आयकर अपीलीय अधिकरण,'एक-सदस्य' न्यायपीठ,मुंबई।

IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "SMC", MUMBAI

श्री जोगिन्दर सिंह, न्यायिक सदस्य, के समक्ष

Before Shri Joginder Singh, Judicial Member,

ITA No.2321/Mum/2015
Assessment Year: 2008-09

Income Tax Officer-32(1)(5), Room No.203, C-11, 2nd Floor, Pratyaksh Kar Bhavan, Bandra Kurla Complex, Bandra (E), Mumbai-400051	**बनाम**/ Vs.	M/s Empire Developers, Shop No.3, Opp. Wireless Station, S.V. Road, Dahisar East, Mumbai-400068
राजस्व / Revenue		निर्धारिती / Assessee
		P.A. No.**AACFE1641B**

राजस्व **की ओर से** / Revenue by	Ms. Mahua Sarkar -DR
निर्धारिती **की ओर से /** Assessee by	None

सुनवाई की तारीख **/ Date of Hearing**	**29/08/2016**
आदेश की तारीख /**Date of Order:**	**01/09/2016**

आदेश / O R D E R

The Revenue is aggrieved by the impugned order dated 27/01/2015 of the Ld. First Appellate Authority, Mumbai. The first ground raised pertains to allowing relief

of Rs.3,61,356/- u/s 36(1)(iii) of the Income Tax Act, 1961 (hereinafter the Act).

2. During hearing, the ld. DR, Ms. Mahua Sarkar, contended that the relief was granted to the assessee without appreciating the fact that no evidence for investment in AOP was filed and thus no income or loss was shown from AOP. It was also pleaded that interest bearing funds were diverted as advances to the sister concern, friends and family members without any business expediency and that too without charging any interest.

2.1. On the other hand, none was present for the assessee in spite of issuance of registered AD notice issued on 29/06/2016 & 13/07/2016. The assessee neither presented itself nor moved adjournment petition. It seems that the assessee is not interested to pursue the appeal filed by the Revenue, therefore, I have no option but to proceed ex-parte, qua the assessee, and tend to dispose of this appeal on the basis of material available on record.

2.2. I have considered the submissions of Ld. DR and perused the material available on record. The facts, in brief, are that the ld. Assessing Officer disallowed interest payment of Rs.3,61,356/- being capital introduced in M/s King Empire Developers (AOP), on the plea that the interest bearing funds were diverted, without charging any

interest, out of own funds. On appeal, before the Ld. Commissioner of Income Tax (Appeal) granted relief to the assessee, which is under challenge before this Tribunal. It is noted that the assessee gave loan and advances to the tune of Rs.23,68,000/- and also invested Rs.1,52,00,427/- in Kings Empire Developers and no interest was charged on these amounts. A show-cause notice was issued to the assessee by the Assessing Officer as to why the interest should not be disallowed u/s 36(1)(iii) of the Act as interest bearing funds were diverted as interest free loan and advances. The submissions of the assessee are summarized hereunder:-

> "The AO noticed that the assessee had debited Rs.43,16,645/- under the head 'interest on loan (Kurla) shown under Schedule F:Administrative Expenses. As per Tax Audit Report, the income received and paid is shown at Rs.Nil. The assessee has given loans and advances to the tune of Rs.23,68,000/- and also invested Rs.1,52,00,427/- in Kings Empire Developers and no interest has been charged on these loans. The assessee was issued a show-cause notice as to why the interest should not be disallowed u/s 36(1)(iii) as interest bearing funds are diverted as interest free loans and advances. To this, the assessee has submitted as under:-
>
> > We have to inform you that, we are a member of AOP M/s Kings Empire Developers and we have introduced capital in the said A.O.P., which is reflected under the investments in our Balance Sheet. We have the said capital introduction in the earlier years and the balance as on 31/03/2007 was Rs. 2,46,80,000/- and the dosing balance as on 31/03/2008 was Rs.1,52,00,428/-
> >
> > The said fact crystalises that , we have not made any new investment in the current year. On the contrary we have made withdrawal from the capital in M/s Kings Empire Developers, as our closing capital is reduced to Rs. 1,52,00,428/- from the opening capital of Rs. 2,46,80,000/-. The further crystalises that, since there is no new investment, there is no source for the same in the current year and hence the details

called for are not applicable to us ".

The AO has, however, not accepted the explanation accorded by the assessee since the assessee has apparently not filed any documentary evidence and also it is not explained as to why interest bearing funds have been diverted to interest free loans and advances to other concerns such as Kings Builders & Developers, Hitesh B. Mehta and Nazma Gulab Shaikh. Therefore, the AO has worked out the disallowance u/s 36(1)(iii) as under

Total loan fund as on 1.4.2007	Rs. 2,82,83,306
Total loan as on 31.3.2008	Rs.2,32,51,728
Interest expenditure debited	Rs.43,16,645
Interest disallowable Rs.23,68,000/- X 15.26%	Rs.3,61,356/-

During the course of appeal, the appellant has submitted that -

1. "The Assessee was a member of AOP of M/s. Kings Empire developers and the Assessee firm M/s. Empire Developers had introduced a capital in M/s. Kings Empire Developers. (Pg. No.8) The business activity of the AOP is also a construction of building and development or property / land.

2. As a member of AOP the assessee firm had made introduction of capital from borrowed funds for the same business activity of construction and development of property / land. The firm had paid an interest on such borrowed fund and claimed the deduction under section 36(1)(iii) of the Act. Section 36(1)(iii) of the Act provides that amount of interest in respect of capital borrowed for the purpose of business or profession shall be allowed as business expenditure. During the A.Y. 2008 — 2009, the same amount of capital introduction was reflected in the balance sheet as Investment.

3. The Assessing Officer failed to observe that said amount was invested in the earlier year and not for the current year. On 31/03/2007 the amount was Rs. 2,46,80,000/- (Pg. No. 25T) and as on 31/03/2008 it Was Rs. 1,52,00,427/- (PG. No. 8) i.e. The assessee firm had utilised the said borrowed funds for the purpose of business activity. And the Assessee had repaid a loan on such borrowings from the capital introduced in a AOP and claimed deduction u/s. 36(1)(iii).

4. During the Assessment Proceedings, the assessee had disclosed all the details before the Assessing Officer related to its business activity.

5. The Assessee further states that there is no question of earning income from the said investment made in Kings Empire Developers. When there is no investment in current year, then there is no question of producing documents for investment as it was available with the Assessee in the form balance sheet which was already in records before the Assessing Officer.

6. There was no any deficiency in the payment of interest. The Assessing officer had wrongly observed that the assessee had diverted its interest bearing funds to interest free loans and advances. And he had made disallowance of Rs. 3,61,356/- on the basis of opening and closing balances of the loans and advances and interest expenditure debited to profit and loss account. The Assessee had submitted the fund flow statement vide letter dtd. 27/08/2013.

7. Without prejudice to the above the main contention that the capital introduce in the AOP was out of own funds and it was in normal course of business activity, the assessee alternatively further submits that for the purpose of calculation of any disallowance, the opening balance pertaining to earlier years cannot be made available for advances during the year. Further the assessee has earned share of profit from AOP of Rs. 69,862/- (Pg. 6). The AOP is an independent assessee the assessee has a JV with Kings Empire Developer for development of Kurla Project. The ledger A/c of Kings Empire Developers is enclosed.

- CIT v. R L Kalthia Engineering & Automobiles (P.) Ltd. 7[2013] 215' Taxman 9 (Gujarat)(MAG.)

Interest paid on borrowed fund on ground that assessee had diverted interest bearing funds for purpose of investment in shares and loans to sister concern, since sufficient interest free funds were available with assessee, disallowance of interest expenditure was not permissible.

CIT v. Raghuvir Synthetics Ltd. (2013) 354 ITR 222 (Guj)(HC)

The transfer of the borrowed funds to a sister concern from the point of view of commercial

> expediency and not from the point of view whether the amount was advanced for earning profits. And considering the material on record and substantial interest-free funds and business expediency, no disallowance of interest was warranted for purpose of advance to sister concerns.
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> Venus Records & Tapes (P.) Ltd. v. Addl CIT (2013) 58 SOT 47(Mum)(Trib)
>
> Where the assessee had sufficient funds in shape of share capital and share application money out of which advance loan to its sister concern, interest paid on borrowed capital would be allowed under section 36(1)(iii)

- CIT vs HDFC Bank Ltd. (Bombay High Court)
- CIT vs Sridevi 192 ITR 165 Kar.
- ITO vs JMP Enterprises (2006) 101 ITD 324 (Asr)"

2.3. After considering the aforementioned submissions and the case laws, relied upon by the assessee, the Ld. First Appellate Authority concluded as under:

> "I have gone through the facts of the case and I find merit in the argument advanced by the appellant that the said amount was invested in the earlier year s and not for the current year and therefore, during the year, it cannot be held that interest bearing funds had been used to advance the interest free loans and advances. In light of this, the proportionate disallowance made by the AO cannot be upheld. The appeal on this ground is allowed."

2.4. If the observation made in the assessment order, leading to addition made to the total income, conclusion drawn in the impugned order, material available on record, assertions made by the ld. respective counsel, if kept in juxtaposition and analyzed, there is uncontroverted finding in the impugned order that the impugned amounts were invested in earlier years and not

in the current year. It is also noted that no evidence has been produced by the Revenue evidencing that the funds were diverted without commercial exigencies. So far as, making investment is concerned, it is the businessman who is to make the investment protecting his business interest. The Assessing Officer cannot be expected to sit in the chare of the assessee and decide in which manner the investment has to be made. Action can only be taken or disallowance can be made only in a situation when it is found that the investment or granting loans is contrary to the provisions of the Act. Therefore, I find no merit in the ground raised by the Revenue, consequently, the stand taken by the Ld. Commissioner of Income Tax (Appeal) is affirmed.

3. The next ground raised by the Revenue pertains to the direction to the Assessing Officer to treat Rs.50 lakh, compensation received by the assessee for cancellation of development agreement, as contractual receipt instead of chargeable as short term capital gain, held by the Assessing Officer.

3.1. The crux of argument advanced Ms. Sarkar, is identical to the ground raised. I have considered the submissions of the ld. DR and perused Before adverting further, I am reproducing hereunder the relevant finding of the Ld. Commissioner of Income Tax (Appeal) for ready reference and analysis:-

"During the course of assessment, the AO noticed that the assessee had furnished a copy of deed of cancellation between Chandralok Fabrics and the assessee which shows that the assessee is a developer and Chandalok Fabrics are the owners of land bearing CTS No.176 admeasuring 1677.27 sq.mts. of Village Pahadi, Taluka- Goregaon, District-Mumbai. The two had entered into a development agreement on 24.10.2005 for the development of the said property and the assessee had paid Rs.10,00,000/- to the owner as security deposit to be repaid to the assessee on completion of the entire development project. In the books of the assessee, the said amount was reflected as investment. However, the agreement has been cancelled subsequently and during the year, the assessee received Rs.50,00,000/- as compensation for the cancellation of the said agreement. The AO issued a show-cause to the assessee as to why the said Rs.50,00,000/- should not be treated as capital gains in the hands of the assessee. The assessee, on the other hand, has shown the said amount of Rs.50,00,000/- as contract receipts against which the assessee has shown cost of goods sold at Rs.37,60,077/-, resulting in a gross profit of Rs.12,39,922/-. Further, Administrative Expenses etc. have been booked against the said gross profit. The assessee was asked to justify the claim of expenses with documentary evidences. The assessee has submitted the details before the AO regarding various expenses incurred and claimed and has also made a submission as to why the said amount should not be treated as capital gains. The assessee has submitted before the AO that the said development agreement was cancelled due to the differences created between two parties and since the work had already been started and expenditure of Rs.37,60,077/- had already been incurred, therefore, Chandalok Fabrics agreed to compensate the firm for the monetary value of the expenditure incurred and the time devoted for the development work. The said amount **is** not for any transfer or sale of asset and therefore, cannot be treated as capital gains.

The AO has, however, not accepted the view of the assessee in view of the fact that the so-called deposit of Rs.10,00,000/- has been reflected by the assessee as investment in the balance sheet. The compensation received of Rs.50,00,000/- has, therefore, been reduced by the said Rs.10,00,000/- and balance Rs.40,00,000/- has been brought to tax as short term capital gain. The assessee is in appeal against this on the grounds that the assessee was neither owner nor had he purchased the said property and therefore, was not liable to capital gains.

Appellant's submissions

During the course of appeal, the appellant has reiterated the argument advanced before the AO and has also referred to the decision in the case of

> "3i Infotech Ltd. v. Addl. CIT (2014) 146 ITD 405 where the compensation had been received by the asscssee on losing its right to receive income in respect of services being rendered by the assessee to the bank. In the facts and circumstances of the case it is a loss of source of income to the assessee and compensation has been determined on the basis of the said loss. It is the case of the revenue that the amount received by the assessee should be considered as income in the nature of revenue. The ITAT held that the compensation received by the assessee was in the nature of capital and not liable for capital gain tax."

3.2. Considering the factual matrix and the judicial pronouncements, the First Appellate Authority conclude as under:-

> "I have gone through the facts of the case. It is an undisputed fact that there was an agreement between the assessee and M/s Chandralok Fabrics . It is also undisputed fact that the said agreement has been cancelled. It is also a fact which has been accepted by the AU that the expenses, as submitted by the appellant before the AO, have not been found to be wrongly claimed as not being incurred. The only line of argument being adopted by the AO is that because Rs.10,00,000/- was advanced by the assessee to M/s Chandralok Fabrics at the outset of the agreement and the same has been classified as investment by the assessee in its books, therefore, subsequently, receipt of Rs.50,00,000/- would also constitute capital receipt . This is clearly a misunderstanding of the factual situation of the said transaction. While definitely the said Rs.10,00,000/- constituted the security deposit which was to be repaid to the assessee on completion of the entire development work, however, it is certainly not a deposit in the nature of capital deposit and more importantly, in the manner that the agreement has been drafted and the project work started and then truncated, the amount of Rs.50,00,000/- comes through as a compensation/ reimbursement payment of the actual expenses incurred by the assessee as a developer in the said agreement. Once the AU is not doubting or debating the actuality of the expenses incurred by the assessee towards part of the development

> of the said project, then how can the payment made by. M/s Chandralok Fabrics to the assessee on this account, not be taken as reimbursement of expenses incurred by the assessee on this account in light of the fact that it was M/s Chandralok Fabrics that was the owner of the said property and after the completion of the development work, the entire property would have remained in the ownership and control of M/s Chandralok Fabrics. In my considered view, the AO has developed a misplaced understanding of the nature of the transaction by treating it as capital receipt. It is clear that the assessee has carried out the expenditure towards the performance of the development agreement. The AO, is therefore, directed to treat Rs.50,00,000/- as contractual receipt.
>
> The AO, is however, free to look into the genuineness of the expenses as claimed since from the assessment order it emerges that exercise has not been carried out. Also the AO may look into the net transaction value considering that Rs.10,00,000/- which was deposited by the assessee that M/s Chandralok Fabrics has not been shown as having been received back. The consolidated exercise may be carried out by the AO now.. The ground of appeal is allowed."

3.3. If the observation made in the assessment order, leading to addition made to the total income, conclusion drawn in the impugned order, material available on record, assertions made by the ld. respective counsel, if kept in juxtaposition and analyzed, there is uncontroverted finding in the impugned order that the assessee carried out the expenditure towards the performance of development expenditure. It is further noted that specific direction is there to the Assessing Officer that he is free to look into the genuineness of the expenses and relevant exercise was not carried out by the Assessing Officer. Considering the totality of facts, I don't find any infirmity in the direction to the Assessing Officer,

therefore, the conclusion drawn in the impugned order is upheld. Thus, this ground of the Revenue is also without any merit, consequently, dismissed.

Finally, the appeal of the Revenue is dismissed.

This order was pronounced in the open in the presence of ld. DR at the conclusion of the hearing on 29/08/2015.

Sd/-
(Joginder Singh)
न्यायिक सदस्य / JUDICIAL MEMBER

मुंबई Mumbai; दिनांक Dated : 01/09/2016

Shekhar, P.S/निजी सचिव

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त/ The CIT, Mumbai.
4. आयकर आयुक्त / CIT- , Mumbai
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

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