessee but auditor has only picked up the credit side of such ledgers without considering the debit balance in the part of those ledgers. The explanation was submitted before the AO but he did not consider this and made an addition of opening credit balance of Rs.37,81,33,632/-. In fact, the CIT (A) has

considered this aspect and has held that there is an opening debit balance of Rs.66,27,71,032/- which has been ignored by the AO. Project wise details of the construction expenses showing opening balances as at 01.04.2005 are added as income of the assessee without granting credit for the debit entries. Merely picking up some ledger balances and excluding some ledger balances addition has been made by the AO. Merely there are some ledgers of the main ledger account, it cannot be said that they are income of the assessee when they have been already considered by adjustment of the main ledger account. In the remand report submitted by the AO before the CIT (A), it was not controverted that the charts submitted by the assessee considering all the accounts of the trial balance and which was also before the AO vide its letter dated 27.03.2009 is incorrect in any manner. Therefore, we do not find any infirmity in the order of the CIT (A) and none has been pointed out by the ld. DR. Now coming to the argument of the Id. DR that the CIT (A) has set aside this aspect about the verification of the amount to the AO is beyond his powers. We disagree with the argument of the ld. DR and without commenting on that much, we are of the view that CIT (A) has given one more opportunity over and above the opportunity of assessment and remand proceedings for verification of these details, cannot be said that it is against the revenue. In fact, according to us, it is in favour of the revenue. Further, in the appeal effect order passed by the AO on 20.11.20121, after verification of these facts, the AO This is a digitally signed order.

The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 12/03/2025 at 21:31:04 has deleted the addition pursuant to the order of the CIT (A) after verification. In view of the above facts, we are of the view that the addition on account of Rs.37,81,33,639/- is unsustainable and hence we confirm the order of CIT (A) on this ground. Therefore, ground no.5 of the revenue's appeal is dismissed."

9. The aforesaid findings are clearly of fact which have come to be decided in favour of the assessee and merit no further consideration by this Court.

10. Question no. 3 as proposed and which pertains to the capitalization of interest expenses as per AS-16 read alongwith Section 36(1)(iii) of the Income Tax Act, 1961, is stood over at the request of learned counsels for respective sides.

11. That only leaves us to deal with the question of reclassification of rental income which was earned with it being urged on behalf of the appellants that it was liable to be treated as income from business and profession. We note that the aforesaid question stands answered in favour of the assessee itself by this Court in light of the decisions rendered in Commissioner of Income Tax, Delhi-IV vs. DLF Ltd. (Earlier DLF universal Ltd.); Commissioner of Income Tax, Delhi - IV vs. DLF Universal Ltd.; Commissioner of Income Tax vs. DLF Universal Ltd. and Commissioner of Income Tax vs DLF Ltd.. We thus find no justification to take a contrary view.

12. The appeals shall now be examined only with respect to question no. 3 which survives.

13. Let these appeals be called again on 14.10.2024. ITA 126/2019 & 32/2020

14. Since these appeals raise separate questions, let them be listed on 25.11.2024."

2. Question 3, as proposed, pertains to Section 36 (1) (iii) of the Income Tax Act, 19611 and the issue of whether the Income Tax Appellate Tribunal2 was justified in setting aside the disallowance of INR 27.45 crores from the total interest expenditure which had been borne by the respondent assessee. From the material facts which have been noticed by the Tribunal itself, we find that the assessee was Act This is a digitally signed order.

The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 12/03/2025 at 21:31:04 aggrieved by the Commissioner of Income Tax (Appeals)3 undertaking a presumptive exercise of disallowing interest expenditure in light of the fusion of funds that were available with the respondent assessee and which comprised of not just borrowed funds but also its own reserves and surplus.

3. Dealing with this issue, the Tribunal noted that the CIT(A) had adopted a formula of 1/3rd of the advance being viewed as being attributable to the own funds and 2/3rd of the advances being liable to be characterized as borrowed funds. It is this issue which ultimately travelled to the Tribunal for consideration. The Tribunal has in this regard further noted that out of the loans taken for various construction projects, the assessee had incurred total interest charges of INR 119,56,56,108/- on fixed period loans and the other interest component amounting to INR 16,41,67,222.

4. There does not appear to be any contestation with respect to the loan having been duly utilized for acquisition of land as well as for financing of projects which were being undertaken by the assessee. Bearing in mind the provisions which are made in AS-16, the parties appear to have proceeded further. The CIT(A), however, disagreeing with the disallowance which was made by the Assessing Officer, proceeded to delete the addition of INR 91,70,13,955 but confirmed the disallowance to the extent of INR 27.45 crores.

5. As the Tribunal notes, the solitary reason underlying the disallowance was based on it noting that although part of the interest on borrowed funds was for the construction of projects, the same came to be "mixed up with own funds and interest free funds". It was this Tribunal CIT (A) This is a digitally signed order.

The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 12/03/2025 at 21:31:04 which led to the CIT(A) undertaking an exercise of presumptive apportionment between the interest component and liability on borrowed funds and the own funds of the respondent assessee, which may have been utilized in connection with the projects in question.

6. The Tribunal has pertinently taken note of para 17.39 as it appears in the order of the CIT(A) and which reads as follows: -

> "17.39 The above findings of the Special Auditors has not been shown to have been incorrect by the AO. It is therefore quite apparent that there is no diversion of interest bearing funds by the appellant for non business purposes. Secondly, the funds that have been given to subsidiary companies of the appellant have been given at the rate of interest which is higher than the cost of borrowing by the appellant. Admittedly, the appellant has a mixed account and there is no direct nexus with allocation of interest bearing funds and utilization thereof The admitted facts on record show that the appellant has earned interest income of Rs.132,27,14,859/- and has incurred expenses on fixed period loan of Rs.119,54,22,543/-. Admittedly, this income is income from 'profit or gains of business' i.e. loans and advances given to subsidiaries in the normal course of carrying on business of the appellant. The appellant is in the business of real estate development, either directly as well as indirectly through its subsidiary companies. Therefore, the act of passing on interest bearing monies to subsidiaries is also a part of the business model of the appellant."

7. We deem it apposite to preface the discussion which follows with the observation that we are, in the facts of the present appeals, not concerned with the interest that may have been earned or could be said to have flowed to the respondent assessee from advances that may have been made to its subsidiaries or other associated entities. This, since Section 36(1)(iii) itself bids us to bear in consideration only borrowed funds and where they were utilised for the purposes of business. It is also pertinent to note that the Proviso which came to be appended to Section 36(1)(iii) of the Act by Finance Act, 2003 with effect from 01 April, 2004 would be of little significance since it is not This is a digitally signed order.

 the case of the appellants that the borrowed funds were not utilised for the creation of assets and which were duly „put to use .

8. The Tribunal has, in our considered opinion, correctly appreciated the question which stood posited bearing in mind the indubitable position that Section 36(1)(iii) is concerned solely with the borrowing of funds for the purposes of business and irrespective of whether it be for incurring capital or revenue expenditure. It has while dealing with this aspect pertinently observed as follows: -

> "44. This ground is against the confirmation by CIT (A) of disallowance of interest expenditure of Rs.27,45,00,000/- out of total disallowance of expenditure of Rs. 1,19,15,13,955/-on account of capitalization of interest expenses by holding that there is no direct nexus which can be established to hold that the loans are utilized for specific projects only and adopting a formula that 1/3rd of the advance has been given out of own funds and 2/3rd of the advances have been given out of the

borrowed funds. Assesse was further aggrieved that despite of information available in assessment order and in the remand report of the assesse, still CIT (A) has set aside the ground to the file of the AD for verification The assesse was also aggrieved by the non-appreciation of facts by CIT (A) that borrowed funds have not been utilized for buying of land or meeting of construction expenses because receipts from the customers being advanced against sale are more than the expenditure incurred on those projects. The assesse is also against application of adopting artificial formula of bifurcation of borrowed fund and own fund. The assesse has also taken an alternative ground that the CIT (A) failed to appreciate that the interest income earned by the assesse is Rs.138.57 crores whereas the interest expenditure is only Rs.136 crores and, therefore, on netting principle there is no interest expenditure incurred by the assesse. Alternatively, it was also stated that CIT (A) did not give direction to allow this interest expenditure based on the percentage completion method against respective projects in this year or in subsequent years, when revenue is recognized.

45. Briefly stated, the facts are that during the year, assesse has incurred total finance charges of Rs.1,19,56,56,l08/- on fixed period loans and other interest amounting to Rs.16,41,67,222/- .

The interest on loan is paid for acquisition of land and for financing the project undertaken by the assesse. The AO took note of the accounting policy of the assesse mentioned in Schedule 24 of the balance sheet wherein it is mentioned that borrowing costs This is a digitally signed order.

 that are attributable to the acquisition or construction of qualifying assets are capitalized part of the cost of such assets. A qualifying asset is one that necessarily takes substantial period of time to get ready for its intended use. All other borrowing costs are charged to the profit and loss account. According to the AD, as the loan from ICICI Bank Ltd. of Rs.300 4rores is taken for project development in its 100% subsidiary company which has acquired 23 acre plot. Further, assesse has taken loan from GE Services and India Limited for the purpose of Icon and Summit projects. Therefore, according to him, these loans are taken for the construction projects which remains unallocated and, therefore; required to be capitalized. He held that Rs.1,19,15,13,155/- is the borrowing cost i.e. attributable for acquisition of construction of qualifying assets and required to be capitalized. The AO further rejected the contention of the assesse that the amount of interest paid should be adjusted against interest income earned u/s 57 of the Act for the reason that income that is offered is taxed as business income and not as an income from other sources and secondly, the land for which these advances have been given are part of the inventory i.e. closing stock of the assesse. Aggrieved by this, assesse carried this matter in appeal before the CIT (A) who in turn deleted the addition ofRs.91,70,13,955/- but confirmed the disallowance ofRs.27.45 crores. The main reason for the confirmation of the disallowance advanced by CIT (A) is that part of the interest on borrowed funds is for the construction of the project and the amount borrowed is mixed up with own funds and interest free funds. Thus, there is no direct nexus which can be established to hold

that loans for which the money was borrowed were utilized for such projects or not. Therefore, he devised a formula that one portion out of three shall be considered being interest free funds available and two portions shall be considered as interest bearing funds. By applying this formula, he held that out of Rs.1,19,15,13,155/-, Rs.70.10 crores of the interest is pertaining to interest earned on loans and advances to group entities and, therefore, net interest expenditure of Rs.49.46 crores shall be capitalized. The findings of CIT (A) based on the special auditors' report in para no 17.39 were as under :-

(a) There is no diversion of interest bearing funds for non-

business purposes.

(b) Amounts advanced to subsidiaries that are also in the business of real estate and therefore amount advanced to subsidiaries are a part of the business model of the appellant.

(c) Funds given to subsidiaries of the assesse company are at the rates of interest higher than the rates of interest of borrowings.

(d) Appellant has a mixed account of funds and there is no nexus of the interest bearing funds and utilisation thereof.

(e) Appellant has earned interest income of Rs 1322714859/- and has interest expenditure of Rs. 1195422543/-. Income is charged to tax under the head profits and gains of business and expenses are also claimed as deduction u/s 36(1) 9iii) as business expenditure.

(f) That part of the interest expenditure of Rs 1191513955/- is required to be capitalized because purposes of the part of the borrowings is fo~ purchase of land and construction purposes and there is no nexus of the funds.

(g) Average Interest free funds are available to the assesse of Rs. 159254 lacs and total interest bearing funds are Rs. 182350 lacs and cost of the project as at 31.3.2006 is Rs. 351.78 crores. Net interest expenditure is Rs. 49.46 crores. Amount invested in group entities is Rs 132.27 Crores.

Based on above as in AY 2006-07, 44.51% of the revenue is recognized out of total cost of project of Rs.351.78 crores, he proportionately worked out that Rs.22.01 crores ,being 44.51% of Rs.49.46 crores shall be interest expenditure allowable as deduction to the assesse. The balance of Rs.27.45 crores, he held that this interest expenditure is required to be capitalized towards non-recognition of proportionate revenue from the projects.

46. Advancing argument against this ground, the Id. AR submitted that the CIT (A) should have considered the netting of principal as interest earned by the assesse is more than the interest expenditure incurred by the assesse. He submitted that in assessee's own case for AY 2007-08, the CIT (A) has accepted this but for this year, he has not accepted the plea of the assesse. He drew attention to para no.9.6 where identical issue has been considered by the CIT (A). He argued that CIT (A) has accepted the concept of netting of and moreover after considering the decision of Hon'ble Supreme Court in the case of SA Builders, wherein Hon'ble Supreme Court has held that there is no diversion of money for non-business purposes and loans to subsidiaries are at higher rates then rates of borrowings paid by the assesse. He further submitted that Accounting Standard 16 issued by ICAI does not have any application on the facts of the case. The next argument was that the case of the assesse is covered by the decision of Hon'ble Delhi High Court in the ease of CIT vs. Tulip Star Hotels Limited wherein if the interest expenditure is incurred for the purpose of busneiss the deduction should be allowed u1s 36(I)(iii) of the Act.

 He further relied on the decision of Hon'ble Supreme Court in the case of DCIT vs. Core Health Care Limited - 298 ITR 194 (SC) wherein Hon'ble Supreme Court has stated that provisions of section 36(1)(iii) has to be read on its own term and it is a code by itself. The Hon'ble Supreme Court further held that it does not make any difference whether the capital is borrowed for revenue purposes or for acquisition of capital assets, requirement of section is that the assesse must borrow capital for the purposes of its business. Therefore, he submitted that as in the case of assesse, the borrowing is for the purposes of business ofthe company, full deduction should have been allowed u1s 36(1)(iii) of the Act. He further stated that borrowing cost policy of the assesse is mentioned with respect to accounting of capitalization of the borrowing cost according to Accounting Standard 16 issued by ICAI which does not apply to inventor and even if it applies, the provision of law should prevail when there is conflict between accounting standard and the taxation laws while deciding issue under the Income Tax. Even otherwise, whole controversy is of academic nature as there is no dispute that all the borrowed funds have been used for the business and even if part of interest is capitalised by linking the same with recognition of revenue, the claim of interest so capitalised is to be allowed as deduction in the AY 2007-08 as the entire receipt was duly subjected to tax in the AY 2007-08. He further submitted that the finding of the CIT(A) in the year under reference being not in conformity with accounting and legal principles, the same has not been approved by the successor CIT(A) in the assesse's own case for A.Y. 2007-08. He submitted that in the past years identical claim of interest has always been allowed in the preceding years and there is no change in facts of the case and nature of claim. He also argued that whole controversy is of academic nature as there is no dispute that all the borrowed funds have been used for the business and even if part of interest is capitalised by linking the same with recognition of revenue, the claim of interest so capitalised is to be allowed as deduction in the AY 2007-08 as entire receipt was duly subjected to tax in the AY 2007-08Therefore, he submitted that the disallowance confirmed by CIT (A) of Rs.27.45 crores may be deleted.

47. Against this, Id. DR submitted that the assesse has utilized funds for the purpose of the project. As the funds are utilized for the purchase of land and construction expenditure of specific project, the expenditure is not of the revenue in nature and, therefore, the same has been rightly disallowed. He further submitted that AO has given detailed reasoning for each and every argument advanced by the assesse for the purpose of making disallowances and the CIT (A) also has worked out the nexus of the funds in a reasonable manner. It was also one of his argument This is a digitally signed order.

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48. In rejoinder, ld. AR submitted that now the issue is squarely covered in favour of the assesse in view of the decision of Hon'ble Supreme Court in the case of Hero Cycles Limited vs. CIT reported in 63 taxman.com 308 (SC). He also relied on the decision of Hon'ble Supreme Court in the case of DCIT vs. Core Healthcare Limited (supra)."

9. Proceeding then to the issue of the disallowance itself, it has correctly taken note of the presumption which operates in favour of the assessee in cases where funds utilised for the purposes of business may be fused with surplus capital that may be held by an assessee itself. As has been repeatedly held by courts in this respect, the presumption would be that an assesse would, at the outset, use the interest free funds generated or available with it and if the same be sufficient to meet the investments. However, this presumption which precedents have propounded as being relevant for the purposes of Section 36(1)(iii), clearly has no application since the same cannot feed the presumptive exercise of apportionment which the CIT(A) ultimately undertook.

10. It would be appropriate to refer to the following conclusions which have come to be recorded by the Tribunal in this respect:-

> "49. We have carefully considered the rival contentions. It appears that the AO has made this addition mainly because of note mentioned by assesse in its accounting policies with respect to borrowing costs according to Accounting Standard 16 issues by ICAI. We have perused notes attached to financial statements and we are of opinion that these notes have arisen in the financial statement of the assesse because of the issue of applicability of Accounting Standard 16 issued by the ICAI. According to Accounting Standard 1 i.e. disclosure of accounting policies, each and every company is required to disclose the accounting policy This is a digitally signed order.
>
> The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 12/03/2025 at 21:31:05 with respect to various significant income, expenditure and assets and liabilities etc. applicable to it. Borrowing cost is also one

of them. ICAI has issued Accounting Standard 16 Accounting for Borrowing Cost wherein it is provided that in case of interest expenditure incurred by the company, it is required to be capitalized if the borrowing is related to the qualifying assets. In this case the inventory is a qualifying assets as it is held for more than 12 months and therefore interest attributable to it is required to be capitalised in the books of accounts as per AS -16. Therefore we do not agree with the arguments of AR that AS -16 does not apply to inventory. However, those are the provisions which are applicable for the maintenance of the accounts of the company and interest is allowable according to provisions of section 36(1) (iii) of the act. Further according to us, the provisions of Accounting Standards and provisions of the Act are two different set of regulations and while deciding this issue, it is well settled judicial precedent that is if there is a contradiction between the two, the provisions of the Act shall prevail. Provisions of section 36(1)(iii) provides that the amount of interest paid in respect of capital borrowed for the purposes of the business or profession deduction is required to be allowed. Proviso inserted w.e.f. 01.04.2004 is the only restriction if condition laid down u/s 36(1) (iii) are satisfied by the assesse. The proviso says that any amount of the interest paid in respect of capital borrowed for acquisition of an asset whether capitalized in books of accounts or not for any period beginning from the date on which the capital asset was borrowed for acquisition of the asset till the date on which such asset was put to use shall not be allowed as deduction. The deduction is to be disallowed even if the interest is capitalized in the books of accounts or not. Hon ble Supreme Court in the case of Core Healthcare [298 ITR 194] has held that provisions of section 36(1)(iii) is a code in itself. In the present case, the interest paid by the assesse is not for the purpose of acquisition of any capital asset but for its inventory. We do not find any restriction in provisions contained u/s 36(1)(iii) which provides that the interest can be disallowed if incurred for the purpose of inventory as provided under Accounting Standard 16. Apparently, in this case, there is no allegation that interest is not paid on capital borrowed for the purpose of the business. Hon ble Mumbai High Court in the case of CIT vs. Lokhandwala Constructions Industries Ltd. [131 taxman 810] has held as under :-

"4. From the facts found by the Tribunal on record, it is clear that assessee undertook two-fold activities. It bought and sold flats. Secondly, the assessee was also engaged in the business of construction of buildings. The profits from both the activities were assessed under section 28 of the Income-tax Act. In this case, we are concerned with the This is a digitally signed order.

The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 12/03/2025 at 21:31:05 second activity (hereinafter referred to, for the sake of brevity, as "Kandivali Project"). According to the Commissioner, loan was raised for securing land/development rights from the Mandal. That, the loan was utilised for purchasing the development rights, which, according to the Commissioner, constituted a capital asset. According to the Commissioner, since the

loan was raised for securing capital asset, the interest incurred thereon constituted part of capital expenditure. This finding of the Commissioner was erroneous. In the case of India Cements Ltd. v. CIT [1966] 60 ITR 52 , it was held by the Supreme Court that in cases where the act of borrowing was incidental to carrying on of business, the loan obtained was not an asset. That, for the purposes of deciding the claim of deduction under section 10(2)(iii) of the Income-tax Act, 1922 [section 36(1)(iii) of the present Income-tax Act], it was irrelevant to consider the purpose for which the loan was obtained. In the present case, the assessee was a builder. In the present case, the assessee had undertaken the Project of construction of flats under the Kandivali Project. Therefore, the loan was for obtaining stock-in-trade. That, the Kandivali Project constituted the stock-in-trade of the assessee. That, the Project did not constitute a fixed asset of the assessee. In this case, we are concerned with deduction under section 36(1)(iii). Since the assessee had received loan for obtaining stock-in-trade (Kandivali Project), the assessee was entitled to deduction under section 36(1)(iii) of the Act. That, while adjudicating the claim for deduction under section 36(1)(iii) of the Act, the nature of the expense - whether the expense was on capital account or revenue account - was irrelevant as the section itself says that interest paid by the assessee on the capital borrowed by the assessee was an item of deduction. That, the utilization of the capital was irrelevant for the purposes of adjudicating the claim for deduction under section 36(1)(iii) of the Act -Calico Dyeing & Printing Works v. CIT [1958] 34 ITR 265 (Bom.). In that judgment, it has been laid down that where an assessee claims deduction of interest paid on capital borrowed, all that the assessee had to show was that the capital which was borrowed was used for business purpose in the relevant year of account and it did not matter whether the capital was borrowed in order to acquire a revenue asset or a capital asset. The said judgment of the Bombay High Court applies to the facts of this case."

Further, in the following decisions of various coordinate Benches, the deduction of interest has been allowed u/s 36(1)(iii) even where the assesse has followed the projection completion method :-

(i) ACIT vs. Tata Housing Development Company Ltd. - 45 SOT 9 (Bom.);

(ii) DCIT vs. Thakar Developers - 115 TTJ 841 (Pune);

(iii) DCIT vs. K. Raheja Pvt. Ltd. - (2006) TIOL 220 ITAT-MUM.;

(iv) K. Raheja Development Corporation vs. DCIT in ITA No.240/Bang./97 dated 22.09.1997

- In this case, reference application filed by the Department has also been rejected by the Hon ble Karnataka High Court vide its order dated 08.11.2000 in Civil Petition No.832/2000 (IT).

Before us, ld. DR could not cite any decision against the claim of the assesse, therefore, respectfully following the decision of Hon ble Bombay High Court and as well as various coordinate Benches, cited above, we do not concur with the view of CIT (A) on disallowance of interest of RS.24.75 crores u/s 36(1) (iii) of the Act. The alternative argument of the assesse regarding adoption of any artificial formula for the purpose of computing interest disallowance. Ld. CIT (A) has presumed proportion of utilisation of funds in absence of the nexus holding that assesse has used mixed funds. Honourable Bombay High court in case of CIT V Reliance Utilities & Power limited 313 ITR 340 has held that "The principle therefore would be that if there are funds available both interest free and overdraft and/or loans taken, then a presumption would arise that investments would be out of the interest-free fund generated or available with the company, if the interest-free funds were sufficient to meet the investments."

Therefore we are of the view that presumption is to be assumed in favour of the assesse and not against assesse. Hence, we reject the formulae adopted by CIT (A) of working out proportionate disallowance by adopting artificial formulae. Therefore respectfully following decisions of Honourable Bombay High court in CIT vs. Lokhandwala Constructions Industries Ltd. [131 taxman 810] and CIT V Reliance Utilities & Power limited [313 ITR 340] We reverse the order of the CIT (A) confirming the disallowance of expenditure of Rs.27.40 crores and direct the AO to allow this interest expenditure u/s 36(1) (iii) of the Act."

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11. Quite apart from Section 36(1)(iii), not incorporating or even envisaging such a presumption being raised, our attention was not drawn to any other provision of the Act which would have sustained the exercise of apportionment and consequential disallowance which was undertaken by the CIT (A).

12. We would, therefore and for all the aforesaid reasons, answer Questions 3 and 2 in ITAs no. 926/2016 and 928/2016 respectively in the negative and against the appellant.

13. The two appeals aforenoted shall, consequently, dismissed on a combined reading of our order of 23 September 2024 and the present judgment that we have rendered on Question no. 3.

14. The appeals of the Revenue to be listed separately as per the order passed by us.

YASHWANT VARMA, J.

HARISH VAIDYANATHAN SHANKAR, J.

MARCH 06, 2025/nd This is a digitally signed order.