IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO. 375 OF 2013

The Commissioner of Income Tax-12,]
1st floor, Room No.121, Aayakar Bhavan,]
M.K. Road, Mumbai – 400 020] ... Appellant
Versus
M/s. Sane & Doshi Enterprises,]
12, Ali Chambers, Tamarind Lane,]
Fort, Mumbai – 400 023.] ... Respondent

WITH
INCOME TAX APPEAL NO. 5313 OF 2010
WITH
INCOME TAX APPEAL NO. 5592 OF 2010
WITH
INCOME TAX APPEAL NO. 6230 OF 2010
WITH
INCOME TAX APPEAL NO. 6232 OF 2010
WITH
INCOME TAX APPEAL NO. 6234 OF 2010
WITH
INCOME TAX APPEAL NO. 1498 OF 2011
WITH
INCOME TAX APPEAL NO. 1504 OF 2012
WITH
INCOME TAX APPEAL NO. 418 OF 2013
WITH
INCOME TAX APPEAL NO. 675 OF 2013

Mr. P.C. Chhotaray for the Appellants in all appeals.

Mr. S.C. Tiwari with Ms. Natasha Mangat for the Respondents in all appeals.

CORAM : S.C. DHARMADHIKARI &
A.K. MENON, JJ.

THURSDAY, 9TH APRIL, 2015

ORAL JUDGMENT : [Per S.C. Dharmadhikari, J.]

1. These appeals were heard together and are being disposed of by a common order. That is because common questions and submissions are raised by parties.

2. Both sides agree that for the sake of convenience, the facts in Income Tax Appeal No.5313 of 2010 can be referred to. The respondent-assessee before us is common to all appeals and it is engaged in the real estate business and constructed a commercial complex viz. May Fair Tower. It is stated to be a partnership firm registered under the Indian Partnership Act, 1932. It filed its return of income for the assessment year 2000-01 dated 25th October, 2000, declaring total income at Rs.5,51,81,680/- including rental income of Rs.45,57,272/- and claimed deduction under section 24(a) of the Income Tax Act,1961 (hereinafter referred to as the "IT Act") of Rs.11,39,318/-. This claim of the assessee was not accepted by the

Assessing Officer. The Assessing Officer treated the rental income as business income on the ground that the receipts from this property were on account of exploitation of commercial assets and as such, it is the business profit of the assessee. He further observed that the assessee is engaged in the business of construction of building with a view to sell the same and not for leasing it. Thus, leasing of unsold units is an integral part of its business. Hence the income earned on leasing was business income. The assessment order was passed on 29th March, 2006.

3. The assessee, aggrieved by this order, preferred an appeal before the Commissioner of Income (Appeals). The Commissioner passed an order on 19th September, 2006 (Annexure C) partly allowing the appeal. The Commissioner concluded that the claim of the assessee of expenses of Rs.45,00,000/- should have been allowed. Therefore, ground No.5 in the Memo of Appeal before the Commissioner and raised by the assessee came to be accepted.

4. The Commissioner also accepted the ground of the assessee and pertaining to the charge of rental income. The Commissioner found

substance in the assessee's grievance and held that this should be treated as income from house property. Thus, Grounds 2, 3 and 4 in the Memo of Appeal came to be allowed Ground No.5 was also allowed. However, the Assessing Officer's order to the extent of disallowance of Rs.1,80,000/- as compensation amount was confirmed. That is how the Commissioner partly allowed the appeal.

5. We are not concerned with the other aspect and particularly about the compensation amount. It is common ground that we are concerned with Ground Nos.2, 3, 4 and 5 which have been allowed by the Commissioner.

6. It is aggrieved by such an order of the Commissioner that the Revenue approached the Income Tax Appellate Tribunal and Bench at Mumbai by filing Income Tax Appeal No.6449/Mum/2006. By the impugned order dated 11th "December, 2008, the Tribunal proceeded to dismiss the appeal.

7. Mr. Chhotaray, the learned counsel appearing on behalf of the Revenue in support of these appeals tenders additional questions and

submits that these are additional substantial questions of law. That be taken into consideration and in addition to those proposed at pages 5 and 6 of the paper-book by the Revenue.

8. Mr. Chhotaray would also submit that there are some more issues in addition to those referred hereinabove. Mr. Chhotaray submits that they arise in Income Tax Appeal No.1498 of 2011, which pertains to assessment year 2006-07. Mr. Chhotaray submits that they arise from the allowance as deduction under section 24(b) of the IT Act as interest on borrowed capital. In Income Tax Appeal No.1504 of 2012 and which pertains to assessment year 2007-08, this additional question of law would also arise according to Mr. Chhotaray. Lastly, he would submit that in Income Tax Appeal No.418 of 2013 also, the additional questions would arise. This appeal pertains to assessment year 2008-09.

9. Thus, it is submitted by Mr. Chhotaray that the following questions are substantial questions of law :

(a) Whether on the facts and in the

circumstances of the case and in law, the Hon'ble Income Tax Appellate Tribunal was justified in directing the Assessing Officer to tax the rental income of Rs.45,57 lakhs as 'income from house property' and to allow deduction u/s 24 ignoring the fact that the income was received from the business asset of unsold flats shown as closing stock?

(b) Whether on the facts and in the circumstances of the case and in law, the Hon'ble Income Tax Appellate Tribunal was justified in directing the Assessing Officer to allow the claim of expenses of Rs.45 lakhs on account of provision for incomplete work ignoring the fact that there was no incomplete work in the project as is evident from the fact that assessee has received rental income out of closing stock shown by him ?

(c) Whether the rental income earned by the

assessee is a business income of the assessee earned on account of exploitation of the business assets or it was an income from house property ?

(d) Whether on the facts and in the circumstances of the case and in law, the Hon'ble Income Tax Appellate Tribunal was justified in treating the rental income as income from house property without appreciating that the assessee has maintained a consolidated profit and loss account treating the rental receipts as part of business receipts?

(e) Whether on the facts and in the circumstances of the case and in law, the Hon'ble Income Tax Appellate Tribunal was justified in treating the rental income as income from house property when the assessee had not maintained any separate account in respect of the income from the house property and all that the assessee has done

> was to take out the items of rental receipt and property taxes from the consolidated profit and loss account for separate consideration without taking out the corresponding proportionate expenses relatable to the rented property in the profit and loss account and at the same time has claimed the huge statutory deduction available for computation of income from house property under section 24(a).”

10. Mr. Chhotaray canvassed oral submissions and during the course of these oral arguments submitted that the appeals raise an important question and of law. In each of these appeals, the Tribunal lost sight of the fact that if the firm carries on business of development in real estate and has constructed buildings comprising of units or flats for sale, then, the unsold flats or units being given on lease by the firm would not enable it to claim the income derived therefrom as income from House property. Since the business of the firm is of development and construction of property, then, this income and which is derived from the stock of unsold units or flats is business income and ought to

be treated as such. Mr. Chhotaray's complaint was that by some jugglery or manipulation of the accounts, the assessee firm claimed the income derived from this lease transactions as income generated from house property. That was not permissible. Mr. Chhotaray has submitted that in each of these matters, the Tribunal lost sight of the fact that the unsold units were given on rent / leave and licence for earning income therefrom. The rental income from these unsold units has been shown as income from house property and huge deduction has been claimed under section 24(a) of the IT Act. However, the Assessing Officer noted that the assessee firm was formed with specific object of construction of buildings with a view to sell the units therein and not letting out the same. A business transaction of leasing of unsold units was thus nothing but a transaction to generate business income. The assessee maintains a consolidated Profit & Loss Account thereby combining its trading and rental receipts. However, to claim the deduction as above, it has taken out the rental receipts and property taxes and shown it under a separate head of income from house property. The Assessing Officer noticed this and strongly commented on the method of drawing up the Profit & Loss Account

by the assessee. He noted that certain expenditure like legal, professional and consultancy charges to the tune of Rs.6,52,000/- and which pertains to the rented property has been claimed as deduction again in computing the business loss. This amounts to a double deduction. If the income from house property is the subject matter of deduction, then, no separate deduction can be claimed in respect of any individual item of expenditure pertaining to the rented property.

11. Mr. Chhotaray has relied upon these findings in the Assessment Officer's order and by referring to the Partnership Deed dated 16th March, 1999 (clause 6 page 3 of the same), he would submit that upon examination of all this material, the Assessing Officer rightly concluded that the rental income is taxable as business income. The Profit & Loss Account was taken as the starting point and that is how the income from rent and leasing the house property was not treated as such, but as business income.

12. The assessee may have succeeded before the Commissioner and the Tribunal, but both missed the point that for the assessment years

2002-03, 2003-04 and 2004-05, the disallowance by the Assessing Officer was in the sum of Rs.97,48,551/-, Rs,99,23,274/- and Rs.1,08,34,876/-. This huge deduction under section 24(a) has been claimed and the revenue implications are, therefore, enormous. The Revenue, therefore, rightly asserted and by relying on case law that the exploitation of business assets would yield business income. Mr. Chhotaray has submitted that the judgments of the Hon'ble Supreme Court in the case of *Commissioner of Income Tax vs. Maheshwari Devi Jute Mills (1965) 57 ITR 36; Universal Plast Ltd. vs. Commissioner of Income Tax 237 ITR 454* and *Commissioner of Income Tax vs. Vikram Cotton Mills Ltd. (1988) 169 ITR 597* and finally the order passed by the Hon'ble Madras High Court in *Commissioner of Income Tax vs. V.S.T. Motors Pvt. Ltd. (1996) 226 ITR 155* clinch the issue.

13. Mr. Chhotaray submits that the tests have been laid down in the case of Universal Plast Ltd. (supra). They have been correctly applied by the Assessing Officer. Mr. Chhotaray, therefore, submits that when the conclusions of the Assessing Officer were based on perusal

of the Partnership Deed, the nature of the business of the firm, method of maintaining accounts, then, they should not have been interfered with by both the First Appellate Authority and the Tribunal. Both have lost sight of the fact that no separate accounts are maintained in respect of the properties which have been let out yielding rental income. One consolidated Profit & Loss account is prepared and on the right side of which trade receipts and rent receipts appear. The expenses are common. No separate account of expenses was maintained in respect of the property let out and from which rental income is received. The expenses pertaining to the let out properties merged with other expenses. There is no bifurcation of the expenses relating to properties let out for other business. It is this consolidated account which was audited. The apparent defect noted by the Assessing Officer in the assessment for the year 2005-06 would go to the root of the case. The assessee never contended that rental income should be separated from trade receipts and that is why single consolidated account was maintained.

14. If the accounts are maintained in the normal course treating the

entire receipts including rental income as business receipts, then, there is no question of claiming deduction under section 24(a). The problem arose when the assessee abruptly deviated from the accounting practice by taking out only two items – rental receipts and property taxes from house property and claimed huge deduction under section 24(a). For the reasons that have been assigned by the Revenue and noted hereinabove, particularly of non maintenance of separate accounts and bifurcation that the deduction was rightly disallowed. Mr. Chhotaray, therefore, submits that the jugglery and the manner in which the deduction was claimed indicated that the assessee was not acting *bona fide* and rather claiming double deduction.

15. Even in relation to this rental income, without prejudice and in the alternative if this income is treated as income from house property, then, the figures adopted by the assessee should not have been accepted straight away. The Commissioner and the Tribunal ought to have sent the matter back to the Assessing Officer to determine this allowable part of the expenditure and pertaining to the letting out of the premises. That is one more reason for which this Court should set

aside these concurrent orders.

16. Then Mr. Chhotaray addressed us on the issue of interest paid as capital brought in by partners. He submits that interest paid on partners capital is claimed as deduction under section 24(b). The assessment years 2006-07, 2007-08 and 2008-09 for which these deductions have been claimed indicate as to how huge sums have been mentioned. They are indicated at page 21 of the written note submitted by Mr. Chhotaray. Though rental income was generated in the earlier assessment years, such deduction was not claimed for the assessment years 2000-01, 2002-03, 2003-04, 2004-05 and 2005-06. Mr. Chhotaray submits that there are two commercial complexes Mayfair-I and Mayfair-II. The construction was completed in financial years 1999-2000 and 2001-2002 respectively. If the construction was carried out with the contribution of capital by partners and the interest paid on partners' capital as tabulated should be allowed, then, it is important to note that the Assessing Officer's order was set aside and this claim has been allowed by the Commissioner without any deduction. The matter has not been

examined by the Tribunal also at length. If the deduction has not been claimed under section 24(b) in respect of this borrowed capital and suddenly such a claim was made in the assessment year 2006-07, then, the Revenue was alerted. The Assessing Officer disallowed it. The explanation given for not making such a claim initially cannot be accepted. It is not satisfactory. If the assets were treated as stock-in-trade and yet the assessee proceeded to claim the deduction in respect of the income generated from leasing out of the flats / units as income from house property, then, this itself shows that conflicting claims were made. If the units constitute the stock-in-trade of the firm, then, dealing with such stock-in-trade would generate only business receipts. As the same reasoning has been adopted to disallow the interest claim, then, the conclusion of the Assessing Officer should not have been interfered with. There was actually no interest expenditure incurred on borrowed capital. All such claims were clearly an after-thought. The partnership capital could have been utilised for different purpose. There should be a clear link between the borrowed money and construction on the property. If no separate account is maintained in respect of the let out property, then, there is a grave doubt about the

claim of the assessee on deduction under section 24(b). For all these reasons he submits that such an important issue having been missed by the Commissioner and the Tribunal, we should proceed to entertain this appeal and allow it. Mr. Chhotaray has pointed out in his written submissions as to how this claim had been elaborated throughout by the Revenue. They have highlighted the conduct of the assessee. For all these reasons he submits that the Commissioner and the Assessing Officer were not in error with regard to this claim and their conclusions were based on the settled legal principles. The existence of the firm and independent of the partners is a principle which has been applied. If there is no such existence as distinct and understood in the case of a company, then, all the more this Court must interfere with the order of the Tribunal.

17. Even with regard to the third issue, Mr. Chhotaray submits that the provision of expenses of Rs.45 lakhs made for alleged incomplete work should be allowed as a deduction. This pertains to assessment year 2000-01. This could not be allowed because the Assessing Officer observed that there was no basis for such a claim. Buildings

have been completed and let out and, therefore, there was no justification for this provision. A new explanation was given before the Commissioner of Income Tax (Appeals) and the Tribunal which has been accepted by the said authorities. Therefore, if they were inclined to take a different view, they ought to have sent the matter back to the Assessing Officer.

18. Mr. Chhotaray's submissions have been countered by Mr. Tiwari appearing for the assessee by pointing out that the additional questions which are proposed have never been subject matter of any arguments either before the Commissioner or the Tribunal. He submits that the appeal before the Tribunal was that of the Revenue. The Revenue could have very well raised all these grounds and requested the Tribunal to consider them. If none of these grounds and now proposed during the course of arguments have been taken up before the Tribunal, then, this Court should not allow them to be raised for the fist time. They do not arise from the impugned orders. The only ground on which the Assessing Officer's order was sought to be supported by the Revenue before the Tribunal was that rental income

was received from business assets and shown as closing stock. Therefore, the additional two questions proposed for assessment year 2000-01, 2002-03 to 2005-06 and first two additional questions proposed for assessment year 2006-07 are identically worded but do not arise. In any event, non maintenance of a separate Profit & Loss account for rental income cannot be a reason for denying the deduction. These questions are based on clearly untenable and erroneous premise that heads of income for the purpose of assessment under Income Tax Act depend upon the treatment given in the assessee's books of account. Mr. Tiwari submits that the computation of income chargeable to income tax is a question that has to be decided on the touchstone of the provisions of the Income Tax Act, 1961, as applicable to the particular case. The treatment given or not given in the assessee's books of account does not decide the assessee's tax liability. In that regard, reliance is placed on *Kedarnath Jute Manufacturing Company Limited vs. Commissioner of Income Tax 82 ITR 363* and *Sutlej Cotton Mills Ltd. vs. Commissioner of Income Tax, 116 ITR 1*. Mr. Tiwari submits that as far as assessment year 2006-07 onwards are concerned, there is no income from sale of apartments.

In none of the assessment orders, the Assessing Officer has found any fault with the Profit & Loss account of the respondent-assessee because in the return of income, the income from house property has been separately computed. Now, a different question cannot be proposed by the Revenue.

19. Mr. Tiwari also points out that as far as the assessment year 2006-07 is concerned for which an additional question is proposed, it is submitted that upto the year 2005-06, the premises were reflected as stock-in-trade because the respondent-assessee was carrying out sale of apartments also. From 2006-07 onwards all apartments have been let out on rent and there is no trading income. For this reason, the deduction of interest under section 24(b) of the Act has been claimed from assessment year 2006-07 onwards and not in earlier years. The Tribunal has duly noted this fact. Mr. Tiwari also relies upon the Indian Partnership Act, 1932 and particularly section 13 thereof to submit that interest on capital and taken from the partners is a permissible. The law does not oblige the assessee to use his own funds for carrying out business and it can also be carried out with the

borrowed funds. Similarly, the assessee's own funds can be utilised for non business purposes. It is only when certain amounts are designated as repayment or borrowed funds from a partner, the assumption as made by the Revenue cannot be made. In these circumstances, the Tribunal was in no error in rejecting this ground of the Revenue. Mr. Tiwari was at pains to point out that the Revenue has substituted the main questions in Income Tax Appeal No.675 of 2013 and Income Tax Appeal No.775 of 2013 because the counsel for the Revenue realises that for these two assessment years, there is no closing stock. Similar, substitution is called for assessment year 2006-07 also in Income Tax Appeal No.1498 of 2011. In the circumstances, Mr. Tiwari would submit that this Court should only focus on the main question and which is the objection of the Revenue for treating the income generated by leasing of the unsold flats or units as income from house property. It is submitted that the Revenue persists in making such arguments and in that regard reliance is placed by Mr. Tiwari on the order passed by this Court in the case of *Mangala Homes Private Limited vs. Income Tax Officer & Ors. 325 ITR 281* and the judgment of the Hon'ble Supreme Court in the case of *East*

India Housing and Land Development Trust Ltd. vs. Commissioner of Income Tax (1961) 42 ITR 49. Mr. Tiwari submits that the reliance on *Universal Plast (*supra) by the Revenue is misconceived. There leasing out the factory as distinguished from the factory building was in issue. Whether the income from that should be assessed under the head "profits and gains of business or profession" or "income from other sources" was the further aspect under consideration. In that decision the Hon'ble Supreme Court did not consider as to whether such income could be termed as income from house property. Therefore, the parameters relating to income from other sources would not apply. For all these reasons, it is submitted that the Revenue appeals are in the nature of seeking a re-appreciation and re-appraisal of the factual materials and, therefore, they deserve to be dismissed.

20. We have, with the assistance of the learned counsel appearing on both sides, perused the Memo of Appeals and which are stated to be raising the above questions. They are common to all and, therefore, the Revenue as also the assessee's counsel pointed out that we need not separately refer to each and every Memo of Appeal and

its annexures. Thus, we are not required to refer to all the Memos of Appeal and the individual facts therein or the view taken by the authorities under the I.T. Act simply because the points or questions raised are common to all of them. We have noted not only the rival stands as emerging from the oral arguments, but from the written submissions only because Mr. Chhotaray submits that the enormity of the Revenue and the impact of the view taken by the Tribunal on other matters requires us to give an in-depth consideration. If this order has become rather bulky, then the reasons for the same are obvious.

21. The Tribunal had before it, the appeal of the Revenue and which according to the Revenue challenges the order of the Commissioner and the Income Tax (Appeals) on various grounds. The three grounds which have been projected and emphasised pertain to treatment of total income as income from house property and allowing deduction under section 24 ignoring the fact that the income was received from the business asset (unsold flats) shown as closing stock. The other was the direction of the Commissioner to the Assessing Officer to allow the claim of expenses of Rs.45 lakhs on account of provision for

incomplete work. The Tribunal noted the rival contentions. It found that there is no dispute that the assessee was engaged in construction business and has constructed a commercial property known as May Fair Tower. The unsold portion of the property was let out and assessee earned rental income therefrom. The Tribunal found that if rental income earned by the assessee could be treated as business income as claimed by the Revenue, or income from house property, is an issue which has been repeatedly raised and considered. An identical issue, according to the Tribunal, was raised before the Hon'ble Supreme Court in the case of *East India Housing and Land Development Trust Ltd. vs. Commissioner of Income Tax (1961) 42 ITR 49.* The Hon'ble Supreme Court held in that case that the assessee company was incorporated with the object of also developing landed properties. The construction of shops and stalls on purchased lands was made and these were let out to different tenants. The question arose as to whether rental income received by the assessee is an income from house property or a business income. The Hon'ble Supreme Court, according to the Tribunal, concluded that income received from tenants or shops and stalls by the assessee company is

liable to be taxed as property income and not as a business income. In relation to that, the Hon'ble Supreme Court further held that income from tenants of shops and stalls is income from house property and the distinct head specified in the erstwhile Income Tax Act of 1922 could be pressed into service. These are mutually exclusive claims of deduction. The character of rental income is not altered just because it was received by a company formed with the object of developing and setting up markets or because occupants are not permanent.

22. Then the Hon'ble Supreme Court decisions and rendered later than this judgment in East India (supra) have been referred by the Tribunal including some of the High Court judgments and the parameters laid down therein. The Tribunal found that the Commissioner examined this issue in detail. Para 2.23 of the Commissioner's order with specific references to the legal provisions have been reproduced in the Tribunal's order. The Commissioner held that the assessee has constructed a building of which it is owner and received income from letting out some portion of this house property. It continued to receive the same even till the date of passing of the

order by the Commissioner. The Commissioner referred to some of the decisions and held that the rental income has been shown as income from house property by the assessee-company. The matter was viewed differently by the Assessing Officer. However, the Tribunal decisions and the judgments of the Hon'ble Supreme Court and some of the High Courts and referred by the Commissioner dealt with identical claim. If the assessee company is engaged in the business of construction and real estate development and it earned income in the form of rent from the tenants / lessees to whom the property was let out, then, whether the property is held as stock-in-trade or otherwise is not what is material. The real and main issue is whether this income is earned in the capacity as a trader or in the capacity of the owner of the premises. If the property belongs to the assessee and part of it which was unsold has been let out, then, the income generated therefrom has been treated as income from house property. The Commissioner's order, therefore, was confirmed by the Tribunal. The Tribunal held that since correct tests and parameters have been applied and the facts and circumstances in the assessee's case are identical to some of the decisions rendered by the Hon'ble

Supreme Court, then, there is no legal infirmity in the findings of the Commissioner.

23. If the Tribunal also had before it the Profit & Loss account and it referred to the treatment given by the assessee therein, then, we do not find how the Revenue can complain otherwise.

24. We have before us a copy of the judgment of the Hon'ble Supreme Court in the case of *East India Housing* (supra). There, the appellant company which was incorporated with the object of buying and developing landed properties and promoting and developing markets, purchased 10 bighas of land in the town of Calcutta and set up a market therein. The question was whether the income realised from the tenants of the shops and stalls was liable to be taxed as business income under section 10 of the Income Tax Act, 1922, or as income from property under section 9. After the rival contentions were noted, this is what the Hon'ble Supreme Court has held :

> *" The appellant contends that because it is a company formed with the object of promoting and developing markets, its income derived from the shops and stalls is liable to be taxed under section 10 of the*

Income-tax Act as "profits or gains of business" and that the income is not liable to be taxed as "income from property" under section 9 of the Act. The appellant is undoubtedly, under the provisions of the Calcutta Municipal Act, 1951, required to obtain a licence from the Corporation of Calcutta and to maintain sanitary and other services in conformity with the provisions of that Act and for that purpose has to maintain a staff and to incur expenditure. But, on that account the income derived from letting out property belonging to the appellant does not become "profits or gains" from business within the meaning of section 6 and 10 of the Income-tax Act. By section 6 of the Income-tax Act the following six different heads of income are made chargeable : (I) salaries, (2) interest on securities, (3) income from property (4) profits and gains of business, profession or vocation, (5) income from other sources and (6) capital gains. This classification under distinct heads of income, profits and gains is made having regard to the sources from which income is derived. Income-tax is undoubtedly levied on the total taxable income of the taxpayer and the tax levied is a single tax on the aggregate taxable receipts from all the sources; it is not a collection of taxes separately levied on distinct heads of income. But the distinct heads specified in section 6 indicating the sources are mutually exclusive and income derived from different sources falling under specific heads has to be computed for the purpose of taxation in the manner provided by the appropriate section. If the income from a source falls within a specific head set out in section 6, the fat that it may indirectly be covered by another head will not make the income taxable under the latter head.

The income derived by the company from shops and stalls is income received from property and falls under the specific head described in section 9. The character of that income is not altered because it is received by a company formed with the object of developing and setting up markets. In United Commercial Bank Ltd. v. Commissioner of Income-tax,

this court explained after an exhaustive review of the authorities that under the scheme of the Income-tax Act, 1922, the heads of income, profits and gains enumerated in the different clauses of section 6 are mutually exclusive, specific head covering items of income arising from a particular source.

In Fry v. Salisbury House Estates Co. Ltd. a company formed to acquire, manage and deal with a block of buildings, having let out the rooms as unfurnished offices to tenants,was held chargeable to tax under Schedule A to the Income Tax Act, 1918, and not Schedule D. The company provided a staff to operate the lifts and to act as porters and watch and protect the building; and also provided certain services such as heating and cleaning to the tenants at an additional charge. The taxing authorities sought to charge the income from letting out of the rooms as receipts of trade chargeable under Schedule D, but that claim was negatived by the House of Lords holding that the rents were profits arising from the ownership of land assessable under Schedule A and that the same could not be included in the assessment under Schedule D as trade receipts.

In Commercial Properties Ltd. v. Commissioner of Income-tax, income derived from rents by a company whose sole object was to acquire lands, build houses and let them to tenants and whose sole business was management and collection of rents from the said properties, was held assessable under section 9 and not under section 10 of the Income-tax Act. It was observed in that case that, merely because the owner of the property was a company incorporated with the object of owning property, the incidence of income derived from the property owned could not be regarded as altered; the income came more directly and specifically under the head "property" than income from business.

> *The income received by the appellant from shops is indisputably income from property; so is the income from stalls from occupants. The character of the income is not altered merely because some stall remain occupied by the same occupants and the remaining stalls are occupied by a shifting class of occupants. The primary source of income from the stalls is occupation of the stalls, and it is a matter of little moment that the occupation which is the source of the income is temporary. The income-tax authorities were, in our judgment, right in holding that the income received by the appellant was assessable under section 9 of the Income-tax Act.*
>
> *The appeal, therefore, fails and is dismissed with costs.*

25. We do not find that the emphasis by Mr. Chhotaray and on certain aspects which allegedly missed and escaped the attention of the Tribunal would enable us to take any different view. Even if what has been emphasised by Mr. Chhotaray is taken into account, what the underlying test and as evolved throughout is whether the income has been derived from property. The treatment given in the books of account as stock-in-trade would not, therefore, alter the character or the nature of the income as held by the Hon'ble Supreme Court. If there is a test and which is in the field and emerging from repeated judgments rendered either by the Hon'ble Supreme Court or by other High Courts, then, even if Mr. Chhotaray's additional questions are

taken into account, a different conclusion cannot be reached. Mr. Chhotaray was at pains to rely on certain judgments and wherein, according to him, the treatment given to the income would be decisive.

26. Let us now refer to some of the judgments. The main emphasis of Mr. Chhotaray was on the judgment of the Hon'ble Supreme Court in the case of *Universal Plast Ltd. vs. Commissioner of Income-tax (1999) 237 ITR 454*. There, the facts emerging from the judgment itself denote that the assessee set up a factory styled as "UPL Factory" for carrying on the business of manufacturing PVC sheets and allied products. The assessee suffered losses for two years. It then entered into an agreement styled as "leave and licence" agreement with M/s. Leatherite Industries Limited for a period of seven years commencing on 30th March, 1977. This was an agreement containing a renewal clause and further stipulations. They would denote that the licencee was to pay licence fee in the sum determined and twenty-five per cent of the net profit of the factory in question with effect from 1st April, 1977. For the first three months which fell in the accounting year

relevant to the assessment year 1977-78, the assessee received only licence fee of Rs.6,00,000/- as no profit was earned by the licencee during this period. That amount was shown by the assessee as part of the business income. The Income-tax Officer did not accept that it was business income and assessed the same as income from other sources. The Commissioner of Income-tax (Appeals), however, accepted the plea of the assessee that it was its business income and allowed the appeal on 27th April, 1985. The Revenue unsuccessfully appealed against the order of the appellate authority before the Income Tax Appellate Tribunal. However, the Tribunal drew up a statement of case and referred the questions of law which have been reproduced in the Supreme Court judgment. These two questions of law are whether the Tribunal was correct in holding that the income received by the assessee by leasing out the factory was business income. Similarly, in the Andhra Pradesh case, whether leasing out of godowns and the letting of the factory with machinery constituted business income of the assessee or not. It is in relation to these questions that the rival contentions have been noted and thereafter the judgments of the Supreme Court in the field. It is thereafter that the propositions have

been summarised and which read as under :

> *"(1) no precise test can be laid down to ascertain whether income (referred to by whatever nomenclature, least,amount, rents, licence fee) received by an assessee from leasing or letting out of assets would fall under the head "Profits and gains of business or profession";*
>
> *(2) it is a mixed question of law and fact and has to be determined from the point of view of a businessman in that business on the facts and in the circumstances of each case, including true interpretation of the agreement under which the assets are let out.*
>
> *(3) where all the assets of the business are let out, the period for which the assets are let out is a relevant factor to find out whether the intention of the assessee is to go out of business or to come back and restart the same.*
>
> *(4) if only a few of the business assets are let out temporarily, while the assessee is carrying out his other business activities, then it is a case of exploiting the business assets otherwise than employing them for his own use for making profit for that business; but if the business never started or has started but ceased with no intention to be resumed, the assets also will cease to be business assets and the transaction will only be exploitation of property by an owner thereof, but not exploitation of business assets."*

27. We cannot ignore the fact that when the assessee was in business, set up factories and entire infrastructure for carrying out certain manufacturing activities suffered losses and thereafter inducted a third party as licencees therein to continue the business. In that

really it was found that the assessee generated the income as licence fees and a share in profits. Admittedly and undisputedly this was generated from the factory and from the godowns which have been given on leave and licence basis. It is in relation to that the Supreme Court held that it is important to lay down a precise test as to whether an income be given the nomenclature, lease amount, rents, licence fee received by an assessee from leasing or letting out of assets would fall under the head "Profits and gains of business or profession". Pertinently the Supreme Court held that it is a mixed question of law and fact and has to be determined from the point of view of a businessman in that business, on the facts and in the circumstances of each case, including true interpretation of the agreement under which the assets are let out. Where all the assets of the business are let out, the period for which the assets are let out is a relevant factor to find out whether the intention of the assessee is to go out of business or to come back and restart the same.

28. We do not think that the reliance by Mr. Chhotaray on this decision is well placed. The tests which have been evolved by the

Hon'ble Supreme Court and which are summarised and noted above themselves indicate that the matter has to be approached by referring and taking into account the facts and circumstances of each case. These are not general tests or rules which have been laid down. They have been evolved and that is how we do not think that reliance by the Revenue on this decision would carry the matter any further. Equally, we do not think that any factual aspect and particularly on the conduct of the assessee and the treatment or non treatment in the books of account would carry the matter further. Eventually, the character and nature of the income is determinative and decisive and it is not the treatment that the assessee gives it in its books of account which would enable us to come to any conclusion. If the legal propositions which have been invoked and the deductions claimed are to be granted by applying the tests evolved and the parameters laid down, the governing conditions would be as to whether the deduction is permissible given the clear language of the section or provision and whether that is applicable to the facts and circumstances of a given case. Similarly, we do not think that the reliance on the judgment of the Hon'ble Supreme Court in the case of *Commissioner of Income-*

tax vs. Maheshwari Devi Jute Mills Ltd. would assist the Revenue. The Madras High Court case ought to be then noticed. There, the assessee was a company carrying on business as authorised dealers in Tata diesel vehicles in a building on Mount Road in Madras. The building consisted of three floors including the ground floor. While the ground floor and the first floor were used for the assessee's business, the second floor was let out to a Government department. In the assessment years 1975-76 and 1976-77, the assessee claimed that the rental receipts in respect of the second floor should be considered under the head “business” as the entire property has been constructed with a view to use the same for the purpose of its business and that the surplus accommodation due to its shifting of branches outside Madras was let out. The Income-tax Officer rejected the contention and treated this income as income from property disallowing the deduction claimed under the head “business” towards repairs. The matter was carried by the assessee before the Tribunal and it allowed the claims. On a reference by the Tribunal, the Hon'ble High Court of Madras held that as the building in question was a commercial asset, the assessee could exploit it either by itself or by letting it to others.

Therefore, in a matter like this, the fundamental position that had been asserted was whether a particular building or premises was a commercial asset or a house property. If the premises were a commercial asset, then, the income derived therefrom would amount to business income, otherwise it would be income derived from property assessable under the head "Property income". If on the facts, the Tribunal found that this was a commercial asset of the assessee used by it from the very beginning as such, then, the letting out of the second floor premises and the income derived by way of rent therefrom was rightly assessable under the head "business income". In holding and taking the above view, the Hon'ble Madras High Court distinguished the judgments and particularly in the case of *East India Housing and Land Development Trust Ltd*. We do not think that such a view and essentially confined to the facts of that assessee's case would enable the Court on the Revenue in this matter to interfere with the concurrent findings of the Commissioner and that of the Tribunal. Eventually, as the Madras High Court held, the fundamental position had to be ascertained and that was whether a particular building or premises was a commercial asset or a house property.

29. We do not think that when the Tribunal relied upon the judgment of the Hon'ble Supreme Court in the case of *East India Housing*, it had committed any error of law or acted perversely. Therefore, assuming that we can allow any mixed questions to be raised for the first time, raising them does not enable the Revenue to urge and contrary to what is held by the Tribunal.

30. The position also appears to be identical in the case dealt with by the Hon'ble Supreme Court in *Commissioner of Income-tax v. Vikram Cotton Mills Limited*. There as well, the property came to be mortgaged and what was before the Supreme Court was the fact that the High Court, with the approval of the assessee and the creditors evolved a scheme where under the business assets of the assessee were let out to M/s. General Fibres Dealers (P) Ltd. It is in that peculiar fact situation that the Supreme Court took the view and with regard to the nature of income. We are of the view that on the essential contentions raised before the Tribunal and as elaborated or additionally proposed before us a different view than the one taken by

the Tribunal is not possible.

31. Similarly, with regard to the expenses claimed on account of incomplete work is concerned, the Tribunal found that the Assessing Officer observed that the assessee has shown the sale of 44,960 sq. feet and the remaining 76,106 sq. feet was shown as closing stock on which the assessee claims to have earned rental income. It disallowed Rs.45 lakhs as expenses incurred on that part of the stock and added the same to the income of the assessee.

32. The Commissioner found that in the Profit & Loss account, the assessee had offered the profit of the May Fair Tower I on the basis that construction work was substantially completed. The entire sale proceeds of the premises had been credited to the Profit & Loss Account. Further, proportionate cost of the premises lying unsold with the asssessee, including premises given on licence had already been taken to the Profit & Loss account. There was a proportionate cost carried forward as closing stock which also included pro-rata provision for incomplete works. If the expenses which are required to

be incurred and are allowable have been debited to the Profit & Loss account in accordance with the matching principle of accounting then the entire provision for incomplete work amount had been actually paid, the proportionate amount of provision of incomplete work of Rs.45 lakhs relating to unsold premises had been carried forward. This explanation which was given by the assessee was carefully examined and the Commissioner being convinced with it, allowed the claim. The Commissioner's factual findings have been reproduced in paragraph 15 of the order passed by the Tribunal and having considered them as also the rival contentions, eventually in paragraph 18, this is what the Tribunal held :

> *"18. Having carefully gone through the Order of the lower authorities in the light of rival submissions, we find that assessee has been following the project completion method and on account of completion of major part of the project, the assessee worked out its profit and offered it to tax. In the P & L account, he claimed a provision of incomplete work of Rs.45 lakhs relating to unsold premises. While calculating its closing stock, he has taken this figure of cost of provision of incomplete work of Rs.45 lakhs. It is an undisputed fact that in the case of project completion method the project is deemed to have been completed on its completion and sale of its 80%. The remaining portion of 20% is under either renovation or under sale. The common areas are generally renovated after the completion of the project. In this situation, making a provision for incomplete work, cannot be called to be*

> *incorrect system of accounting. More over, the claim made by the assessee were not doubted by the Assessing Officer. He has simply disallowed the claim of the assessee on the ground that the provision of incomplete work should not have been made in the impugned assessment year, without looking to the facts that same cost of incomplete work was taken in the closing stock. Keeping in view of the facts of the case, we are of the opinion that CIT (A) has properly adjudicated the issue in the light of given facts and circumstances of the case. We, therefore, find ourselves in agreement with the Order of the CIT (A). Accordingly, we confirm the same."*

33. We do not think that the Assessing Officer's view having been interfered with in such a scenario that any substantial question of law arises for our determination and consideration. Thus, the appeals fail on these two grounds.

34. Then what remains for our consideration is the argument of Mr. Chhotaray that the Tribunal should not have granted the deduction under section 24(b) of the IT Act as interest on borrowed capital. In relation to that what has been pointed out to us is that this question arises for the assessment years which are subject matter of Income Tax Appeal Nos.6234/2010, 1504/2012 and 418 of 2013. It is argued that these claims are huge and enormous. The Tribunal ought not to have

granted them when the conduct of the assessee was *mala fide*. The assessee claimed this deduction by giving conflicting versions. The assessee could not have argued in one matter while claiming deduction under section 24(a) and adopted a contrary position with regard to the claim under section 24(b). The argument is that the claim was made for the first time in the assessment year 2006-07. The explanation given is that this claim was not made in the initial years because in those years the stock-in-trade is completely unsatisfactory. If these were stock-in-trade, then, the income derived therefrom was definitely business income.

35. Section 24(b) of the IT Act on which reliance is placed reads thus :

> *"24. Income chargeable under the head "Income from house property" shall be computed after making the following deductions, namely :-*
>
> *(a) ……*
>
> *(b) where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital.*
>
> *Provided that in respect of property referred to in sub-section (2) of section 23, the amount of deduction shall*

not exceed thirty thousand rupees :

Provided further that where the property referred to in the first proviso is acquired or constructed with capital borrowed or after the 1st day of April, 1999 and such acquisition or construction is completed within three years from the end of the financial year in which capital was borrowed, the amount of deduction under this clause shall not exceed one lakh fifty thousand rupees."

36. A perusal thereof would indicate as to how deductions from income from house property are permissible. Income chargeable under the head "Income from house property" shall be computed after making the deduction, namely, a sum equal to 30% to the annual value and (b) where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital. The proviso, and particularly the second proviso stipulates that where the property referred to in sub-section (2) of section 23 is acquired or constructed with capital borrowed on or after 1st April, 1999 and such acquisition or construction is completed within three years from the end of the financial year in which the capital was borrowed, the amount under this claim shall not exceed Rs.1,40,000/-. This proviso and the explanation thereafter has not been pressed into service.

37. The Tribunal in Income Tax Appeal No.3216/Mum/2009 for assessment year 2006-07 dealt with this ground of the Revenue in paragraph 8.1 and 9. However, what is material to note is that the Commissioner had rendered detailed findings and which came to be confirmed by the Tribunal. The Tribunal found that in ground No.4 of the appeal, the non-allowing of deduction of interest amounting to Rs.59,77,030/- on borrowed capital against the income from house property was the issue. The argument was that this deduction was already allowed by the Assessing Officer while assessing the rental income as business income. This ground was taken with a view that the rental income would be treated as income from house property and then as a natural corollary the interest paid on the amounts borrowed for the construction of the property should be allowed as a deduction against the rental income. Since ground Nos.1 and 2 pertained to the rental income and taxing the same as income from house property that the Commissioner held that in the light of his findings and conclusions on ground Nos.1 and 2, the Assessing Officer should grant this claim of deduction of Rs.69,77,030/- as interest on borrowed capital. That is

the conclusion which was before the Tribunal and the Tribunal found that the assessee had earned substantial rental income and, therefore, the interest on borrowed funds has to be allowed. The Tribunal also perused the Profit & Loss account and where the closing stock was shown as Nil. The Tribunal presumed that the entire income is related to the premises which were let out by the assessee. Therefore, there is no reason to interfere with the order of the Commissioner.

38. However, Mr. Chhotaray has invited our attention to the Memo of Appeal in Income Tax Appeal No.1504 of 2012. He highlighted the substituted question of law and submits that there the Commissioner had not granted such a claim.

39. In that regard, we have perused the order passed by the Commissioner on 30th July, 2010, copy of which is at Annexure C. The Commissioner in para 3.3. held that the claim was made for interest under section 24(a) which was allowed without examining the basis of the claim for interest. The claim for interest falls under section 24(b) and which pertains to interest paid to the partners from their capital. The Commissioner held that relationship of borrower

and lender must come into existence before it can be said that any money is borrowed by one person from another. There must be a real transaction of borrowing and lending in order to amount to any borrowing. Where there is no relationship of borrower and lender, no deduction is permissible towards interest. In the instant case, the assessee's business was to construct flats or commercial units and sell them at profit. The partners of the firm had subscribed capital for the purpose of business and interest deduction to partner from business income has been allowed over the years. The partner's capital contribution has not been made for the purpose of acquiring property or construction of property for ownership and then for the purpose of letting it out and earning house property income on it. It is only because some flats remained unsold that these were let out and income from house property was earned. The Commissioner placed reliance on a judgment of the High Court of Allahabad in the case of *Manse Ram & Sons vs. Commissioner of Income Tax (1991) 54 Taxman 308*. He held that the assessee had borrowed amounts for business (banking business) and was utilised for construction of properties, interest was not allowable deduction under section 24(i)(vi). Where the assessee

was a partner of a firm and on dissolution of the firm, it took over all assets and liabilities including a building, another judgment was relied upon and rendered by the High Court of Punjab & Harayana in the case of *Commissioner of Income Tax vs. Four Fields (P) Ltd. (1998) 96 Taxman 143* which held that no relationship of borrower and lender had come into existence and deduction of interest on acquisition of building claimed against rental was disallowed. Thus, the entire basis was that there must emerge a relationship of borrower and lender. The Partnership Act was referred to and it was held the firm's partners are indistinguishable from one another. It is only by a legal fiction that interest on capital is allowed as a deduction from "business income". No such legal fiction has been created under the head "Income from house property". Since the amount is held as not a borrowing for the purposes of section 24(b), the question of nexus between the capital contribution of the partners and its use for acquisition / construction of relevant properties is not relevant. He, therefore, confirmed the order of the Assessing Officer by such reasoning.

40. While carrying the matter to the Tribunal, the assessee

specifically urged that the Commissioner erred in rejecting his claim without appreciating the fact that interest is paid to partners on the amount contributed by them and the said amounts in this case had been utilised for the purpose of construction of the property from which the appellant had earned the rental income (ground No.2). It is in relation to this ground that the Tribunal held in paragraph 4 as under :

> *"4. We have heard the arguments of both sides and also perused the relevant material on record. Although the learned DR has strongly supported the impugned order of the learned CIT(Appeals) confirming the disallowance made by the AO on account of the assessee's claim for deduction u/s 24(b) for interest paid on partners' capital account by relying on the various reasons given in the impugned order, the learned counsel for the assessee has filed a written submission to meet satisfactorily each and every point raised by the learned CIT(Appeals) while confirming the disallowance made by the AO on account of assessee's claim for deduction u/s 24(b). Moreover, as rightly submitted by the learned counsel for the assessee, a similar issue involved in the immediately preceding year i.e. assessment year 2006-07 was decided by the learned CIT(Appeals) in favour of the assessee in the similar facts and circumstances and the said decision of learned CIT(Appeals) giving relief to the assessee has been upheld by the Tribunal vide its order dated 20th April, 2010 passed in ITA No.3216/Mum/2009. As held by the Tribunal in the said order, the entire interest paid on the partners' capital was related to the premises which were let out by the assessee and the same, therefore, was allowable as deduction u/s 24(b) while computing income of the assessee under the head "Income from*

> *house property". Respectfully following the said decision of the Tribunal in assessee's own case for assessment year 2006-07, we direct the AO to allow the claim of the assessee for deduction on account of interest paid on partners' capital u/s 24(b)."*

41. The Tribunal held that if a similar issue was involved in the immediately preceding assessment year 2006-07 and there a finding was rendered in favour of the assessee by the Commissioner (Appeals), then, it was not possible to take a different view particularly because that finding of the Commissioner was upheld by the Tribunal by its order dated 20th April, 2010. If the facts and circumstances in which the claim arose were identical, then, the Tribunal concluded that a different view on facts was impossible.

42. We do not think that any larger question or wider controversy needs to be determined. If the matter was approached in this angle by the Commissioner and in the same factual backdrop, then, there is no justification for taking a contrary view. If two conflicting views of the Commissioner were placed before the Tribunal and the Tribunal found that it had concurred with one of those views and that the view with which it concurred prevails, then, we do not think how the Revenue can raise this issue. The issue has been considered bearing in mind

the typical factual background. If the entire interest paid on the partners' capital was related to the premises which were let out by the assessee but the construction thereof came from the contributions of the partners, then, the interest was due and payable to them. That interest was payable not only in terms of the general principle of partnership and highlighted in the Indian Partnership Act, 1932, but also on the broad consideration under section 24(b) of the Income Tax Act, 1961. If the income is income from house property and that is a deduction which could be granted from the same we do not think that the Revenue should be permitted to raise this ground. Even otherwise, the finding being consistent with the factual position which is not disputed, then all the more even this ground cannot be considered as a substantial question of law. We do not think any reference is required to the detailed written submissions or the case laws in this regard.

43. As a result of the above discussion, each of these appeals by the Revenue fail. They are dismissed. There shall be no order as to costs.

A.K. MENON, J. ***S.C. DHARMADHIKARI , J.***