Mancon Enterprises Vs. Cit

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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Jan-08-2007

Judge : O Narayanan, S K Yadav, J Member

Appellant : Mancon Enterprises

Respondent : Cit

Judgement :

1. These two appeals are filed by the assessees. The relevant assessment year is 2004-05. The appeals are Afiled against the orders passed by the Commissioner under Section 263 of the Income Tax Act, 1961.

2. The assessees in these cases are partnership firms running the businessof rendering services and warehousing services. These two assesseesentered into a joint venture project to construct a multi-storied commercial complex. In fact, the assessees purchase certain lands and the rights in respect of the tenants and thereafter proceeded to construct the said g commercial complex. The construction of building complex was entrusted to M/s. Larsen & Toubro on the basis of an agreement. As per the agreement L&T would construct the entire multi-storeyed commercial complex at their own cost on the land provided by the assessees jointly. In consideration thereto, the assessees would allot a specified built up area to M/s. L&T. The project being a huge one, it was completed in phases spanning over so many assessment years in between.

3. When the construction was under progress, certain units of thecommercial complex were completed. Before finally settling the contractual obligations and selling the built up areas to others, the assessees hadlet out certain units fit for consumption. As per the leave and licenceagreements executed between the assessees in one hand and the tenantson the other hand, the consideration flowing from the tenants to theassessees comprised of two segments. The first segment is the Rentproper; the second segment is the charges against various services rendered by the assessees to those tenants.

4. The assessees in their returns of income for the impugned assessment year 2004-05, computed their income on the basis of dividing the total amounts received between rent and service charges. As far as the rent portion is concerned, the assessees claimed statutory deductions and offered the balance amount under the head "Income from house property".

The other part of the consideration treated by the assessees as c service charges has been offered as business income after claiming various items of expenditure, 5. The assessees have also sold certain extent of built up area to different parties including M/s. L&T in the previous year relevant to the assessment year under appeal. The assessees treated 20% of the corresponding sale consideration as profit on sale of the built up area, thereby claiming 80% as cost of construction and other connected expenses.

6. Both the assessees have filed the returns of income for the impugned assessment year 2004-05 in the pattern discussed above. The respective assessments were completed under Section 143(3) of the Income Tax Act.

In completing the said scrutiny assessments, the assessing officer has accepted the proposition of the assessees that the consideration received on leave and licenc e need to be bifurcated as income from house property and business income. The assessing officer has also accepted that the profit of 20% offered by the assessee on sale of built up area was reasonable. The assessments were completed after making certain other disallowances not connected with the above two items. The assessments were thus completed under Section 143(3).

Thereafter the Commissioner of Income-tax, City-22 at Navi Mumbai perused their assessment records and came to a conclusion that the assessment orders passed by the Assessing Authority are erroneous and prejudicial to the interests of-the revenue. After a detailed examination of the issues in the light of the statutory provisions and in the light of judicial pronouncements, the Id,, Commissioner came to a conclusion that the entire receipts against leave and licence should have been assessed as "income from house property". He held that the assessing officer has gone wrong in treating a part of the consideration as business income. According to the Commissioner, the action of the assessing officer treating a part of the consideration as business income has provided impermissible opportunities to the assessees to claim deduction of expenses, which are otherwise inadmissible. He, therefore, concluded that the action of the assessing officer is erroneous which has straightaway resulted in loss of revenue thereby prejudicial to the interest of the revenue. Regarding the sale of built up area to various parties including M/s. L&T, the learned Commissioner held that the assessing officer has not made any necessary enquiries before accepting the proposition made by the assessees. He observed that the method of accounting followed by the assessee in computing the profit on sale of built up area is not scientific and proper and there was no basis to make an estimate of 20 per cent of the consideration as profit of the impugned assessment year. He observed that the method of accounting followed by the assessee has not reflected the correct value of the built up stock by way of work-in-progress and the appropriation of expenditure project-wise and year-wise were not properly arranged and thereby distorting the working results to the advantages of the assessees from time to time. He also found that the assessees have not accounted any profit on the sale of 23,307 sq.ft. super built up area allotted to M/s. L&T. According to the Commissioner, the correct procedure in the matter of accounting in respect of the construction was to provide the entire cost of the land and building in the books of account and the cost of the constructed area sold during the year should be worked out on the basis of the cost per sq. ft. which would be equal to the total cost to the assessees divided by the total built up area. Thus he observed that the non-accounting of the profit arising out of the allotment of 23,307 sq.ft. of super built up area to M/s. L&T and also the inconsistent method of accounting have resulted as fatal errors in completing the assessments.

Therefore, the Commissioner himself computed the profit attributable on the sale of built up area including the extent of 23,307 sq.ft. allotted to M/s. L&T.7. On the basis of the above findings, he set aside the computation of income made by the assessing authority and directed to revise the assessments on the basis of the computation suggested by the Commissioner and set aside the assessments under Section 263 through his orders dated 31 -3-2006 and 7-4-2006. It is against the above that the assessees have come in appeals before us.

As these appeals are filed by two assessees inter-connected on the basis of the common issue involved and on the basis of their status as partners of the joint venture, we find that these appeals be disposed off through this common order.

10. Shri S.K. Tulsiyan, the learned Counsel who appeared for the assesseesargued the case at length. The contentions and arguments advanced by learned Counsel are summarised as below: (i) that the Commissioner of Income-tax has violated the fundamentalprinciples in the matter of exercising jurisdiction under Section 263.ITAT Mumbai 'H' Bench in the case of Mrs. Khatiza S. Oomerbhoy v. Income Tax Officer (2006) 100 ITD 173 has explained the fundamental principlesthat should be observed by the revisional authority while invokingjurisdiction under Section 263.

That the Commissioner must record his satisfaction that the order of the assessing authority is erroneous and prejudicial to the interests of the revenue and both the conditions must be fulfilled.

That Section 263 cannot be invoked to correct each and every type of mistake or error committed by the assessing authority and when an order is erroneous, then alone the section could be attracted.

That every loss of revenue cannot be treated as prejudicial to the (tm) interest of the revenue. If the assessing authority has adopted one of the courses permissible in law or where two views are possible and the assessing authority has taken one view with which the Commissioner does not agree, it cannot be treated as an erroneous order unless the view taken by the assessing authority is unsustainable in law.

(ii) That the assessing officer exercises quasi-judicial power vested in him and if he exercises such power in accordance with law and arrive at a conclusion, such conclusion cannot be held erroneous only for the reason that the Commissioner does not agree with the conclusion.

That where the assessing officer has made enquries during the course of assessment proceedings on the relevant issues and the assessee has given detailed explanations in writing and the Assessin Officer accepts the explanations furnished by the assessee upon his satisfaction, then the decision arrived at by the Assessing authority cannot held erroneous.

(iii) The decision of the assessing authority to treat the income from tenants under two heads viz., house property and business income are supported by a number of decisions; Some of which are: (iv) That the Commissioner of Income-tax while exercising the jurisdiction under Section 263 does not sit in appeal on the orders passed by the assessing authority. The Supreme Court has held that if two views are possible on an issue and the assessing authority has accepted one view, the Commissioner would not be justified in invoking Section 263, so as to thrust his view in the assessment Malabar Industrial Co. Ltd. v. CIT .

(v) That the assessing officer has decided the issues on merit in respect of service charges on the basis of the decisions available on the subject. The Supreme Court in the case of CIT v. G.M. Mittal Stainless Steel (P.) Ltd. (2003) 130 Taxman 67 has held that in deciding an issue, if the assessing authority has followed the orders of the jurisdictional High Court, it cannot be said that his order was erroneous and therefore prejudicial to the interest of the revenue.

(vi) The CIT has computed assessees' profit on the sale of units of the multi-storied building by including the sale consideration of the third unit comprising a built up area of 14,646 Sq.ft. made over to M/s. L&T Ltd. The said sale consideration could not form part of assessees' receipts. Firstly on the technical ground that such an issue was not raised by the Commissioner in the show-cause notice issued by him under Section 263. The Calcutta High Court in the case of Bagsu Devi Bafna v. CIT has held that if the revision order under Section 263 is based on grounds not disclosed in the show-cause notice, the same is a nullity.

(vii) On merit also the finding of the Commissioner is without any basis. The complex was constructed by M/s. L&T Ltd. in the light of an agreement dated 8-8-1996 on the land owned jointly by the assessees. In other words, the property development was entrusted upon M/s. L&T Ltd. Instead of paying the cost of construction to M/s. FL&T in cash, the agreement was to allot 20 per cent of the total built up area to M/s. L&T. Therefore, the consideration attributable to A that space allotted to M/s. L&T could never form part of the income of the assessees.

11. The Id. Counsel has filed before us the details of the income furnished by the assessees for the three assessment years i.e. 2002-03, 2003-04 and 2004-05 along with copies of assessment orders to bring home the point that the assessees were following a regular method of accounting to ascertain the income and the final position would be declared on completion of the project as a whole. He has also filed copies of the judgments relied, on him. The Id. Counsel has also filed paper books before us containing copies of agreements, notices, replies etc.

12. Shri N.N. Mishra, the Id. Commissioner of Income-tax (DR) argued the case along with Shri Z. S. Klar, the Commissioner of Income-tax who passed the impugned revision orders.

13. The revenue has filed before us four sets of paper books containing c all the relevant matters available in the assessment files. The case has been strenuously argued by the revenue. The detailed arguments and contentions advanced by the Id. Commissioner are briefed below: (i) The assessment orders passed by the assessing authority have not touched any of the vital aspects of the assessments concerning property income and profit on sale of built up units. This is clear from the reading of the assessment orders. Instead of concentrating on the above important areas, the assessing officer has discussed certain other flimsy issues like motor car expenses, telephone expenses, operating expenses, travelling expenses etc. Therefore, it is very clear that the assessing officer had failed to make necessary enquiries and to apply his mind in a proper manner in respect of the claims of the assessees regarding income from hous;e property visa-vis income from business and profit on sale of built up units. Therefore, the assessment orders passed by the assessing authorities E are erroneous and

prejudicial to the interest of the revenue as very much detailed in the respective revision orders.

(ii) The expression "erroneous" defined in Blacks Law Dictionary VI Edition, page 542 means "involving error, deviating from the law".

An error should be an error in approach, error in computation, error in applying the relevant law and facts or any error- in selecting a principle which would not govern the fact situation etc. as held by p Karnataka High Court in the case of S.S. Muddanna v. State of Karnataka 89 STC 90.

(iii) Assessment orders passed by the assessing authority answered in all respects to the above negative qualities and, therefore, rightly held as erroneous by the Commissioner. The revenue also agrees as held by the Bombay High Court in the case of CIT v. Gabriel India Ltd. (1993) 203 ITR 1081 that Section 263 does not visualise a case of substitution of the judgment of the Commissioner for that of the assessing authority.

(iv) The revenue agrees with the principle laid down by the Supreme Court in the case of Malabar Industrial Co. Ltd. v. CIT . But the propositions made by the Hon'ble court in the said decision are not applicable to the facts of the present case. This is gbecause failure on the part of the assessing authority to make enquiries, makes an order erroneous as held by the Supreme Court in the cases of Rampyari Devi Saraogi v. CIT and Smt Tara Devi Aggarwalv. CIT (v) The assessees have contended that the order under Section 263 has been framed on certain issues, which were not part of the notice issued under Section 263. Notice under Section 263 was issued on the basis of materials available on record pertaining to the cost of units sold during the year as shown in the return of income in the light of the prevailing market price. Regarding house property income/ business income, the assessees have shown the leave and licence income entirely as business income for the earlier assessment years 2001-02 and 2002-03 whereas for the impugned assessment year, the assessees have bifurcated the income as income from house property and business income. This shift in the stand has provoked the Commissioner of Income-tax to make further enquiries on the issue. The cost of the built up units sold by the assessees in the relevant

previous year had to be recomputed because the transfer of built up area to M/s. L&T was not disclosed by the assessees in the returns. There is no restriction on the Commissioner to consider only those issues raised in the first show-cause notice. If subsequent issues come to the notice, those issues could again be considered by the Commissioner, on which an opportunity was given to the assessee. Therefore, it is not true to argue with the recomputation of the cost of construction was made by the Commissioner without hearing the assessee.

(vi) The revisional power conferred on the Commissioner of Income-tax under Section 263 are of wide amplitude. It enables the Commissioner to call for and examine the records of any proceeding under the Act. It empowers the Commissioner to make such enquiry as he deems Fnecessary. The above principles has been upheld by the Supreme Court in the case of CIT v. Shree Manjunathesware Packing Products & Camphor Works (1998) 231 ITR 533.

(vii) The only limitation on the power of the Commissioner under Section 263 is that he must have some materials which would enable him to form a prima facie opinion that the order passed by the assessing officer was erroneous insofar as it is prejudicial to the interest of the revenue. Once he comes to the conclusion on the basis of the material that the order of the Officer was erroneous and prejudicial to the interests of the revenue, the Commissioner is empowered to pass an order as the circumstances of the case may warrant. He may pass an order, enhancing the assessment or he may modify the assessment. He is also empowered to cancel the assessment and direct a fresh assessment. The Commissioner is fully empowered to adopt any one of the three courses indicated by the provisions of Section 263. Reliance has been placed on the decision of the Madras High Court in the case of CIT v. Sehasayee Paper & Boards Ltd. .

14. The Commissioner further argued at length on the question of C the profit arising out of the sale of built up units. Those arguments are as follows: (i) As per assessees' own version and the method of accounting followed by them, revenue from sale of unit is computed on an estimated basis of a percentage of the sale price. But the data and details furnished by the assessees have shown that the profit on sale of units on estimated basis has not been made out by the cissessees

on the d basis of any yardstick and they have not followed any consistent method.

(ii) The Commissioner has worked out the income on sale of the units on the basis of the materials furnished by the assess;ees themselves. He was justified in assessing the correct profit from the sale of the units as the ad hoc method adopted by the assessees did not provide for a correct accounting of cost of construction.p (iii) The assessees have contended that they were following project completion method whereas in fact according to their own statements, they were following work-in-progress method. The Commissioner in his order passed under Section 263 h as not disturbed the method of work-in-progress followed by the assessee except making mathematical calculation of profit on the basis of work-in-progress method rather than ad hoc percentage adopted by the assessee.

(iv) As per the revised accounting standard AS-7 issued in 2002, project completion method is not applicable in the matter of long-term projects involving construction of their own projects.

15. Regarding the nature of leave and licence income, the Commissioners argued that detailed discussions have been made in the respective revision orders establishing that the assessees have not rendered any service to the tenants and, therefore, no justification to treat part of rental income as business income. The assessees are not running business centres. Assessees were not in a position to explain why different treatment has been given for the service charges received from different tenants. The service charges are inseparable from the rental amount and the Commissioner has rightly revised the decision of the assessing authority on the issue.

16. We heard both sides in detail and examined the rival contentions carefully. We have gone through the orders on record in a detailed manner, in the light of the paper books filed before us, case laws referred and written submission placed.

17. The assessment orders involved in these cases have been passed on 29-12-2005. While the assessing officer has passed those orders, a series of judicial pronouncements were available on the subject of house property income vis-a-vis business income. Where an assessee claimed the carrying of the activity of

complex letting out of properties, the courts have held that whether the income is exclusively the income from house property or the income is exclusively business income or the income is of mixed character is to be decided on the basis of the facts and circumstances of each case. The courts have upheld the principle of division of such complex activities where assessees are letting out properties coupled with providing various services. The Supreme Court in the case of Karnani Properties Ltd. v.CIT has considered a case of an assessee letting out the properties as well as various services rendered to the tenants were the result of its activities carried on continuously in an organised manner with a set purpose and with a view to earn profits, those income need to be considered as business income. This decision was rendered by the Supreme Court on 27-8-1971. The Bombay High Court in the case of CIT v. Associated Building Co. Ltd. has considered an analogues case where the court held that running of several activities by the assessee involved the maintenance of safe and close supervision and the object of the activities was to earn income, such income would be in the nature of business income coupled with house property income on letting out of the properties. This judgment was rendered on 5-2-1982. A similar view was taken by the Calcutta High Court in the case of CIT v. Russell Properties (P.) Ltd. through their judgment dated 10-11-1981. The Gujarat High court in the case of CIT v. Sarabhai (P.) Ltd. (2003) 263 ITR 1973 has considered the issue in a very elaborate manner. The court explained that "income from house property" is an artificially defined income and the liability arises from the fact that the assessee is the owner of the property. The word "business" has been defined in Section 2(13) of the Income-tax Act, 1961, to include any trade, commerce or manufacture. This definition, being an inclusive one, is indicative of an extensive and expanded meaning rather than a restricted or narrow meaning. The court held that in view of this, the activities, which may amount to business need not necessarily be by way of trade, commerce or manufacture, or be in the nature of a profession. They may even consist of rendering of services as in the case of selling agents, managing agents and these services may be of a variegated character. Since a specific head of charge is provided for income from the ownership of house property, rents or other income B from the ownership of house property cannot be brought to tax under any other head. However, when the property has been let out not only as a

property but with services which is a complex letting, the income cannot be said to be derived from mere ownership of house property but may be assessable as income from business. The court thus concluded that if an owner holds a property for a business purpose and receives from his tenants rents which include charges for supplying various services, the owner would be chargeable under this section in respect of the annual value of the property and further under Section 28 in respect of the profits he makes by rendering the services to the tenants. A recent judgment of the Kerala High Court considered the dual character of income involved in the case of complex letting in the case of Attukal Shopping Complex (P.) Ltd. v. CIT which decision has been later on confirmed by the Supreme Court. In the said decision, the court has held that where the assessee is carrying on the complex activities of letting out the q property along with rendering of multifarious services, the income would be of dual character, one segment being property income and the other segment being business income.

18. All these decisions were available before the assessing officer at the time of passing the assessment orders. The assessing officer has followed the law declared by the courts through various judgments. Now the question is whether the facts of the case are answerable to the propositions made out in the above judgments. The assessees have let out on leave and licence basis only those units whose construction was completed and made functional. But the commercial complex as such undertaken by the assessees was not completed and reached finality. It was under construction in an appropriate stage. Therefore, the entire management of the property would be invariably the responsibility of the assessees and, therefore, in the hands of the assessees. Even though certain built up units were leased out to certain parties, construction p works were still going on and final finishing works were going on and the whole complex was under the operational control of the assessees. In such circumstances, it is only a matter of common place knowledge that the assessees will have to render number of services regarding security, car parking, water supply, electricity supply etc.

Therefore, the facts remained that the assessees have rendered services to the tenants.

19. In the above factual matrix, when the assessing officer has decided the issue in the light of the judgments available before him at the time of passing the assessment orders, it is not possible to hold that the orders of the assessing authority on this point were erroneous.

20. Regarding the computation of profit on sale of the built up area, there is no material on record to show that the assessees have deviated from the consistent method for the impugned assessment year 2004-05.

For the assessment years 2002-03, 2003-04 and 2004-05, the assessees have consistently estimated the profit on sale of built up area at 20% of the consideration. There are no materials available on files that the sale consideration stated in the agreements were false and some higher considerations have changed hands. The finding of the Commissioner in a different line is on the basis of cost of construction worked out by him where he has not included the cost of construction incurred by M/s. L&T Ltd. Thereby the Commissioner has reduced the cost of construction compared to the cost declared by the assessee. Further to the above, the Commissioner has included the market value of the built up area allotted to M/s. L&T Ltd. on the basis of the agreement between the assessees and M/s. L&T. Thereby he has increased the receipts. Therefore, the disparity pointed out by the Commissioner of Income-tax is the dual effect of reducing the cost of construction and increasing the amount of sale consideration. At this point, the Commissioner of Income-tax has over looked the fact that as per the agreement entered into between the concerned parties, the construction cost of the complex was to be borne by M/s. L&T Ltd., for which as consideration, the assessee had to allot 20% of the built up area. It means that the assessees did not receive any money consideration from L&T for that specified area. There is no reason to suspect the conditions stipulated in the agreement. In such circumstances, the view taken by the assessing officer is consistent and proper especially when compared to the earlier assessments. The assessees have time and again submitted that the profit income is worked out on an estimated basis and the ultimate position will be declared once the project is complete and the corresponding return is filed. This position has already been honoured by the assessees for the succeeding assessment year.

21. Therefore, in the above facts and circumstances of the case, we find that the assessing officer has accepted the profit reported by the assessees following the principle of consistency and the Commissioner of Income- tax has recomputed the profits on the basis of his opinion.

Therefore, the order of the assessing authority on this point also cannot be treated as erroneous.

22. In the facts and circumstances of the case, we conclude to state that the assessment orders passed by the assessing authority in these two cases cannot be held as erroneous. Accordingly, we have to hold that the orders passed by the Commissioner of Income-tax under Section 263 are not sustainable in law. Therefore, the revision orders passed by the Commissioner of Income-tax are hereby set aside.