

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

INCOME TAX APPEAL NO.519 OF 2003

M/s. Jayantilal Investments .. Appellant.
v/s.
Asstt. Commissioner of Income-tax .. Respondent.

Mr. Swapnil Bangur with Mr. Niranjan Deshpande I/by Y.R.Shah for
Appellant.
Mr. Arvind Pinto, for the Appellant.

**CORAM: M.S.SANKLECHA &
SANDEEP K. SHINDE, JJ.**
DATE : 4th July, 2018.

P.C:-

This appeal under Section 260A of the Income Tax Act, 1961
(Act) challenges the order dated 26.2.2003 of the Income Tax Appellate
Tribunal (Tribunal). It was admitted on 20.7.2004 on the following
substantial question of law:

“ Whether the Appellate Tribunal is correct on facts and
in law in confirming the Assessing Officer's action to
capitalize the interest expenditure amounting to
Rs.6,98,342/- incurred towards 'Lucky Shoppe' acquired as
stock in trade ?”

- 2 This appeal relates to Assessment Year 1988-89.
- 3 The appellant is a partnership firm and engaged in

construction activity. The appellant filed its return of income for the subject Assessment Year declaring an income of Rs.15,280/-. Subsequently revised return of income was filed by the appellant declaring a loss of Rs.2.30 Lakhs. In the revised return, the appellant had claimed amount of Rs.9.52 Lakhs as interest expenditure allowable under Section 36(1)(iii) of the Act and an amount of Rs.2.16 of interest was capitalized. During the course of assessment proceedings on being so called upon by the Assessing Officer, the appellant explained that so far as interest is concerned, it capitalizes interest to the extent it is expended , till the commencement of the project, therefore the interest is taken as revenue expenditure. However, the Assessing Officer still entertained doubts about allowing as deduction Rs.6.98 Lakhs being the interest expenditure claimed on account of its construction project 'Lucky Shoppe' . The appellant pointed out that the above amount of Rs.6.98 Lakhs was debited to profit & loss account but was wrongly capitalized in the original return of income, as during the previous year relevant to the subject Assessment Year the work in the Lucky Shoppe project had commenced. This was not accepted on the ground that mere placing of orders would not amount to commencing of the project. Thus, not allowable as revenue expenditure. The alternate submission of the appellant that open plot of land in respect of 'Lucky Shoppe' forms stock-

in-trade. Therefore, the interest paid on the loan taken to purchase open plot of land for Lucky Shoppe project is allowable as revenue expenditure being its stock-in-trade. This alternative submission was negated by the Assessing Officer on the ground that purchase of plot of land is capital in nature. Hence, interest must also be capitalized. Thus, by Assessment order dated 31.3.1993 the Assessing Officer disallowed the deduction of Rs.6.98 Lakhs being interest paid on plot of land of Lucky Shoppe project while determining the taxable income of Rs.7.76 Lakhs.

4 Being aggrieved with the Assessment Order dated 31.3.1993, the appellant filed an appeal to the Commissioner of Income Tax (Appeals) [CIT(A)]. By an order dated 19.7.1993 the CIT(A) found that interest paid on land was being allowed as revenue expenditure in the earlier Assessment Years and it was only in the subject Assessment Year that the Assessing Officer for the first time treated the same as work in progress and capitalized the same. The CIT(A) held that the interest paid on the loan taken for the purpose of its stock-in-trade i.e., plot of land for the 'Lucky Shoppe' project has to be allowed as expenditure to determine its income. In support reliance was placed on the decision of this Court in **S.F.Engineer & Ors. v. Commissioner of Income-tax 57 ITR 455 (Bom)**. Consequently, by order dated 19.7.1993 the CIT(A) deleted the disallowance of Rs.6.98 Lakhs done by the Assessing Officer in respect of

interest paid on 'Lucky Shoppe' project.

5 Being aggrieved with the order dated 19.7.1993 of the CIT(A), the Revenue filed an appeal to the Tribunal. By the impugned order, the Tribunal held that crucial question to be decided is, whether the appellant can be said to have commenced work on Lucky Shoppe plot of land during the previous year relevant to subject assessment year. On facts it held that the appellant has not shown any work had commenced on 'Lucky Shoppe' project plot of land during the previous year relevant to the subject Assessment Year. Thus, it concluded that the assessing officer was justified in coming to conclusion that interest expenditure in respect of Lucky Shoppe project (plot of land) could not be allowed as revenue expenditure. Thus, the impugned order dated 26.2.2003 of the Tribunal allowed the Revenue's appeal and disallowed deduction of interest of Rs.6.98 Lakhs in respect of 'Lucky Shoppe' project.

6 Mr. Bangur the learned counsel for the Appellant submits that it is undisputed position that interest of Rs.6.98 Lakhs was paid on the amounts borrowed for investing in land i.e. for acquiring stock-in-trade. Thus, admittedly paid interest as loan obtained for carrying on its business as builders. Thus, allowable as a deduction. In any case, it is submitted that prior to Assessment Year 2004-05, interest under Section 36(1)(iii) of the Act was allowable as deduction in respect of any amount paid as

interest for the purpose of its business irrespective of it being on capital or revenue account.

7 On the other hand, Mr. Pinto the learned counsel for the Respondent supports the impugned order on the ground that interest of Rs.6.98 Lakhs has been correctly disallowed. This on the basis of the finding of fact by the Tribunal that no work has commenced on the plot of land relating to Lucky Shoppe. Consequently, leading to the conclusion that interest amounts paid towards acquisition of Lucky Shoppe plot of land can be allowed as expenditure, as no work had commenced on the plot of land. This finding of fact that no work has commenced as the Lucky Shoppe project is final and is not subject matter of challenge before this Court. It is further submitted that the Appellant is developer and had made its account on the basis of project completion method. Thus, on the basis of the manner in which the Appellant maintained its accounts, the amount of Rs.6.98 Lakhs on Lucky Shoppe project cannot be allowed as revenue expenditure. In any case, it is submitted that interest can only be allowed as a deduction if there is any income which is earned by the respondent-assessee. There is no income earned by the respondent-assessee in respect of Lucky Shoppe project.

8 We note that before the Assessing Officer the appellant-

assessee had made alternate submission to the effect that the plot of land which was purchased out of borrowed funds on which interest was paid, forms part of its stock-in-trade. Therefore, interest paid on purchase of stock-in-trade is to be allowed as revenue expenditure. This was negated by the Assessing Officer on the ground that purchase of plot is necessarily capital in nature and, therefore, interest thereon is also to be capitalised. However, the fact is that the loan on which interest of Rs.6.98 Lakhs is paid was taken for purchase of plot of land in the course of its business. This fact is undisputed before us. Therefore, the interest has been paid to acquire stock-in-trade. In the above circumstances as held by the CIT(A), the same has to be allowed as revenue expenditure. However, the Tribunal in the impugned order has completely ignored the above findings and applied the test of the Assessing Officer namely that it is only if work is commenced on Lucky Shoppe project, would the same be allowed as revenue expenditure and not otherwise. This specifically on the basis of the manner in which accounts are maintained by the Appellant. In fact Mr.Pinto also supports the impugned order on the basis of the manner of accounting followed by the Appellant. As held by the Supreme Court in **Kedarnath Jute Manufacturing Co. Ltd. v. CIT 82 ITR 363** the entries in the books of accounts will not determine the assessee's entitlement to deduction. This has to be examined on the touchstone of the provisions of

the Act.

9 In view of Section 36(1)(iii) of the Act as existing prior to amendment with effect from 1.4.2004 all interest paid in respect of capital borrowed for the purpose of business or profession has to be allowed as deduction while computing income under had income from business. Prior to amendment made on 1.4.2004, there was no distinction based on whether the borrowing is for purchase of capital asset or otherwise, interest was allowable as deduction in determining the taxable income. It was only after introduction of proviso to Section 36(1)(iii) of the Act w.e.f. 1.4.2004 that the purpose of borrowing i.e. acquisition of assets then interest paid would be capitalized. The Supreme Court in Dy. CIT v. Core Healthcare Ltd. 218 ITR 194 has held that prior to 1.4.2004 interest paid on borrowings for purchase of asset i.e. Machinery is to be allowed as a deduction under Section 36(1)(iii) of the Act. This even if the machinery is not received in the year of booking. It held that the restriction introduced in the proviso to Section 36(1)(iii) of the Act was effective only from Assessment Year 2004-05 and not for earlier Assessment Years. In this case, we are concerned with the Assessment Year 1988-89 i.e., prior to amendment by addition of proviso to Section 36(1)(iii) of the Act. Therefore, the interest paid on the borrowings to purchase

the 'Lucky Shoppe' project plot of land is allowable as a deduction under Section 36(1)(iii) of the Act. This is so as it was incurred for the purposes of its business.

10 Mr. Pinto's submission is that the deduction under Section 36(1)(iii) of the Act will not be available as no income has been earned in respect of Lucky Shoppe project. We are unable to appreciate this submission. It is an undisputed position that the appellant-assessee has filed return of income declaring income under the head income from business. The appellant has various projects executing construction projects and, therefore, interest expenditure is to be allowed as deduction to arrive at profits and gains of business or profession of builders carried out by the Appellants. It is not a case where the only project of the appellant was the Lucky Shoppe project. The reliance by Mr. Pinto on **Challapalli Sugars Ltd. v. Commissioner of Income Tax 98 ITR 167** to contend that the interest payment has to be capitalized is in the present facts not correct. This for the reason that in **Challapalli Sugars Ltd. (Supra)** dealt with a case where interest was paid on the borrowing made to acquire and install the plant and machinery prior to commencement of business/production. Admittedly, in this case the business of the Appellant as developer had already commenced and income offered to tax. We find no merit in the Revenue's objection that these are issues of fact, which this

903-ITXA-519-2003

Court should not go into as the finding of fact, by the Tribunal is final. We have decided this issue on a question of law viz. applicability of Section 36(1)(iii) of the Act.

11 In the above view, substantial question of law is answered in negative, i.e., in favour of the appellant-assessee and against the respondent-revenue.

12 Appeal allowed in the above terms. No order as to costs.

(SANDEEP K. SHINDE,J.)

(M.S.SANKLECHA,J.)