07/04/92

IN THE OFFICE OF THE COMMISSIONER
OF INCOMETAX(APPEALS)III, ANDHRA
PRADESH: HYDERABAD

Shri J.G. PENDSE, IRS
Commissioner of Incometax(Appeals)III
Andhra Pradesh:Hyderabad

Date of order [redacted]

Appeal No. [redacted]

Instituted on the [redacted] from the order of J.Albert, AC

1. Asst.year [redacted]

2. Name of the appellant [redacted]

3. Income assessed

4. Penalty/fine/incometax demanded 4,53,000/-

5. Section under which order appealed against was passed. 143(3)

- -

Date of hearing [redacted]

Present for appellant [redacted]

APPELLATE ORDER AND GROUND OF DECISION

ITA No.11/MC.1(2)/CIT(A)XII/80-81

The first ground of appeal is the addition of Rs.4,10,920/- and Rs.2,44,730/- and Rs.60,000/- being the expenditure incurred on development of Seth Group of Land, Purushottam Land and Durga Prasad land. The facts of the case are as under:-

2. The appellant is doing the business of developer of property into commercially viable structures. The development activities during the year for the above 3 properties can be broadly classified as under-

1) The appellant enters into an agreement with the owners of the land/existing property/existing buildings and structures on lease;

2) the lease agreement promises the appellant to construct new structures/buildings at the appellant's own costs;

3) The appellant is allowed to lease/give on rent/compensation the structures during the period of lease;

4) the appellant is required to pay the lease rent that is agreed upon under the agreement;

5) on the expiry of the agreement the appellant is required to give vacant possession of the property along with the buildings and structures erected by the appellant;

6) The clauses in the agreement regarding the ownership of the structures which put up by the appellant are slightly different. The relevent Clauses are as under:

Seth Group of Agreements: Clauses of ownership are as under:

> (a) though the cost of construction of the said building/structure shall be borne and paid by the Developer alone, such constructions shall be carried out and completed by the Developer for and on behalf of and in the name of the owners;
>
> (b) As and when such construction is put up and progress, the same shall belong and form part of the property of the owners and shall be the asset of the owners and such completed structures shall also belong to the owners;
>
> (c) The Developer shall not have or claim any proprietary rights in or to such building or structures or any part thereof.

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Purushothem Property - The ownership clause reads as under:

> "It is clearly and distinctly understood and agreed as a vital part and integral term and condition of this agreement that the construction shall be carried out and completed by the Developer at his own cost. However, brick by brick the construction so made shall belong to the owners and the developers shall not claim any ownership right on the super structure raised."

Durgapresad Land - The clause reads as under:

> "The underwriter suggested certain optional work for more effectively marketing the property and it is mutually agreed that the costs of such optional work shall be borne by the underwriter who shall reimburse the same to the owners from time to time. It is also agreed that the optional work shall be completed in all respects by 1st June,1978

4. The activities of the appellant can be summarised as under:

The appellant incurs expenditure on development of property. The expenditure is in the nature of construction activities ie, capital structure like building, office premises, xxxxxxxxx warehouse,etc are erected at his own cost by the appellant. According to the lease agreement, the appellant has full control and the right of user of the property so developed and buildings and structures so erected. Thus, the appellant has undisputed legal, lease hold interest in the property so constructed. As per the terms of the agreement, the possession of the structures is to be handedover to the owners at the expiry of the lease period.

5. The appellant is entitled to sub-lease the buildings and premises at his own option. The appellant is not required to take any prior permission of the lessors of the property. It is agreed that the development expenditure incurred was towards bringing into existence of new capital asset in the form of building, etc.

6. The appellant claimed the amounts as revenue expenditure for the following reasons:

(a) according to the appellant, the expenditure was incurred to acquire an enduring benefit, the possession of which was essential for carrying on his business and therefore it was a capital outgoing not entitled for deduction.

He relied on the decision of the Supreme Court in Abdul Khayoom Vs. C.I.T. (44 ITR 689) in support of this proposition."

(b) The land on which the commercial complex is constructed does not belong to him. Under the specific terms of the agreement the construction of the complex at every stage of its construction belongs to the owner of the land and at no stage does the appellant assumes ownership either of the land or the superstructure. The construction of the complex is done for and on behalf of the owner of the land who assumes right and title over it right from the inception. In consideration of the amounts spent by the appellant in the construction, he receives rent from the premises over a period of time stipulated in the agreement. What he receives by way of rent is a mere compensation for the investment and labour and entrepreneurial skill put in by the appellant. By this he has not acquired any right in the structures put up by him which remain the property of the owner throughout the agreement period and later.

(c) The expenditure related to the carrying on or conduct of the appellant's business and it is an integral part of the profit-earning process. The expenditure was not incurred for acquisition of an asset or a right of permanent character which the appellant wanted for the purpose of his business as a developer. On a proper construction of the various clauses of the agreement it would be clear that the right, if any acquired by the appellant, was in the income arising from the complex and not in the capital field.

The appellant referred to case of CIT Vs. Madras Auto Services Ltd (156 ITR 740). The appellant contended the ratio of the case as under:

"company took on lease land and building in Bangalore to house its branch in that city. As the building was old, the company entered into an agreement with the land lord whereby it agreed to demolish the existing building and construct a new one and as a consideration for the same, the land lord agreed to take a very low rent compared to the prevailing market rents in the area. The assessee spent sizable amounts over two years on the construction and claimed the amount as deductible business expenditure.

On the above facts, the High Court held that no tangible or intangible asset came into existence as a result of demolishing the old building and constructing a new one. The High Court noticed that the new construction, brick by brick belonged to the owner and the assessee had no rights in it. It also held that the circumstances of the case clearly showed that the assessee entered into this agreement only because of the obvious, savings in the rent charges. It allowed the expenditure as a business loss."

The appellant contended that the decision of the Madras High Court is applicable to the appellant's case.

7. The case of Madras Auto Services Ltd is distinguishable. In that case, the appellant had taken on lease an old building and constructed a new one for consideration of a low rent. However, this case is distinguishable in view of the provisions of section 32(1A) introduced regarding the depreciation admissible. Section 32(1A) reads as under

32(1A) - Where the business or profession is carried on in a building not owned by the assessee but in respect of which the assessee holds a lease or other right of occupancy and any capital expenditure is incurred by the assessee for the purposes of the business or profession after the 31st day of March, 1970, on the construction of any structure or doing of any work in or in relation to, and by way of renovation or extension of, or improvement to, the building, then, in respect of depreciation of such structure, or work the following deductions shall, subject to the provisions of section 34, be allowed -

Provided that such deficiency is actually written off in the books of the assessee

(i) such percentage on the written down value of the structure or work as may in any case or class of cases be prescribed.

(ii) in the case of any such structure or work which is, sold, discarded, demolished, destroyed or is surrendered as a result of the determination of the lease or other right of occupancy in respect of the building in the previous year (other than the previous year in which it is constructed or done) the amount by which the moneys payable in respect of such structure or work together with the amount of scrap value, if any, fall short of the written down value thereof:

Provided that such deficiency is actually written off in the books of the assessee."

The appellant had contended that if the appellant was to take on lease the ready-made structures and thus, to sub-lease the same, the appellant could not have obtained the same at a nominal rate of Rs. 0.35 per sq.foot as against the on going commercial rate of Rs.3 to 4 per Sq.ft. The appellant objected to the applicability of the sec.32(1A) on the ground that it contemplates the the subsisting lease and under the right of occupancy over the building belonging to some-one else and facilities, the carrying on the business of the assessee thereon by creating additional structures. In the present case, the constructed building

becomes the property of the owner at stage by stage construction as in the case of Purushottam Land by brick by brick construction. Thus, the appellant wants to set up a plea that the cost of construction is nothing but lease rent paid and being the lease rent it will be an out-go on revenue account in the hands of the appellant.

8. The plea of the appellant is not tenable for the simple reason that in that case the lessor should have shown the cost of construction as the lease rent received and paid the tax on the same. However, the lessor has not done the same. Thus, there is no such mutual agreement between the parties. Hence, the plea of the appellant that the expenditure constitutes lease rent has to be rejected.

9. Section 32(1A) envisages allowance of the capital expenditure during the lease period and write-off of the balance expenditure when the lease agreement is terminated either by handing over the structures to the owner or by demolishing the scrap value is obtained and the amount remaining in excess of scrap value allowed as deduction. The appellant set up a plea that the appellant is not the owner. Hence section 32(1A) will not be applicable. This contention of the appellant is not correct. Section 32(1A) has the following features:-

(i) building used for business should not be owned by the assessee;

(ii) the assessee should hold a lease or other right of occupancy;

(iii) the capital expenditure should be incurred by the assessee to carry on his business or profession after 31st March, 1970 by way of renovation or expansion of the building.

All the conditions are satisified in the case of appellant. As the appellant has taken the property on lease and he is not the owner. The appellant has set up buildings and structures. The constructions of structures which are basically capital assets. In view of the above, I am of the opinion that the provisions of sec. 32(1A) will apply and the appellant will be entitled to depreciation during the year on the value

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of constructions of buildings and structures done by him for purposes of business. In view of the above I hold that (a) the expenditure incurred by the appellant on construction of the buildings, warehouse, commercial office is capital expenditure;

(b) the appellant is entitled to depreciation on the buildings, structures and commercial office so set up by the appellant in terms of section 32(1A).

10. The assessing officer is directed to allow depreciation as per rules, on all three properties.

11. The second ground of appeal is that the expenditure incurred of Rs.60,000/- on Durga Prasad land has not brought any addition to the capital asset of the appellant. The expenditure was incurred on modifying the property by renovating and was called as optionnl work. Under these circumstances, I hold that this is rightly a capital expenditure incurred by the lessee. Hence this ground of appeal is dismissed.

12. For statistical purposes, the appeal is partly allowed.

Sd/-
(J.S. REDDY)
Commissioner of Incometax(Appeals)XXI
Andhra Pradesh:Hyderabad

Certified copy
Copy of the Order Forwarded to
1: Appellant with D. N.
2. I.T.O. with records
3. CIT. A.P. Hyderabad
4. IAC. of Incometax.

Commissioner of Income Tax
(APPEALS) III,
HYDERABAD.

BEFORE COMMISSIONER OF INCOME-TAX (APPEALS)-III, AHMEDABAD

IN CASE OF SATISHCHANDRA MODI

APPEAL No. 31/AC.1(2)/CIT (A)-III/90-91 ASSESSMENT YEAR 1987-88

- - -

The appellant makes the following submissions in support of the grounds urged before YOUR HONOUR in connection with his appeal for the assessment year 1987-88.

1. Among other activities, the appellant carries on his individual business as a developer of property into commercially viable units. He has been carrying on this business from 1982.

1.1 The nature and modus operandi of the appellant's business as a developer has been discussed in detail in the assessment order.

1.2 Briefly stated the assessee undertakes to develop the open land or land with old structure owned by others into modern commercial complexes. Under the agreement with the owner, the appellant has to meet the cost of the construction of the complex. The agreement provides that every stage of construction, to put it in the language of the agreement, "brick by brick" the structure belongs to the owner of the land. In return, the appellant is entitled to give out the completed structure on lease to the tenants of his choice and earn the rental income for a specified period. During the period of agreement the assessee has to pay municipal taxes on the structures and also a nominal lease amount of Rs. 0.35 for sq. ft. of the constructed area to the owner of the land. At the end of the agreement period, the appellant has to surrender the land with the superstructure to the owner of the land who becomes the full owner thereof clear of all claims by the appellant.

On the above facts, the appellant claimed that:

i) the activity undertaken by the appellant constituted his business and the rental income derived by him with assessable as his business income u/s. 28 of the Act.

ii) The expenditure incurred by him on the development of the property was expenditure wholly and exclusively laid out for the purpose of his business as a developer and is eligible for deduction from the income derived on letting out the premises.

...2.

1.3 The appellant started this business in 1982 and has been declaring his income/loss for assessment on the basis of the above claims from the assessment year 1983-84 and onwards. The Income-tax Officer rejected the claim. He held that the income was assessable under the head "other sources" and also that no deduction for the expenditure incurred on development of the property was admissible. The Successive Commissioner of Income-tax (Appeals) however allowed the appellant's claim on both the counts. The department is in appeal for all the earlier years before the Income-tax Appellate Tribunal and the appeals are pending.

2. For the year under appeal (Assessment Year 1987-88) the Assistant Commissioner of Income-tax accepted the appellant's claim that the income was assessable under the head "Business". But he rejected the appellant's claim that the expenditure laid out for the development of the property was revenue in nature. He treated it as appellant's capital outgoing and added it back. He held the view that by expenditure the amount on the development of the property, the appellant acquired a right to lease out the premises to the tenants of his choice and receive the rental income from them. He viewed that what the assessee acquired was a source of income. The expenditure, according to him, was incurred to acquire an enduring benefit, the possession of which was essential for carrying on his business and therefore it was a capital ~~xxx~~ outgoing not entitled for deduction. He relied on the decision of the Supreme Court in Abdul Khayoom Vs. C.I.T. (44 ITR 689) in support of this proposition.

2.1 The appellant submits that the view taken by the Assistant Commissioner of Income-tax is untenable. The appellant is a developer of property simplicitor. The land on which the commercial complex is constructed does not belong to him. Under the specific terms of the agreement the construction of the complex at every stage of its construction belongs to the owner of the land and at no stage does the appellant assumes ownership either of the land or the superstructure. The construction of the complex is done for and on behalf of the owner of the land who assumes right and ~~xitx~~ title over it right from the inception. In consideration of the amounts spent by the

...3.

appellant in the construction, he receives rent from the premises over a period of time stipulated in the agreement. What he receives by way of rent is a mere compensation for the ~~in~~ investment and labour and entrepreneural skill put in by the appellant. By this he has not acquired any right in the structures put up by him which remain the property of the owner through out the agreement period and later. The Supreme Court decision in the case of Abdul Khayoom Vs. C.I.T. relied upon by the Assistant Commissioner of Income-tax has no application to the facts of the appellant's case. In that case, by paying a lumpsum royalty the assessee acquired an exclusive right to fish and collect conch shells from the specified area, of the sea shore. Whether the assessee would obtain any shells at all and if so what quantity was not known. There was no certainity about the quantity and the payment made by the assessee was not relatable to any quantity of the shells to make the payment an outgoing on the acquisition of raw material. The decision of the Supreme Court turned on the above facts. In the appellant's case, on the other hand, he had a clear idea of the whole project, and what he could normally expect from the premises and therefore there was no uncertainty about the potentiality of the venture at the time of entering into the agreement. The agreement was entered into with the full knowledge of the profitability to the appellant, in the project. The expenditure incurred was for the purpose of making a handsome profit in his business as developer of property. The expenditure related to the carrying on or conduct of the appellant's business and it is an integral part of the profit-earning process. The expenditure was not incurred for acquisition of an asset or a right of permanent character which the appellant needed for the purpose of his business as a developer. On a proper construction of the various clauses of the agreement it would be clear that the right, if any acquired by the appellant, was in the income arising from the complex and not in the capital field. Kind attention is invited to the Madras High Court Judgment in the case of C.I.T. Vs. Madras Auto Service Ltd. (156 ITR 740).

....4.

2.2 In this case, the assessee company took on lease land and building in Bangalore to house its branch in that city. As the building was old, the company entered into an agreement with the land lord whereby it agreed to demolish the existing building and construct a new one and as a consideration for the same, the land lord agreed to take a very low rent compared to the prevailing market rents in the area. The assessee spent sizable amounts over two years on the construction and claimed the amount as deductible business expenditure.

2.3 On the above facts the High Court held that no tangible or intangible asset came into existence as a result of demolishing the old building and constructing a new one. The High Court noticed that the new construction, brick by brick belonged to the owner and the assessee had no rights in it. It also held that the circumstances of the case clearly showed that the assessee entered into this agreement only because of the obvious, savings in the rent charges. It allowed the expenditure as a business loss.

2.4 The above judgment, it is submitted, squarely applies to the appellant's case. Here also, the appellant acquired no tangible or intehgible asset by the expenditure incurred by him on the construction. By entering into such an agreement with the owner of the land, the appellant had kept in view the higher lease amount he had to pay to obtain a ready made commercial complex and the comparatively higher margin of income he would earn in this arrangements, over the period of the agreement taken as a whole.

2.5 To a similar effect is the decision of the Madras Bench of the Income-tax Appellate Tribunal Vs. Gemini Pictures Circuit (P) Ltd., reported in 34 ITD page 94.

....5.

2.6. The Assistant Commissioner of Income-tax equally erred in holding that the appellant acquired an enduring asset by incurring the expenditure on the construction. In this connection reference is invited to the observations of the Supreme Court in their decision in Empire Jute Co. Vs. CIT 124 ITR 1.

"What is material is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital filed the expenditure would be disallowable. If the advantage consists merely in facilitating assessee's trading operation or enabling the management and conduct of the assessee's business to be carried on more efficiently and more profitably while keeping the fixed capital untouched, the expenditure would be an revenue account even though the advantage may induce for an indefinite future".

The Supreme Court, further held "what is outgoing as capital or what is outgoing on account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of legal rights, if any secured, employed or exhausted in the process".

2.7 In the appellant's case, the expenditure was incurred by him with an eye on the profitability of the venture in the shape receipt of handsome rents in the agreement period. The expenditure was incurred in the course of his business as a developer of profits. He did not acquire any benefit of an enduring nature in his capital field.

2.8. The Assistant Commissioner of Income-tax does not dispute that the assessee's activity constituted business. But he failed to notice that the expenditure was not incurred by the appellant to expand or improve his capital base. The appellant admittedly had no interest in the land or the superstructure of the commercial complex. The expenditure has therefore not been brought him any advantage of enduring nature in the capital filed of he has no capital structure of his own at all.

2.9. It is now well-settled that where the assessee incurs an expenditure on providing a capital structure which is to belong to others, in the process of carrying on his own business, the expenditure, laid out by him is in the realm of revenue expenditure.

Reliance is placed on the decision of the Supreme Court in L.H. Sugar Factory & Oil Mills (P) Ltd. Vs. CIT (125 ITR 293) and CIT Vs. Associated Cement Co. Ltd. (172 ITR 287). In the second mentioned case, under an agreement, the assessee agreed to create the infrastructure for supply of water and electricity to the Shahabad town (AP) and lay contract road at its cost - all of which is to belong to the Municipality. In return, the assessee obtained immunity from payment of Municipal taxes for a period of 15 years. The assessee incurred an expenditure of Rs. 2,09,459/- during the year on providing the structures and claimed it as an allowable outgoing. The claim was allowed by the S.C. The reasoning of the S.C. in allowing the expenditure is two-fold; viz:

(i) The assessee incurred the expenditure for providing capital asset for the Municipality and it did not bring into existence any capital asset for the company.

(ii) The expenditure laid out by the company benefitted the company with immunity from municipal taxes which, if paid by the company, was an allowable payment.

2.10. The above judgment clearly applies to the facts of the appellant's case. By spending the amount on construction he did not acquire any enduring advantage for himself in the capital filed as the structures developed belonged to the owners under the agreement.

2.11. If the appellant was to take a ready made structure or lease and sub-lease the same to the tenants, he would have been obliged to pay inter alia higher lease amount to the owner and that higher amount would have been eligible for deduction in the computation of his income. By spending the amount, he need pay lease amount to the owner at a nominal rate of @ 0.25 per sq. ft. whereas the normal lease for commercial in properties in the area was between Rs. 3/- to Rs. 4/- per sq. ft.

2.12. Thus, from any angle, the view taken by the Assistant Commissioner of Income-tax that the expenditure laid out was capital in nature was not sustainable. Kind attention is also invited to the decision of the ITAT, Hyderabad Bench in Hotel Krishna Vs. ITO 31 ITD page 273 in which on more or less similar facts, the cost of structures put up by the assessee in the property taken on sub-lease by it was allowed as a revenue expenditure. The appeal may therefore be kindly allowed.

3. In the course of the earlier hearing of the case, the CIT(A) was pleased to raise the question whether the arrangement would fall for consideration u/s. 32(1A) - see Explanation 1 to sec. 32. In this connection the appellant makes the following submissions.

3.1. Sec. 32(1A) is an extension of sec. 32 of the Act providing for allowance of depreciation on capital structures constructed by the assessee as a holder of lease or right of occupancy of a building used for his business or profession. It contemplates existence of a subsisting lease or right of occupancy over building belonging to some one else and the facilities carrying on his business the assessee raises thereon additional structure or undertakes renovation or expansion thereof at his cost.

3.2. In the assessee's case there has been no such pre-existing lease or right of occupancy obtained by him. In most cases, there was no building on the land taken by the appellant for development. Even if there was one, it was an old structure which was to be demolished. It was only by virtue of the agreement with the owner of the land to develop it into a commercial complex does the appellant enter upon the land to execute the work under the agreement. Prior to the agreement he had no manner of right or interest in the property as contemplated by sec. 32(1A).

3.3. Another aspect is that sec. 32(1A) refers to the "capital expenditure" incurred by the assessee for the construction of the additional structure or renumeration of the existing structure as qualifying for depreciation. This leaves no doubt or dispute about the nature of the expenditure covered by sec. 32(1A) for allowance of depreciation. The section therefore does not come into operation if the expenditure is of a revenue nature. The issue involved in appeal before your Honour is precisely whether, on the facts and in the circumstances of the case, the expenditure incurred by the appellant on raising the commercial complex is capital or revenue in nature. A decision on this issue will decide the applicability or otherwise of sec. 32(1A). If only it could be held that the expenditure falls in the area of capital expenditure, the applicability of sec. 32(1A) would require to be considered.

3.4. Another aspect that merits consideration is that unlike in the situation contemplated by sec. 32(1A), the structure put up by the appellant in the premises becomes the property of the owner of the land stage by stage of the construction and the ownership does not vest with the appellant. Under sec. 32(1A) depreciation is earned on such structure by the lessee on the footing that he is the owner of the structure during the subsistence of the lease.

3.5. For these reasons it is submitted that the provisions of sec. 32(1A) have no application to the case of appellant.

4. To sum up, the appellant pleads that the expenditure having been incurred by the appellant in the course of carrying on his business as a developer of properties, the expenditure incurred by him is admissible for deduction as a revenue out going. It is also submitted that the provisions of sec. 32(1A) have no application to the facts of the appellant's case as the conditions and circumstances envisaged by the 32 (1A) are not present in his case.

— your explanation

1 to Sec 32