

**IN THE INCOME TAX APPELLATE TRIBUNAL
“C” BENCH : BANGALORE**

BEFORE SHRI GEORGE GEORGE K., VICE PRESIDENT
AND
SHRI LAXMI PRASAD SAHU, ACCOUNTANT MEMBER

ITA No.385/Bang/2023
Assessment year : 2017-18

MFAR Developers Private Ltd., # 3, Lavelle Road, Bangalore – 560 001. PAN : AAFCM 6271M	Vs.	The Deputy Commissioner of Income Tax, Circle 4(1)(3), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	S/Shri C.R. Krishna & Sachin Mehta, CAs
Respondent by	:	Shri Saravanan B., CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	31.08.2023
Date of Pronouncement	:	06.09.2023

ORDER

Per Laxmi Prasad Sahu, Accountant Member

This appeal is filed by the assessee against the DIN & Order No.ITBA/NFAC/S/250/2022-23/1051459055(1) dated 28.03.2023 of the CIT(Appeals), National Faceless Appeal Centre, Delhi [NFAC], for the AY 2017-18 on the following grounds:-

- “1.1 On the facts and circumstances of the case, the learned National Faceless Appeal Center (NFAC), erred in disallowing interest u/s 36(1)(iii) of Rs 3,28,69,300/- as interest on borrowed funds used for bringing into existence a fixed asset, being a building.

- 1.2. On the facts and circumstances of the case, the learned, National Faceless Appeal Center (NFAC), erred in not appreciating the fact that the let-out part of the building during the above said assessment year was an existing building in respect of which interest was already capitalized and no further interest was required to be capitalized.
- 1.3. Without prejudice to the above contentions, on the facts and circumstances of the case, the learned National Faceless Appeal Center (NFAC), erred in not considering depreciation allowance u/s 32 of the Income Tax Act, 1961 for interest capitalization u/s 36(1)(iii).
- 2.1. On the facts and circumstances of the case, the learned National Faceless Appeal Center (NFAC), erred in disallowing a sum of Rs. 3,15,06,556 under section 14A of the Income Tax Act, 1961.
- 2.2. On the facts and circumstances of the case, the National Faceless Appeal Center (NFAC), erred in not appreciating the fact that the assessee company has not earned any dividend during the year.
- 2.3. On the facts and circumstances of the case, the learned, National Faceless Appeal Center (NFAC), erred in not appreciating the fact that the assessee company has not incurred any expenditure towards exempt income and the investment made were out of surplus funds in prior years.
- 2.4. On the facts and circumstances of the case, the learned National Faceless Appeal Center (NFAC), erred in not considering the principles set out in the order passed by the Honorable Income Tax Appellate Tribunal, Bangalore in the assessee's own case in respect of similar ground of appeal in previous years.

The appellant seeks leave to add to, to amend, alter or delete any of the foregoing grounds as and when considered necessary/at the time of hearing.”

2. The brief facts are that the assessee is engaged in the business of construction and leasing out of commercial premises. Assessee filed return of income on 30.10.2017 declaring loss of Rs.29,81,88,300. Subsequently assessee filed revised return declaring total income of Rs.19,20,01,278. The case was selected for scrutiny and statutory notices were issued to the assessee.

3. During the course of assessment proceedings, the AO noted that a sum of Rs.2,33,515 debited to Profit & Loss account towards interest on TDS. The AO asked the assessee as to why this expenditure is allowable. In response, the assessee submitted that due to oversight, the interest on TDS was not disallowed, accordingly the AO added it to the total income and it was accepted by the assessee.

4. Further, on verification of financial statements, the company has work-in-progress of Rs.96.69 crores. Investment in capital work-in-progress part of MMTP Phase IV during the year is Rs.17.53 crores. As per submission of the assessee, Phase IV was ready during the year, Accordingly, the AO noticed that the interest paid should be disallowed u/s. 37(1) and accordingly proportionate interest was proposed to be disallowed u/s. 36(1)(iii). The assessee submitted its reply as under:-

“The relevant building known as MFAR Manyata Tech Park, Green Phase IV had been completed to a major extent in the earlier year and income thereof from lease rent has been offered for tax in AY 2017017. Assessee also provided details of payment with commencement date.”

5. The AO noted that various leases have been concluded spread across the year and total of 2,35,579 sq.ft. has been completed during the year and given to leases and the assessee also provided the interest cost to be capitalized based on put to use date. Accordingly, the AO disallowed proportionate interest u/s. 36(1)(iii) of Rs.3,28,69,300.

6. Further the AO noted from the financial statements that assessee has non-current investment of Rs.71.20 crores in equity shares and assessee has not reported any expenditure attributable to investment made to earn exempt income and assessee has incurred significant interest expenditure of Rs.36.12 cores and additional loan has been taken @ 9.65% amounting to Rs.115,42,09,894 during the year. The investment in subsidiaries/sister concerns increased from Rs.22.15 crores to Rs.71.20 crores, resultantly there was increase of Rs.49.05 crores. Accordingly, the AO noted that part of loan has been utilized by assessee for investment to earn exempt income and assessee was asked why section 14A of the Act should not be made applicable. The assessee submitted that during the year assessee has not received any exempt income, therefore no disallowance can be made and relied on some judgments. The AO proceeded to calculate disallowance u/R 8D(2)(i) of Rs.2,68,39,060 and u/R 8D(2)(ii) of Rs.46,67,496 resulting in total disallowance of Rs.3,15,06,556 and completed the assessment. Aggrieved, the assessee filed appeal before the CIT(Appeals).

7. The CIT(Appeals) after considering the detailed submissions and relying on certain judgments, dismissed the appeal of the assessee. Aggrieved, the assessee is in appeal before the Tribunal.

8. The Id. AR of the assessee reiterated the submissions made before the lower authorities. He further submitted that the total area of building was 7,52,521 sq.ft. out of which 5,16,942 sq.ft. was constructed and let out in the preceding AY and the rest of Rs.2,35,579 sq.ft. was completed in the impugned AY on different dates. Major portion was completed in the previous AY for which interest has been capitalized and income from rent from MFAR Manyata Tech Park Greenheart Phase IV had been offered for tax in the AY 2017-18. Only certain interiors and finishing works for certain tenants were taken up during the year. The purpose of claiming interest paid on loan as revenue expenditure is considering the entire building as one unit and it was put to use. Alternatively, he submitted that depreciation on such capitalized interest amount of Rs.3,28,69,300 should be granted to the assessee. The assessee is eligible for depreciation as per section 32 r.w.s. 43(1) of the Act.

9. He further submitted that the AO is not justified in making disallowance u/s. 14A because during the year no exempt income was received by the assessee. As per Note 21 of financial statement the assessee has received interest income, discount, claim, liabilities/provisions no longer required written back and miscellaneous income. Accordingly relying on various judicial precedents, the assessee

submitted no addition can be made u/s 14A of the Act as it has not received any exempt income on such investments. He further submitted that the amendment made to section 14A has prospective effect as per the judgment of Hon'ble Delhi High Court in the case of *PCIT v. Era Infrastructure (India) Ltd. [2022] 141 taxmann.com 289 (Del)*.

10. The Id. DR relied on the orders of the lower authorities and has filed written synopsis which is as under:-

"1. The 1st ground of appeal is that CIT (Appeals) erred in confirming addition interest of Rs. 3,28,69,300/- used for bringing into existence a fixed asset, a building, u/s 36(1)(iii) of IT Act, 1961 ("the Act"). It is argued that the let out part of the building was an existing building in respect of which interest was already capitalized earlier and no further interest was required to be capitalized. Also argued that the CIT (Appeals) erred in not allowing depreciation.

1.1. The issue is whether the interest related to the period before the date on which an asset is put to use should be capitalized or allowed as revenue expenditure in P&L account. Section 36(1)(iii) provides:

"(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.

(emphasis supplied).

Explanation.--Recurring subscriptions paid periodically by shareholders, or subscribers in Mutual Benefit Societies which fulfil such conditions as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause;

1.2. The above Proviso is clear and unambiguous. It means that the interest for the period upto date of putting an asset to use will be capitalized. The admitted fact is that some part of the building was not let out at all during the year or let out for the first time for part of the year. The assessee had submitted list of tenants with date of commencement of tenancy. This showed since when the property was put to use. Assessing Officer disallowed the interest related to capital borrowed for construction of such portions only. The Supreme Court held in **Innamuri Gopalam and Maddala Nagendrudu v State of A. P., 1964 2 SCR 888, 1963 14 STC 742 SC**, "If the provision is unambiguous and if from the provision the legislative intent is clear, the court need not call into aid the other rules of construction of statutes. The other rules of construction are called into aid only when the legislative intent is not clear."

1.3. Rowlatt J. in his classic statement in **Cape Brandy Syndicate v I.R.C. (1 KB 64, 71)** held, "In a taxing statute one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can look fairly at the language used."

1.4. CIT (Appeals) cited the case law of **CIT vs. Vadilal Dairy International Ltd (2010) 328 ITR 544 (Guj)** in support of his decision. Further, in **CIT Vs. Vardhman Polytex Ltd. (2008) 299 ITR 152 (P&H)**, it was held, "*Interest paid on capital borrowed for setting up of a new unit in the same line of business — capital expenditure — Interest on capital borrowed for the purpose of acquisition of the assets of the new unit is to be allowed as a revenue expenditure only when such assets start yielding income and not for any period prior thereto — Section 36(1)(iii) to be read along with Explanation 8 to Section 43(1) — Proviso to Section 36(1)(iii) added by Finance Act, 2003 is merely clarificatory as it has made explicit what was already implicit.*"

1.5. Therefore, it is prayed that the appeal on this point may kindly be dismissed and the CIT (Appeal)'s order may kindly be upheld.

2. Next ground of appeal is that CIT (Appeals) erred in confirming addition of Rs. 3,15,06,556/- u/s 14A of IT Act, 1961 because assessee company did not earn any income which does not form part of the total income during the year and in doing so, CIT (Appeals) and AO did not follow ITAT's order in the assessee's own case.

2.1. Section 14A reads,

"Expenditure incurred in relation to income not includible in total income.

14A. (1) Notwithstanding anything to the contrary contained in this Act, for the purposes of] computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act.

(2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act.

(3) The provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act :

Provided that nothing contained in this section shall empower the Assessing Officer either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before the 1st day of April, 2001.

Explanation.—For the removal of doubts, it is hereby clarified that notwithstanding anything to the contrary contained in this Act, the provisions of this section shall apply and shall be deemed to have always applied in a case where the income, not forming part of the total income under this Act, has not accrued or arisen or has not been received during the previous year relevant to an assessment year and the expenditure has been incurred during the said previous year in relation to such income not forming part of the total income.

2.2.It is important to note that AO never stated that assessee had actually earned exempt income. AO stated that as the investments made by the assessee has potential to give exempt income, assessee was asked its comments. In Para 4.2 of assessment order, AO wrote, *"The assessee has not responded to view of the AO that investments made by it has potential of giving exempt income."* In his contention AO and CIT (Appeals) followed Circular no. 5/2014 dated 11.2.2014 which stated that by the word, "includible" in headnote of Section 14A

of IT Act, 1961, as well as Rule 8D of income Tax Rules, 1962, it means it is not necessary that the exempt income should be included in that year's income. The Circular also stated that Section 14A did not use the words "income of the year" — which is specific for the year - but used the words "income under the Act" — which is general. This means that for invoking disallowance under section 14A, it is not necessary that the assessee had actually earned exempt income during the year under consideration." This means, even if it is just includible and not actually included, the section will attract. In other words, if money is spent with the intention of earning exempt income but in reality, such income is not received yet, then too such expenditure is to be disallowed because of the word "includible" which means "able to be included". It is pertinent to consider why the word "included" is not given in the headnote and "includible" meaning "able to be included" is given in the section. Similarly, it is pertinent to consider what meaning would have conveyed if "income of the year" were given instead of "income under the Act" as is given by the legislature.

2.3. The legislative intent is clear from these words. It is clearer from the fact that such intent has been made clearer by insertion of the Explanation by Finance Act, 2022, w.e.f. 1.4.2022.

2.4. To illustrate, if during a previous year, an assessee incurs an expense of Rs. 1 lakh to earn non-exempt income of Rs. 1.5 lakh and also incurs an expense of Rs. 20,000/- to earn exempt income which may or may not have accrued/received during the year. By holding that provisions of section 14A of the Act does not apply in this year as the exempt income was not accrued/received during the year, it amounts to holding that Rs. 20,000/- would be allowed as deduction against non-exempt income of Rs. 1.5 Lakh even though this expense was not incurred wholly and exclusively for the purpose of earning non-exempt income. Such an interpretation defeats the legislative intent of both section 14A as well as section 37 of the Act.

2.5. In the present case, appellant invested Rs. 71.20 crore in equity shares of different companies which did not yield any dividend true, but it very much could yield dividend which is not includible as part of total income under the Act.

2.6. Appellant has submitted copy of Supreme Court's judgment in Oil Industry Development Board v. PCIT in support of his claim. It is seen that in this order Supreme Court has simply refused to grant special leave in view of its earlier judgment in CIT v. Essar Teleholdings Ltd 3 SCC 253. As stated in Para 2 and 3 of the judgment

in CIT vs. Essar Teleholdings Ltd (2018) 3 SCC 253, the only two questions answered in the judgment were:

- (i) "Whether sub section (2) and sub section (3) of Section 14A inserted with effect from 01.04.2007 will apply to all pending assessments?
- (ii) Whether Rule 8D is retrospectively applicable?"

The question whether the section will attract even when there is potential of exempt dividend income from share investment has not been the subject matter of this judgment. Therefore, it is distinguished and not applicable.

2.7. All the judgments, including the order dated 19.1.2018 of honourable C Bench, Bangalore of the Tribunal, as cited were delivered before insertion of the Explanation by Finance Act, 2022, which has made legislative intention clear now. In view of the above, it is prayed that the matter may kindly be reconsidered in the light of Explanation to Section 14A, Circular no. 5/2014 issued by CBDT and the Memorandum to Finance Bill, 2001, and decided in favour of the department."

11. The Id. DR further submitted that the AO and the CIT(A) have rightly considered the issue in the light of section 36(1)(iii) of the Act. The assessee itself has provided the quantum of disallowance towards interest to be capitalized for the assets which were not put to use in terms of section 36(1)(iii) read with proviso. Therefore the claim of revenue expenditure of interest is not justified. The assessee is also not eligible for depreciation if the assets were not put to use for business purpose.

12. After hearing the rival contentions and perusing the material available on record, we note that the AO has disallowed the interest paid on loan taken for construction of building for the year under consideration on which the assets were not put to use in terms of

proviso to section 36(1)(iii) as per the calculations submitted by the assessee at the time of assessment. The calculation of interest to be capitalized is clear from page no.28 of PB. On further perusal of page No.26 of PB, the details of lease commencement date as per rental invoice have been given. On examination of the same, the lease commencement dates are different, it clearly shows that different units were put to use on different dates which are less than/more than 180 days in a year. Earlier, the assessee itself capitalized the interest in the previous AY for the units which were not completed and/or not put to use. However, the assessee has treated it as revenue expenditure in the impugned AY which is not correct as per section 36(1)(iii) & the proviso is very clear. On going through the facts of the case, the assessee has not satisfied the conditions laid down in proviso of section 36(1)(iii). Accordingly, we find merit in the submission of the Id. DR regarding disallowance of interest claimed as revenue expenditure should be capitalized. In view of the above, ground Nos.1.1 & 1.2 are rejected.

13. In ground No.1.3, the assessee has claimed that if interest is capitalized, then the assessee is eligible for depreciation on such capitalized portion of interest. We note that 2,35,579 sq.ft. was leased out on different dates as per column 04 of lease commencement and as per col.no.5 of PB page No. 26 , the assessee has raised invoice for rent on different dates, accordingly the assets were put to use for the business of assessee during the year as the date mentioned therein & out of 2,35,579sq. ft. the 15075 sq. ft were leased out on 11.07.2017 as

per the letter dated 01.09.2023. Therefore the assessee is eligible for depreciation as per section 32(1) r.w.s. 43(1) of the Act. We direct the AO to grant depreciation on interest capitalized of Rs.3,28,69,300 as per law and for subsequent years also. Accordingly, we allow ground No.1.3 in the above terms.

14. Ground Nos. 2.1 to 2.4 raised by the assessee are in regard to disallowance made by the AO u/s. 14A of the Act even when there is no exempt income received by the assessee. We have gone through the financial statements of the assessee at Note No.21, the assessee has not shown any exempt income in the form of dividend or any other exempt income. It is not in dispute that the assessee has paid interest during the year. The ld. AR also relied on the various judgments including the judgment of Hon'ble jurisdictional High Court in the case of *Sterling Developers Pvt. Ltd. v. PCIT*, 129 taxmann.com 116 where it is held that when there is no exempt income, no disallowance can be made. During the year the assessee has not reported any exempt income from the investments made. There is also amendment made by the Finance Act, 2022 w.e.f. 1.4.2022 is not from retrospective effect as decided by the Hon'ble Delhi High Court in the case of *Era Infrastructure (India) Ltd. (supra)*. We further note that in assessee's own case for AY 2013-14, the coordinate Bench in ITA No.1443/Bang/2017 dated 19.1.2018 has held similar view in favour of the assessee. Considering the above judgments, we allow grounds No.2.1 to 2.4.

15. In the result, the appeal of the assessee is partly allowed.

Pronounced in the open court on this 06th day of September, 2023.

Sd/-

Sd/-

(GEORGE GEORGE K.)
VICE PRESIDENT

(LAXMI PRASAD SAHU)
ACCOUNTANT MEMBER

Bangalore,
Dated, the 06th September, 2023.

/Desai S Murthy /

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.