

IN THE HIGH COURT OF KERALA AT ERNAKULAM

PRESENT:

THE HONOURABLE THE ACTING CHIEF JUSTICE MR.ANTONY DOMINIC

&

THE HONOURABLE MR. JUSTICE DAMA SESHADRI NAIDU

THURSDAY, THE 11TH DAY OF JANUARY 2018 / 21 ST POUSHA, 1939

ITA.No. 27 of 2015

AGAINST THE JUDGMENT IN ITA 805/2013 of I.T.A.TRIBUNAL, COCHIN BENCH DATED
18-07-2014

APPELLANT

MUTHOOT FINANCE LTD
MUTHOOT CHAMBERS, BANERJEE ROAD, ERNAKULAM-682 018.

BY ADVS.SRI.P.BALAKRISHNAN (E)
SRI.MOHAN PULIKKAL
SRI.P.P.NARAYANAN
SRI.K.S.MENON (K)

RESPONDENT:

THE JOINT COMMISSIONER OF INCOME TAX,CIRCLE 1(2)
KOCHI.

R. BY ADV. SRI.JOSE JOSEPH, SC, FOR INCOME TAX

THIS INCOME TAX APPEAL HAVING BEEN FINALLY HEARD ON 11-01-2018,
THE COURT ON THE SAME DAY DELIVERED THE FOLLOWING:

ITA No.27 of 2015

APPENDIX

APPELLANT'S ANNEXURES;

ANNEXURE A: TRUE COPY OF THE ASSESSMENT ORDER DTD.12.12.2011 OF THE JT.COMMISSIONER OF INCOME TAX (OSD) CIRCLE 1(2), KOCHI.

ANNEXURE B: TRUE COPY OF THE ORDER DTD.23.10.2013 OF THE COMMISSIONER OF INCOME TAX (APPEALS) II, KOCHI.

ANNEXURE C: TRUE COPY OF THE ORDER DTD.18.7.2014 OF THE INCOME TAX APPELLATE TRIBUNAL, COCHIN BENCH.

ANNEXURE D: TRUE COPIES DEBIT NOTES DTD.29.3.2006 ISSUED BY SHUBH REALITY (SOUTH) PVT.LTD.

ANNEXURE E: TRUE COPY OF THE LETTER DTD.17.3.2006 ISSUED BY TNEB TO THE APPELLANT.

ANNEXURE F: TRUE COPY OF THE AGREEMENT DTD.29.3.2006 BETWEEN TNEB AND THE APPELLANT.

ANNEXURE G: TRUE COPY OF THE LETTER DTD. 4.2.2006 FROM THE APPELLANT TO SHUBH REALTY (SOUTH) PV.LTD.

ANNEXURE H: TRUE COPIES DEBIT NOTES DATED 16.2.2006 & 28.2.2006 ISSUED BY SHUBH REALTY (SOUTH) P.LTD.

ANNEXURE I : TRUE COPIES OF FINANCIAL STATEMENTS OF THE APPELLANT AS ON 31.3.06.

TRUE COPY

p.s.to judge

CSS/

Antony Dominic & Dama Seshadri Naidu, JJ.

I. T. Appeal No.27 of 2015

Dated this the 11th day of January, 2018

JUDGMENT

Dama Seshadri Naidu, J

Introduction:

The appellant-assessee, a public limited company, advances loans against the gold ornaments pledged with it. It established windmills in Tamilnadu. Of the amounts it spent, the Revenue doubted the nature of some. The assessee claims that it spent those amounts on infrastructure development; the Revenue, on the contrary, concludes that the expenditure relates to land development. What has the assessee spent on: infrastructure or land?

2. Equally in dispute is a certain investment. The assessee establishes a “new line of business.” It claims that the investment is from its own funds; the Revenue concludes that it is from the borrowed funds. What is the nature of assessee’s investment: revenue or capital?

Procedural History:

3. The appellant-assessee filed its return of income for the assessment year 2006-07. The Revenue reopened the assessment and determined a higher income. Aggrieved, the assessee filed an appeal before the Commissioner of Income Tax (Appeals), Kochi, (“CIT(A)”); it ended in dismissal, through an order, dated 23.10.2013. Further aggrieved, the assessee filed the second appeal, ITA No. 805/Coch/2013, before the Income Tax Appellate Tribunal, Cochin Bench (“the Tribunal”). It too failed. The Tribunal, through its order dated 18.07.2014, dismissed the appeal. So, the assessee came before this Court.

Facts:

4. The assessee advances loans against the gold ornaments pledged with it. On 16.11.2006 it filed its return of income for the assessment year 2006-07, declaring a total income of Rs. 34,07,48,202/-, eventually declared to be Rs.34,52,67,560/- under section 143(3) of the Income Tax Act, 1961 (“the Act”).

5. Through a notice, dt.16.03.2011, under section 148 of the Act, the Revenue reopened the assessment. Finally, it completed

the assessment; the Assessment Officer (“AO”) determined the total income at ₹35,74,65,160. In fact, AO disallowed ₹38,76,000 and ₹83,21,600—the depreciation claimed on the wind mills and interest on investment in the assessee’s new line of business, respectively.

6. Aggrieved, the assessee filed an appeal before the CIT(A) but to no avail. Further aggrieved, the assessee filed the second appeal, ITA. No. 805/Coch/2013, before the Tribunal, the result being no different. So, this appeal to us.

(a) Wind-Mills:

7. To be more specific, during 2005-06, the assessee purchased three windmills or Wind Turbine Generators. The assessee erected them at Kavalakurichi, Kadanganeri, and Kaduvettin in Tamil Nadu. They cost it ₹18,05,98,860. Out of this amount, the assessee paid ₹1,41,90,000 to M/s.Shubh Realty (South) Pvt. Ltd.

8. The breakup of ₹1,41,90,000 paid to Shubh Realty runs thus: ₹45,00,000 towards land purchase for erecting the three windmills; and ₹96,90,000 towards Infrastructure Development

Charges (IDC) paid to Tamil Nadu Electricity Board (“TNEB”). The assessee added all this expenditure to the cost of wind mills and claimed depreciation.

9. The AO treated ₹96,90,000 paid to TNEB for infrastructure development charges also towards the cost of land and disallowed depreciation on ₹38,76,000 (50% for second half additions).

(b) New-Line of Business:

10. During the same assessment year, the assessee entered a new line of business: He obtained a licence for operating an FM Radio, by paying ₹8,32,16,000 towards licence fee to the Ministry of Information & Broadcasting and Bharati. The assessee had its own funds—₹63.73 crore—as on 31.03.2005. But the AO assumed that the assessee borrowed capital for starting the new-line of business and, so, disallowed ₹83,21,600, which is 10% of the expenditure on the new-line of business.

Submissions:

Assessee's:

11. Sri Mohan Pulickkal, the learned counsel for the

appellant-assessee, has submitted that the assessee paid the land cost of ₹45 lakh separately. The rest of the expenditure, according to him, is towards infrastructure development, relatable to the Wind Turbine Generators.

12. To elaborate, Sri Mohan has contended that the debit notes, letters and agreements placed before the AO reveal that the amounts paid to TNEB through Shubh Realty were only towards infrastructure development charges. In other words, the work connected with the land—registration, easy and free access to land, the up-keep of the vacant area around, and so forth—was carried out by Shubh Realty. And the assessee paid it separately as was evident from the six debit notes, dated 16.02.2006 and 28.02.2006.

13. On the assessee's investment in the new-line of business, the learned counsel has contended that the AO, the lower appellate authority, and the Tribunal have discarded the audited statements of accounts. They in fact establish that the assessee had sufficient funds of its own to invest in the new business. So the disallowance of ₹83,21,600, out of the interest expenditure claimed, asserts the learned counsel, was grossly unjustified.

14. In the end, Sri Mohan submitted that the Tribunal ought to have appreciated that the proviso to Sec. 36 (1)(iii) “disallows deduction of interest only for the period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use.”

15. On facts, Sri Mohan contends that the assessee duly acquired the licence and, on its strength, it commenced work for setting up the FM Radio station. So it cannot be said that the asset was not “put to use.”

Revenue’s:

16. Sri P. K. Ravindranatha Menon, the learned Senior Counsel for the Revenue, in his usual methodical manner, took us through the entire record. He read out the salient aspects of the AO’s order, as well as both the appellate forums’.

17. The learned Senior Counsel, to put it briefly, has strenuously supported the concurrent findings of the AO and the other adjudicatory authorities. He has submitted that both the issues—the nature of expenditure and the source of investment—primarily turn on factual findings. Therefore, concurrent findings

of fact do not call for any interference.

18. Heard Sri Mohan Pulickkal, the learned counsel for the appellant-assessee and Sri P. K. Ravindranatha Menon, the learned Senior Counsel for the Revenue, besides perusing the record.

Substantial Questions of Law:

1. Has the Tribunal justified in confirming the disallowance of ₹38,76,000 out of the total depreciation claimed on the Wind Turbine Generators?
2. Has not the assessee established that its spending ₹96,90,000 was part of the capital cost to establish and operate the Wind Turbine Generators and that it is entitled to claim depreciation?
3. Has the Tribunal erred in confirming the disallowance of interest on investment expenditure the assessee incurred for establishing its new line of business, without examining the assessee's claim that it had sufficient interest-free funds and had no necessity to borrow?
4. Has not the assessee entitled to an allowance of interest-free expenditure under Sec.36(1)(iii) of the Act?

Discussion:

19. The appellant-assessee, primarily, advances loans against the gold ornaments. During 2005-06, the assessee purchased three

windmills and erected them in Tamil Nadu. They cost it ₹18,05,98,860. Out of this amount, the assessee paid ₹1,41,90,000 to M/s.Shubh Realty (South) Pvt. Ltd.

20. Shubh Realty, in turn, paid ₹96,90,000 towards Infrastructure Development Charges (IDC) to TNEB. The AO treated Rs.96,90,000/- paid to TNEB towards the cost of land and disallowed depreciation on ₹38,76,000 (50% for second half additions).

21. During the same assessment year, the assessee obtained a licence for operating an FM Radio—a new-line of business. It paid ₹8,32,16,000 towards licence fee to the Ministry of Information & Broadcasting and Prasar Bharati. The AO assumed that the assessee borrowed capital for starting this business. So he disallowed ₹83,21,600, which is 10% of the expenditure on the new-line of business.

22. To sum up, the AO disallowed ₹38,76,000 and ₹83,21,600—the depreciation claimed on the wind mills and interest on investment in the assessee's new line of business, respectively.

23. As seen from the record, the AO has concluded that the depreciation of ₹38.76 lac claimed on Wind Mills had actually been incurred for developing the land—not the windmill infrastructure. While affirming the AO's decision, the CIT (A) and the Tribunal held that the debit notes produced by the assessee itself revealed that the amounts were paid “towards IDC representing infrastructure development charges.” Guided by the expression “registration charges” in those debit notes, both the forums concluded that the entire cost had been incurred for developing the land because “registration” only concerns land.

25. Factual as it may seem, let us consider how sound the Tribunal's conclusion is.

26. Annexure D has three debit notes; they were raised by Shubh Realty on the assessee. They identically read thus: “Being amount paid to the TNEB on your behalf towards IDC-NOC, registration charges, processing and supervision charges for 1 WTG of 1250 KW at location ...” Annexure E, which predates Annexure D, is the communication from the TNEB to the assessee. The communication contains the conditions the assessee

had to comply with. Among those conditions or clauses 12 and 13, which read as follows:

12. The cost of electrical interfacing work, including the cost of infrastructure facility charges, will have to be borne by you. The interfacing lines will become Board's property on commissioning.

13. The difference in infrastructure facility charges, if any, in force at the time of commissioning of Wind Electric Generators is to be borne by the Developer.

Equally pertinent is condition 26, which reads thus:

27. Since the amount towards infrastructure development charges of Rs. 32.19 lakhs (at Rs. 25.75 lakh/MW) paid with the application of M/s. Shubh Reality (South) Pvt. Ltd., Valliyoor, is taken into your account and the same is not eligible for refund in future to Shubh Reality (South) Pvt. Ltd., Valliyoor.

27. From the debit notes and the TNEB's communication, one cannot help concluding that the amount was spent on developing the infrastructure of the Wind Turbine Generators. In these documents, the red herring that led the authorities seems to be the expressions such as "registration", "processing", "supervision". So they concluded that the entire expenditure was towards land development.

28. Regrettably, TNEB has nothing to do with the registration of land, much less with its development or processing. Neither the record reveals nor the revenue asserts that the assessee purchased the land from TNEB. That accepted, the land registration lies with the revenue, and its development with any other person or entity than TNEB.

29. From the record we also gather that the assessee paid the charges for “evacuating the land”, as seen from Annexure G. This is another red herring, so to say. Indeed, lexically to evacuate is to withdraw or depart from; vacate. *American Heritage Dictionary* (5th Ed.) gives these additional meanings: to excrete or discharge of waste from (the bowl, for example); to empty or remove the contents of (a closed space or container). The subject of Annexure G, a letter the assessee wrote to Shubh Reality, reads: “arranging land and TNEB evacuation for 3 nos. 1250 KW WTG.”

30. But the body of the letter, we must say, does not refer to TNEB’s evacuating the land. In the letter, the assessee merely asks Shubh Reality to arrange “for the land (a prox. 2 acres per WTG)”. The assessee also requires Shubh Reality to “pay

Infrastructure Development Charges (IDC) @ ₹32.30 lakh per WTG” to TNEB. Therefore, the Tribunal’s concluding that the expenditure was “more in the nature of administrative charges paid for getting permission for use of land/evacuation of land for unhindered space and hence the payment of NOC and registration” cannot be sustained.

31. To install the wind turbine generators, the assessee must have excavated some earth on the land it purchased. Such excavation, to our mind, does not amount to improving the land; rather, it amounts to a preparatory step for erecting the wind turbines. Therefore, the land evacuation, if any, must be taken as part of infrastructure development for establishing the windmills.

32. CIT (A) has observed that the assessee has separately paid to one Suzion Infrastructure Ltd for the infrastructure development and commissioning of the Wind Turbines: Wind Mill foundation, electrical yards, erection, installing, testing, and commissioning Transmission Lines. True. But do these payments constrain us to conclude that whatever was paid to TNEB must have been towards developing land, with which TNEB has

nothing to do? No.

33. So we are compelled to conclude that the AO and both the appellate authorities have misread and misapplied the evidence, and that has led to the perversity of findings. We reckon it to be a judicially reviewable error and accordingly set aside the Tribunal's finding on the depreciation. As a result, the depreciation of ₹38,76,000 (50% for second half addition) claimed on the windmills was allowed.

New Line of Business And Source of Capital:

34. The assessee assails the AO's disallowing ₹83.21 lakhs towards interest on investment expenditure the assessee incurred on its new the line of business.

35. To dilate, the assessee secured a licence to operate an FM Radio, investing ₹8,32,16,000, though it had not yet started the broadcast. In response to an AO's notice, the assessee maintained that it invested in the new line of business from its own funds and that it had no occasion to capitalize the interest. In other words, it had borrowed no capital. The AO disbelieved the assessee's assertions.

36. While rejecting the assessee's claim, the AO has found that that the company's balance sheet as on 31.3.2006 showed borrowed funds at ₹805.87 crore. Against this, the assessee's own funds, excluding the statutory reserves, are shown at only ₹77.98 crores. He concluded that the assessee had no influx of funds during the year, but had its borrowed funds increased by ₹100 crore. As a result, the AO worked out interest @10% on the investment, the total amounting to ₹83,21,600/-

37. In this context, we may examine section 36 (1) of the Income Tax Act.

36. Other deductions.— (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in Section 28—

(i) . . .

(ii) . . .

(iii) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession:

Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset [* * *] (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.

38. Section 28 concerns profits and gains of business or profession. Under section 36 (1) of the Act, if assessee pays interest on the capital borrowed for the business or profession, it can deduct the interest. But the proviso carves out an exception: the assessee may borrow capital to acquire an 'asset'—distinguished from 'business or profession'. Then, till the asset is used, the assessee cannot claim the deduction.

39. Indeed, the assessee asserted that it had its own net fund of ₹63.73 crores as on 31.3.2005; it submitted before the AO a copy of its audited financial statement.

40. Pithily put, the assessee objected to AO's capitalising interest. It contends that its new line of business is only an expansion of its existing business. It has also contended that it has not diverted funds to any third party. And so the investment must be treated as revenue expenditure.

41. As seen from the record, the authorities have concurrently held that the assessee has forayed into an entirely new business, and so whatever investment it has made must

amount to capital investment. Eventually, the authorities have held, applying the proviso to section 36 (1) (iii), that the assessee borrowed capital to acquire an asset (a licence to broadcast) and that the business had not commenced.

42. The Tribunal, while concurring with the primary and appellate authorities, has observed that to claim the benefit of expenditure, it must concern business carried on by the assessee, and the profits to be computed and assessed to tax should be earned after the business is set up. It has concluded on facts that, by the time the assessee claimed the tax benefit, it had not set up the business or made it operational; so the question of interest concession under section 36 (1) (iii) of the Act does not arise.

43. Indisputably, the assessee could not demonstrate to AO's satisfaction that it actually invested its own funds rather than those it borrowed. Thus, we find it difficult to upset the concurrent findings. Indeed, the assessee did enter a new line of business, unconnected to its existing business, and it had not by then commenced that new business.

44. So, we uphold the Tribunal's findings on the AO's

disallowing Rs.83.21 lac towards interest on investment expenditure the assessee incurred on its new the line of business.

45. To sum up, we answer the substantial questions of law one and two in assessee's favour; three and four in the Revenue's favour. Thus, the appeal is partly allowed.

No order on costs.

**sd/- Antony Dominic
Acting Chief Justice**

**sd/- Dama Seshadri Naidu
Judge**

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P.S.TO JUDGE