

CHAPTER 5

SPECIAL PROVISION FOR CIVIL CONSTRUCTION

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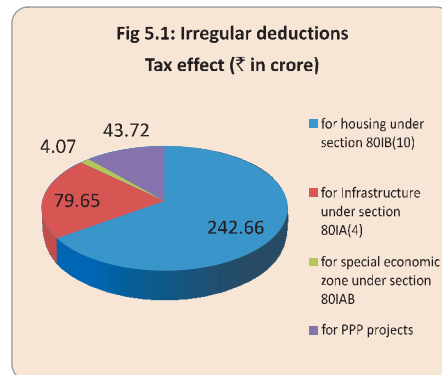
CHAPTER 5

SPECIAL PROVISIONS FOR CIVIL CONSTRUCTION

- Deductions admissible for housing projects under section 80 IB(10) and for infrastructure development under section 80IA(4) were allowed even though assesseees were not eligible to claim deductions as they did not fulfill the conditions provided in the Act. We noticed mistakes in 142 cases involving tax effect of ₹ 326.38 crore due to lack of proper monitoring of deductions granted for developing housing projects/ infrastructure.
- Mistakes in assessments of Public Private Partnership projects were noticed in seven cases involving tax effect of ₹ 43.72 crore relating to depreciation on Government leased assets, expenses against exempt income, escapement of income for not following regular method of accounting.
- We noticed 67 cases involving tax effect of ₹ 140.59 crore where revenue was not recognized by applying the percentage completion method as per Accounting Standard 7 as revised with effect from 2003.

5.1 Deductions for Housing/Infrastructure projects

The assesseees engaged in the business of civil construction availed irregular deductions falling in five major categories, namely; for development of housing projects under section 80IB(10) and infrastructure under section 80IA as well as for development of Special Economic Zone (SEZ) under section 80IAB and the deductions allowed in absence of audit report by the chartered accountant involving tax impact of ₹ 326.38 crore in 142 cases.



5.2 Deduction for developing housing projects under section 80IB(10)

The Act provides hundred per cent deduction to profits of an undertaking derived from the developing and building housing projects approved before, 31.03.2008 subject to fulfillment of certain conditions.

We observed 92 cases involving tax effect of ₹ 242.66 crore where deductions were allowed even though assesseees had not fulfilled either of the conditions as provided in the Act. Different categories of inadmissible deductions are discussed below:

5.2.1 Housing projects having excess commercial area

Charge: CIT-IV Delhi, AY 2007-08

As per conditions of admissibility, deduction under section 80IB(10) shall be admissible only if the built up area of the shops and other commercial establishments is not more than five per cent of the aggregate built up area of the housing project or 2000 square feet whichever is less.

M/s Eldeco Infrastructure and Properties Ltd. was allowed a deduction of ₹ 51.88 crore against a project with total built up commercial area of 15450 square feet¹⁹ in deviation of the condition stated above. The mistake resulted in short levy of tax of ₹ 23.23 crore.

5.2.2 Housing projects having excess built up area

Charge: CIT-II, Ahmedabad AYs 2006-07 & 2007-08

For claiming deduction under section 80IB(10), a residential unit must have built up area not exceeding 1000 square feet and 1500 square feet for Metro and non Metro cities respectively. Further, built up includes balconies and projections but does not include the common areas shared with other residential units.

M/s Ganesh Housing Corporation Ltd. (GHCL) was allowed deductions of ₹ 34.40 crore under section 80IB(10). Audit examination revealed that the built up residential area being 1677.76 sq feet exceeded the maximum permissible limit. Moreover, GHCL did not include the area of balconies and

projections including covered independent parking for working out the built up area. Thus, the deduction was inadmissible. The mistake resulted in short levy of tax of ₹ 14.55 crore. The Department has initiated action (July 2010) to reopen the assessments.

5.2.3 Filing return after due date

5.2.3.1 Charge: CIT-VI, Delhi, AY 2008-09

Section 80AC of Income Tax Act, 1961, provides that deduction under section 80IB shall not be allowed to an assessee unless he furnishes a return of his income for such assessment year on or before the due date specified under sub-section (1) of section 139.

M/s Unitech Ltd.²⁰ was allowed deduction of ₹ 30.14 crore under section 80IB (10) which was not admissible at all as the assessee filed the return on 02 April 2009, i.e. after due date of filing return on 30 September 2008. The mistake resulted in short levy of tax of ₹ 13.12 crore including interest.

¹⁹ Used in the name of shopping mall, Arcadia

²⁰ Assessment was completed under section 143(3) r.w.s. U/s 153A in December 2008

Department replied (February 2011) that the observation appeared to be correct and remedial action was being taken.

5.2.3.2 Charge: CIT- I, Hyderabad, AYs 2004-05 to 2008-09

Andhra Pradesh Housing Board, Hyderabad awarded work on a integrated township project with world class facilities²¹ to **M/s Cesma International Private Ltd**, at a project cost of ₹ 186.68 crore. The Return for 2005-06 was filed late. We found that AO did not charge the interest of ₹ 11.30 crore for delay in filing return of income. Besides, penalty of ₹ 1 lakh for delay in getting the accounts audited and delay in implementing the appellate orders by 9 months was also not levied.

5.3 Deduction for infrastructure development under section 80IA

Section 80IA(4) provides that where total income of an assessee includes profit and gains of an undertaking from eligible business, the assessee shall be eligible for specified deduction for specified period subject to fulfillment of certain conditions.

Mistakes in application of the above provision resulted in incorrect admission of deduction under section 80 IA (4) in 48 cases involving revenue impact of ₹ 79.65 crore. Different categories of inadmissible deductions are discussed below:

5.3.1 Irregular allowance of deduction under Section 80IA against works contract

Charge: CIT-I, Coimbatore, AYs 2004-05 &2005-06

Explanation below section 80IA(13) introduced by the Finance Act, 2007 in May 2007 with retrospective effect from 1 April 2000 provides that deduction under section 80-IA shall not be admissible to a contractor in respect of a works contract entered into with the undertaking or enterprise, as the case may be.

M/s Chettinadu Lignite Transport Services Ltd. was disallowed deduction of ₹ 12.03 crore under section 80IA for AY 2004-05 which was upheld by CIT(Appeal) but allowed by the ITAT in July 2007. Similarly deduction ₹ 12.26 crore for AY 2005-06, initially disallowed by

the AO, was allowed by CIT(Appeal) in March 2008, following the ITAT decision for the earlier AY. The assessee, being only a sub contractor executing a contract on behalf of others, was covered by the Explanation below section 80IA(13) introduced by Finance Act, 2007 in May 2007 and was not eligible for the said deduction. Non consideration of the Explanation brought out in the Act by the Finance Act 2007 resulted in irregular allowance

²¹ Named Singapore Sanskruthi Township at Pocharam village, Ghatkesar Mandal, RR District

of deduction aggregating ₹ 24.29 crore involving short levy of tax of ₹ 8.80 crore.

5.4 Deduction for development of Special Economic Zone (SEZ)

The section 80IAB provides that deduction at one hundred percent shall be admissible to an undertaking from any profits and gains derived from the business of developing a Special Economic Zone (SEZ), notified on or after 1 April, 2005 under the SEZ Act, 2005.

We found two cases involving tax effect of ₹ 4.07 crore as illustrated below:

5.4.1 Charge: CIT-II, Ahmedabad, AY 2007-08

M/s Mundra Port & Special Economic Zone Ltd. (MPSEZ) engaged in port operations and logistics had been allowed an expenditure of ₹ 120.39 crore which included a sum of ₹ 6.81 crore as a provision for “demurrage charges”, which were neither accrued nor known liabilities. Since the said provision was not laid out or expended wholly and exclusively for the purpose of business for the year under consideration, this was required to be added back for the purpose of computation of business income and chargeable to tax. This resulted in short levy of tax of ₹ 2.29 crore.

5.4.2 Charge: CIT-VI Mumbai, AYs 2006-07 & 2007-08

M/s. Mahindra Gesco Developers Ltd. was allowed deduction of ₹ 0.24 crore and ₹ 3.73 crore respectively under section 80IAB for developing an Export Processing Zone approved in September 2004, prior to April 2005 and hence, the deduction allowed was not in order. The mistake resulted in under assessment of income aggregating ₹ 3.97 crore involving short levy of tax amounting to ₹ 1.78 crore. Department stated in its reply that notice u/s 148 was issued to assessee in respect of assessment year 2006-07.

5.5 Mistakes In Assessments Of Public Private Partnership Projects

5.5.1 To encourage private investment in infrastructure, Governments have entered into PPP projects where a variety of fiscal concessions like tax incentives, revenue retention for a fixed lease period, etc. are being given. In order to identify revenue risks arising from assessments of incomes from these projects we test checked the assessment records pertaining to a few PPP projects. We found mistakes in the nature of depreciation on Government leased assets, expenses against exempt income, escapement of income for not following regular method of accounting involving tax effect of ₹ 43.72 crore in seven cases.

5.5.2 Depreciation on Government leased assets

The Act provides that owner of the asset is entitled to depreciation if the asset is used in the business. However, accounting standard AS 19 effective from 2001 requires finance leases to be capitalised in the books of lessee. CBDT has clarified that AS 19 will have no implication on the allowance of depreciation under the Act. The lessee will capitalize and depreciate the asset for accounting purposes and legal owner will continue to avail depreciation u/s 32.

In Andhra Pradesh we found four cases where the assessee claimed depreciation on roads/ bridges/toll ways, developed under PPP mode. As the assets belong to

Government and no commercial operations were involved, allowing claims of depreciation on these assets were not correct. These omissions resulted in incorrect allowance of depreciation involving tax effect of ₹ 31.41 crore. An illustration is given below:

5.5.2.1 Charge: CIT-III, Hyderabad, AY 2005-06

M/s Swarna Tollway Pvt Limited claimed depreciation of ₹ 63.54 crore on leased Government assets developed under PPP mode. As the said assets belonged to the Government, claim of depreciation was not correct. Omission to disallow the same resulted in incorrect allowance of depreciation with a potential tax of ₹ 23.25 crore.

5.5.3 Expenses against exempt income.

Section 14A of the Act provides for disallowance of expenditure incurred in relation to income not includible in total income. Further, Section 115JB requires companies to prepare their profit and loss account in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956.

We found a case where Government entities were forming joint venture companies with private developers and certain expenses unrelated to total income offered for tax were being incorrectly allowed for

deduction as illustrated below:

5.5.3.1 Charge: CIT-II Hyderabad AY 2007-08

M/s EMAAR Hills Township Pvt Ltd (EHTPL), a special purpose vehicle formed by the Andhra Pradesh Industrial Infrastructure Corporation (APIIC), with Emaar Properties PJSC, Dubai for development of world class Golf course with integrated township projects was allotted land by APIIC on 66 years lease in AY 2007-08 in return of 26 percent equity holding. The agreement mentioned that the accounting for the project would be to the mutual satisfaction of both the parties. EHTPL entered into another development agreement with Emaar-MGF Land Holdings Pvt. Ltd, for construction of villas, luxurious apartments etc on the leased land without permission of

Government of Andhra Pradesh thereby, violating conditions of PPP agreement. Against total sales of ₹ 5.36 crore, EHTPL offered a total loss of ₹ 4.40 crore adjusting other expenses of ₹ 15.74 crore. As the project was not developed by EHTPL and was ultimately entrusted to another company, the entire income of ₹ 5.36 crore received from Emmar-MGF Land Holdings Pvt Ltd should have been treated as sales commission received from sub contractor and brought to tax by disallowing the expenses of ₹ 15.74 crore. The omission resulted in entire income of ₹ 5.36 crore escaping assessment involving tax effect of ₹ 1.80 crore.

5.5.4 Escapement of income

Income under the head 'profits and gains of business or profession' is computed in accordance with the method of accounting regularly adopted by the assessee. Where the assessee follows the mercantile system of accounting, the profits and gains are worked out on due or accrued basis.

We found two cases of income escaping assessment involving tax effect of ₹ 12.74 crore as illustrated below:

5.5.4.1 Charges: CIT-IV Hyderabad & CIT-III Hyderabad, AY 2004-05

M/s **PVR Industries Ltd (PVRIL)** claimed ₹ 6.01 crore payable towards sub contract to M/s **Associated Engineering Enterprises (AEE)** whereas AEE admitted ₹ 3.82 crore as receivable from PVRIL for the same period which shows variation of ₹ 2.19 crore. Both the assessee had followed mercantile system of accounting. Hence, the difference, being excess claim of ₹ 2.19 crore needed to be disallowed. The mistake involved tax effect of ₹ 0.79 crore.

5.5.4.2 Charge: CIT- VI, Mumbai, AY 2007-08

M/s Ideal Road Builders Pvt. Ltd worked out surplus income of ₹ 26.70 crore pertaining to prior period after allowing certain deductions like amortization, maintenance expenses on Build Operate and Transfer (BOT) project. However, the Department did not consider the surplus as income. Omission resulted in underassessment of income by ₹ 26.70 crore with consequent short levy of tax of ₹ 11.95 crore.

5.6 Accounting issues:

The Section 145(2) of the Act provides that Central Government may notify accounting standards to be followed by any class of assessee or in respect of any class of income. Since civil construction projects take time, the business transactions spill over many accounting periods, leading to accounting problems. Our earlier report pointed out that there was a tendency among the entities engaged in civil construction to misuse the 'Project Completion Method' of accounting by postponing account of profits and thereby taxes indefinitely. We recommended that the stage of project completion be

defined for identifying proportional completion and accounting. The Accounting Standard on construction contracts (AS-7) was revised in 2003 which laid down that revenue from such ongoing contracts shall be recognised year after year on the basis of Percentage of Completion of such contracts.

The assessing officer is empowered²² to reject the accounts of the assessee if the same have not been prepared in accordance with the prescribed accounting standards and may proceed to determine the income on best judgment basis.

We noticed 67 cases involving tax effect of ₹ 140.59 crore where revenue was not recognised by applying the percentage completion method though advances were received from customers against sale of immovable properties as against work-in-progress/closing stock. Three cases are illustrated below:

5.6.1 Charge: CIT-III Kolkata, AYs 2006-07 & 2007-08

M/s Bengal Park Chambers Development Ltd commenced a housing project (Sunrise point) in August 2005 with likely completion by August 2008. Our analysis revealed that percentage of actual expenditure to estimated cost of the project was 18.27 and 51.51 upto March 2006 and March 2007 respectively. However the assessee did not recognize revenue as per AS 7. As a result, there was underassessment of income during above AYs having a revenue impact of ₹ 2.16 crore.

5.6.2 Charge: CIT-II Delhi, AYs 2004-05 & 2005-06

M/s Malibu Estates Pvt. Ltd. received full payment of ₹ 62.25 crore and ₹ 24.40 crore in the above AYs respectively against 392 and 234 properties ready for transfer in favour of customers. However, no revenue was recognised against these properties in the said assessment years. The omission to do so resulted in underassessment of income aggregating ₹ 86.65 crore involving short levy of tax of ₹ 41.49 crore.

5.6.3 Charge: CIT-IV Delhi, AYs 2005-06 & 2007-08

M/s DLF Commercial Developers Ltd. completed 66.74 per cent of its Hyderabad project under percentage completion method during 2007-08 and recognized revenue of ₹ 329.47 crore in the profit and loss account under the head 'Revenue from constructed properties'. The correct percentage of completion was 72.58 percent instead of 66.74 percent worked out by the assessee. In doing so, revenue of ₹ 28.83 crore from this project was short recognized as income of the assessee.

²² Section 145 (3) of the Act

Besides, the assessee purchased land valuing ₹ 185.77 crore and transferred land costing ₹ 68.69 crore to fixed assets. However, assessee claimed ₹ 144.97 crore expenses of land as against ₹ 117.08 crore. Further, during AY 2005-06, the assessee had shown ₹ 49.81 crore in transfer from work in progress as against closing stock of ₹ 43.83 crore during earlier assessment year. The mistakes involved tax aggregating ₹ 31.42 crore.

5.7 Recommendations

We recommend that

- *CBDT may issue necessary instructions to monitor the deductions allowed for housing and infrastructure projects by providing suitable checks through internal audit.*

(Para nos. 5.1 to 5.5)

CBDT stated (June 2011) that necessary instructions have been included in their Internal Audit Manual of 2011. They have assured further sensitization.

- *Assessing Officers may ensure that accounting treatment for ongoing construction projects commenced after April 2003 conform to Accounting Standard 7 as revised.*

(Para no. 5.6)

CBDT accepted (June 2011) the recommendation.