

AS-7 not mandatory for all real estate developers for working out profits

Summary – The Jaipur ITAT in a recent case of Krish Infrastructure (P.) Ltd., (the Assessee) held that It is not mandatory for all real estate developers to workout their profits by following percentage of completion method as prescribed by Institute of Chartered Accountants of India under AS-7.

Facts

- The assessee-company was engaged in business of developing and selling real estate projects. It filed Nil return of income both, for assessment years 2008-09 and 2009-10, by adopting project completion method.
- The Assessing Officer rejected the assessee's accounts on the ground that the assessee had not followed Accounting Standards-7 for recognition of revenue which required it to deduce income on the basis of percentage completion method by working out the profits at the end of each financial year as the projects were spread over in the series of financial years. He computed profit on percentage completion method and completed assessment.
- The Commissioner (Appeals) upheld the rejection of accounts as well as estimation of income by percentage completion method.

Held

- The assessee maintained complete books of account, which are duly audited by duly qualified chartered accountants. It has also maintained its account on mercantile basis by regularly applying project completion method. The assessee, in assessment for assessment year 2008-09, has also consistently followed the same method as was applied for assessment year 2009-10. The auditors have reported no change in method of accounting adopted by the assessee.
- The Delhi High Court in the case of *CIT v. Smt. V. Sikka* [1984] 149 ITR 73 has entertained a view that even for the first year, the method of accounting is deemed to have been employed if the same is shown to have been regularly employed in subsequent years as is also the case in appeal. The real estate developer is not a pure contractor but is a seller of flats/goods. It is not mandatory for all real estate developers to follow percentage completion method as prescribed by Institute of Chartered Accountants of India under AS-7.
- The Delhi High Court in the case of *CIT v. Manish Buildwell (P.) Ltd.* [IT Appeal No. 928 of 2011, dated 15-1-2011] has ruled that Accounting Standard-7 issued by the Institute of Chartered Accountants of India recognizes the position that in the case of construction contracts the assessee can follow either the project completion method or percentage completion method.

- Neither the revised Guidance Notes 2012 issued by the Institute of Chartered Accountants of India nor the 'Exposure Draft for Guidance Note on recognition of revenue' issued by the Institute of Chartered Accountants of India in 2011 are mandatory.
- It is the option of the assessee to follow either the completed contract method or the percentage completion method. The completed contract method followed by the assessee, in the instant case, therefore, could not be faulted with by the revenue authorities and on that basis it is neither correct nor justified to say that the accounts did not present correct and complete picture of its profits. The accounts rejected by the Assessing Officer on the basis adopted by him are, thus, not found tenable.
- The same result could be attained by any one of the accounting methods. The completed contract method is one of such methods. Under the completed contract method, the revenue is not recognized until the contract is completed. Under the said method, costs are accumulated during the course of the contract. The profit and loss is established in the last accounting period and transferred to the profit and loss account. The said method determines results only when the contract is completed. The method leads to objective assessment of the results of the contract. On the other hand, the percentage of completion method tries to attain periodic recognition of income in order to reflect current performance. The amount of revenue recognized under this method is determined with reference to the stage of completion and can be looked at under this method by taking into consideration the proportion that costs incurred to date bears to the estimated total costs of contract.
- Therefore, there is no justification in rejection of accounts by application of provisions of section 145(3) and changing the method from project completion to percentage completion method by the Assessing Officer.
- The ITAT held that such an exercise being beyond the scope of his power and as the decision as such taken by him being unjust and uncalled for, the Commissioner (Appeals) has erred in confirming his decision. Therefore, the order of the Commissioner (Appeals) is set aside.