

From
Vista Homes,
5-4-187/3 & 4,
2nd Floor, Soham Mansion,
M.G. Road,
Secunderabad – 500 003.

Date :15-04-2021

To
Assessing Officer,
National –e Assessment Centre,
Delhi.

Respected sir/Madam,

Sub: IT Scrutiny Assessment Proceedings – Own case – PAN No.AAGFV2068P
Assessment Year 2018-19 – Submission of information – Reg.

Ref: your letter dated 12-04-2021 DIN: ITBA/AST/F/17/2021-22/1032371581(1)

In connection with the income tax assessment proceedings for Assessment Year 2018-19, certain explanation/clarification requested for is submitted herewith for your kind consideration.

1. Based on your Computation of revenue and cost to be recognized, it is proposed to add an amount of Rs 4,59,20,928/- which upon analysis we find that the break-up of the same as compared with our workings will be as under:

	As per Notice	As per our workings	Difference
% of completion	71.51%	69.46%	
Revenue to be recognised (in Rs)	48,56,26,245	47,17,23,681	1,39,02,564
Basis of computation of cost to be recognised	% of area sold	Estimated GP based on stage of work completion	
	79.275%	14.49%	
Cost to be recognised (in Rs)	37,13,31,132	40,33,49,495	(3,20,18,363)
Difference proposed to be added			4,59,20,927

A. Sambharao

2. In the letter it is stated that we follow percentage completion method in order to recognize profit from your Construction Contract Business i.e., Real Estate Development Business. In this regard we would like to submit the following for your kind consideration:

- a) At the outset it is submitted that we are not into Construction Contract Business but we are into the business of Real Estate Developers. There are certain significant differences between Construction Contract Business and Real Estate Development business.
- b) Certain Income Computation and Disclosure Standards (ICDS) have been notified vide Notification No 86-87-88/2016 dated 29.09.2016 including Income Computation and Disclosure Standard III relating to Construction Contracts (ICDS III).
- c) The term 'Construction contract' is not defined under the Income Tax Act. However, it is defined under Income Computation and Disclosure Standard III relating to construction contracts (ICDS III) as under:

"Construction contract" is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use and includes:

- (i) contract for the rendering of services which are directly related to the construction of the asset, for example, those for the services of project managers and architects;
- (ii) contract for destruction or restoration of assets, and the restoration of the environment following the demolition of assets.

- d) Plain reading of the above definition clearly suggests that the construction undertaken by real estate developer does not satisfy the above definition as the contract is not negotiated for the construction of asset. The real estate developer constructs the asset as per his scheme and contracts with the buyer to sell the asset i.e., sale of a Flat/apartment in our case. It is not the case that for the purposes of undertaking the construction of flats/apartments, the firm first enters into a contract with the prospective buyer and then start the construction. Further, the design, flat layout, construction specification and various other things are decided by the builder and the prospective buyer has no say in that except for minor changes/modification in the specifications. The firm enters into an agreement of sale of a finished flat and therefore this agreement of sale cannot be said or equated to be a Construction Contract.

A. *Subashir*

- e) Further, Paragraph 1 outlines the scope of ICDS III. It states that this ICDS should be applied in determination of income from a **construction contract of a contractor**.
The same reads as under:

This Income Computation and Disclosure Standard should be applied in determination of income for a construction contract of a contractor.

- f) The CBDT has also clarified in the FAQ issued on 23rd March, 2017 vide Circular No 10/2017 (Reply to Question No.12) that this ICDS is not applicable to real estate developers.

- g) Thus, it is submitted that ICDS III – Construction Contracts is not mandatorily applicable to us as we are neither into the business of the Construction Contracts nor a Contractor.

- h) Even in the situation it is held or a view taken that as per section 43CB r.w.s. 145(2) of the Income Tax Act, 1961 and ICDS III – Construction Contracts (ICDS III) is applicable to us, there is a Transitional provision vide Para 22.1 and 22.2 which provides as under:

22.1 Contract revenue and contract costs associated with the construction contract, which commenced on or after 1st day of April, 2016 shall be recognised in accordance with the provisions of this standard.

22.2 Contract revenue and contract costs associated with the construction contract, which commenced on or before the 31st day of March, 2016 but not completed by the said date, shall be recognised based on the method regularly followed by the person prior to the previous year beginning on the 1st day of April, 2016.

- i) The project of the firm is commenced from FY 2011-12 i.e. before 1st day of April, 2016, the ICD III-Construction Contract is not applicable.

3. The workings for the claim of the cost of construction for FY 2017-18 of Rs.40,33,49,495/- is explained as under:

- a) The total expected project cost of Rs.67,43,29,905/-, the cost incurred upto 31-3-2018 is Rs.46,84,08,456/- which translates to 69.46% of the work completed (or progressed). Thus, the cost to be recognized for the period upto 31-3-2018 works out as under:

A. Saubalivchar

i)	69.46% of expected revenue for sale of Rs.67,91,02,566/-47,17,04,642	=====
ii)	Expected Gross profit on the project is 14.49%	
iii)	The cost of sales will be thus 85.51% ((i.e. 100% (-) GP of 14.49%) 85.51%	
iv)	The cost to be recognized till 31-03-2018 will be 85.51% of Rs.47,17,04,642/-	40,33,49,495
v)	Less: Cost recognized is earlier upto 31-3-2017	(-)24,42,06,509
	Cost to be recognized for Financial year 2017-18	15,91,42,986 =====

- b) The above method of cost recognition is in line with the basic concept of PCOM that the revenue and cost associated with the project should be recognized as revenue and expenses respectively by reference to the stage of completion of the construction at the reporting date.
- c) The above method also ensures that the profit in respect of the revenue that got recognized is correctly declared. It satisfies the principle of revenue and cost matching. On a revenue of Rs. 47,17,04,642/- the corresponding estimated gross profit of the project @ 14.49% should be Rs.6,83,55,147/-. It may be noted that in the above workings the gross profit is coming to Rs. 6,83,55,147/- (i.e., revenue of Rs 47,17,04,642/- minus corresponding cost of Rs 40,33,49,495/-).
- d) The above method has been consistently followed over past years. The first Asst. Year is Asst. Year 2015-16 where the stage of construction has reached above 25% and the revenue and cost got recognized following PCOM.
- e) The scrutiny assessments u/s 143(3) have been completed for Asst. Year 2015-16, Asst. Year 2016-17 and Asst. Year 2017-18. During all scrutiny assessment proceeding for all the said years the workings and computation of revenue and cost recognition have been called for and after examination is accepted.
4. The explanation/clarification with regard to the computation of Total Cost is as under:
- a) In our computation, Total cost is of Rs.67,43,29,905/- [Land- Rs 3,03,07,905/- + sanction cost- Rs 2,00,00,000/- + construction cost- 60,47,20,000/- = Rs 65,50,27,905/-].
- b) The difference between Rs.67,43,29,905/- and Rs 65,50,27,905/- will be Rs 1,93,29,005/- and not Rs.2,40,74,651/- arrived in your letter.

A. Sambasiva Rao

- c) The above difference of Rs.1,93,29,005/- is due to line item for cost of the club house is missed in the sheet that has been submitted. The cost of club house for 9651 sft is estimated at the rate of Rs 2,000/- which comes to Rs 1,93,29,005/-. The corrected sheet is enclosed herewith-**Annexure 1**. It is submitted that there is no error in the computation of Total Cost. It is requested to kindly consider this sheet for the workings and we sincerely regret for the clerical error.
- d) It may be noted that considering the working sheet submitted now, the Percentage of completion will remain at 69.46% and not at 71.51% as worked out in your letter adopting the total cost at Rs 65,50,27,905/-.
5. The explanation/clarification with regard to the Computation of revenue recognition as per percentage completion method as on 31/03/2018 is as under:
- a) In the Computation given in your letter, there are two components which are resulting in the difference in the amount of cost that is to be recognized.
- b) The first component is the percentage of completion that has been arrived at 71.51% due to arithmetical error of Rs.2,40,74,651/- pointed out in your letter and
- c) The second component is the adoption of total cost of land & construction at Rs 37,13,31,132/- [79.275 % of Rs.46,84,08,456/-].
- d) In respect of the first component the clarification and explanations are as given in Point No 3 above. It is once again requested and submitted that there is no arithmetical error in the computation of the Total Cost.
- e) The second component with regard to the total cost of land & construction at Rs 37,13,31,132/- it is noted that the cost is arrived at adopting the percentage of total sold area @ 79.275%.
- f) It appears that your workings are on the stand that ICDS III – Construction Contracts (ICDS III) is applicable to us. In Point No 1 we have in detail explained as to why ICDS III is not applicable to us and we reiterate the same.
- 5) Further, even if it is held that ICDS III is applicable, it does not provide for the methodology as to how the revenue and the cost is to be recognized. It only lays down the principle that **the revenue and cost associated with the project should be recognized as revenue and expenses respectively by reference to the stage of completion of the construction at the reporting date.**
6. What is imperative to note is that the ICDS III refers to the *stage of completion of the construction* at the reporting date and it does not provide for determining the cost in relation to the percentage of the area sold out of the total saleable area.

A. Sambasiv Rao

7. For the sake of quick reference, the relevant extract of the ICDS III is reproduced below:

Recognition of Contract Revenue and Expenses

16. Contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date.

17. The recognition of revenue and expenses by reference to the stage of completion of a contract is referred to as the percentage of completion method. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed.

18. The stage of completion of a contract shall be determined with reference to:

- (a) the proportion that contract costs incurred for work performed upto the reporting date bear to the estimated total contract costs; or
- (b) surveys of work performed; or
- (c) completion of a physical proportion of the contract work.

Progress payments and advances received from customers are not determinative of the stage of completion of a contract.

19. When the stage of completion is determined by reference to the contract costs incurred upto the reporting date, only those contract costs that reflect work performed are included in costs incurred upto the reporting date. Contract costs which are excluded are:

- (a) contract costs that relate to future activity on the contract; and
- (b) payments made to subcontractors in advance of work performed under the subcontract.

20. During the early stages of a contract, where the outcome of the contract cannot be estimated reliably contract revenue is recognised only to the extent of costs incurred. The early stage of a contract shall not extend beyond 25 % of the stage of completion.

8. The recognition of revenue and expenses by reference to the stage of completion of a contract is referred to as the percentage of completion method under Para 17 of ICDS. **Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed.**

A. Sambasivam

9. Thus, it is submitted that the method adopted in your computation disregards the principle provided as above in the ICDS-III.
10. In our PCOM workings all the revenue and the cost is recognized with reference to the stage of work completion and is in line with the ICDS-III and it also meets the requirement of the ICDS that profit which can be attributed to the proportion of work completed is recognized.
11. The method adopted by us has been followed consistently over past years and as stated herein above the scrutiny assessments u/s 143(3) have been completed for Asst. Year 2015-16, Asst. Year 2016-17 and Asst. Year 2017-18. During all scrutiny assessment proceeding for all the said years the workings and computation of revenue and cost recognition have been called for and after examination is accepted.
12. It is important to note that the actual revenue/cost and the actual profit for the project will finally get determined at the end of the project. Under the PCOM method there is only an issue of timing difference with respect to the profit during the construction period for first year, second year and onwards and till the completion of the project. The overall profits will get ultimately declared and offered to tax.
13. Hence it is requested not to disturb the PCOM workings which has been consistently followed over the years and which in line with the principle laid down in ICDS-III. The method of PCOM workings followed by us is not flawed as viewed by you in the letter.
14. We have submitted our clarification and explanation on the proposed addition of Rs 4,59,20,928/- mainly due to adoption of a different method of PCOM as against the PCOM method followed by us and hope you will find the above information in order.
15. Without prejudice to the above submissions, it is submitted that in the event it is held that the PCOM workings adopted by us needs to be disturbed and resultant profits are to be added in this year, we request that for such additional income, the set-off/adjustment is done against the income already declared in the subsequent Asst. Years so that there is no double taxation on the said amount.

Thanking you,

Yours faithfully,

For VISTA HOMES,

A. Sankar Sivar

(AUTHORISED SIGNATURE)