

IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "G", MUMBAI

Before Shri Joginder Singh(JUDICIAL MEMBER)

AND

Shri G Manjunatha (ACCOUNTANT MEMBER)

I.T.A No.5413/Mum/2015
(Assessment year: 2011-12)

M/s Wadhwa Residency Pvt Ltd, 301, 3 rd Floor, Platina, Plot C-59, G Block, Bandra Kurla Complex, Bandra (E), Mumbai-400 051 PAN : AADCR0872M	vs	Addl CIT, Range 9(3), Mumbai
APPELLANT		RESPONDENT

Appellant by	Shri Jitendra Jain (Adv)
Respondent by	Shri Abhijit Patankar

Date of hearing	25-04-2018
Date of pronouncement	20-06-2018

ORDER

Per G Manjunatha, AM :

This appeal filed by the assessee is directed against the order of the CIT(A)-21, Mumbai dated 07-09-2015 and it pertains to AY 2011-12.

2. The brief facts of the case are that the assessee company is engaged in the business of real estate development, filed its return of income for AY 2011-12 on 30-09-2011 declaring total income at Rs.1,44,49,230. The case has been selected for scrutiny and notices u/s 143(2) and 142(1) of the Act were issued. In response to notices, the authorized representative of the assessee appeared from time to

time and furnished the details, as called for. The assessment has been completed u/s 143(3) on 28-03-2014 determining the total income at Rs.4,36,53,826 interalia making addition towards disallowance of expenses incurred in relation to exempt income u/s 14A r.w.r. 8D, disallowance of unpaid service tax liability u/s 43B of the Act for Rs.54,78,681 and adhoc disallowance of expenses of Rs.5 lakhs.

3. Aggrieved by the assessment order, assessee preferred appeal before the CIT(A). Before the CIT(A), the assessee made threefold arguments on the issue of disallowance of expenditure incurred in relation to exempt income u/s 14A r.w.r. 8D. The first and foremost argument of the assessee is that the AO has not recorded his satisfaction having regard to the accounts of the assessee in respect of expenses incurred in relation to exempt income which is a pre-condition as per the provisions of section 14A(2). The AO has not recorded his satisfaction about incorrectness of claim made by the assessee having regard to its accounts. The AO has disallowed expenses by applying the principles of Rule 8D(2). The assessee also made an alternative submission challenging amount quantified by the AO u/r 8D(2)(ii) of I.T. Rules, 1962 by stating that the assessee's own funds in the form of share capital, reserves, interest free unsecured loans and advances collected from customers is more than the value of investments made in

partnership firm which earned exempt income. Therefore, once there is a mixed fund available with the assessee including interest bearing fund, a general presumption is drawn to the effect that the investments made in investments are out of interest free funds, therefore, no disallowance can be made. The assessee also made one more argument on the issue of determination of interest disallowance u/r 8D(2)(ii) by stating that the AO was erred in considering interest expenses of Rs.104,20,09,566 relating to WIP as the said term loan borrowed from India Bulls was exclusively utilized for development of project and no part of funds has been used for investments in partnership firm. If interest paid on term loan borrowed from India Bulls is excluded for the purpose of determination of disallowance, then the actual disallowance works out to Rs.25,22,600 which may be considered. Insofar as disallowance of expenditure u/r 8D(2)(iii), assessee submitted that no part of the administrative expenses can be considered as relating to earning exempt income as the assessee has made a single investment in partnership firm for which there is no necessity of deploying any personal or other expenses. Therefore, the AO was incorrect in determining disallowances by invoking Rule 8D(2)(iii).

4. Similarly, in respect of disallowance of service tax liability u/s 43B, the assessee submitted that in accordance with the Finance Act, 2010,

builders / developers were made liable to service tax for consideration received on sale of flat under construction. However, such levy of service tax has been challenged by Maharashtra Chamber of Housing Industry before the Hon'ble Bombay High Court and the Hon'ble High Court granted interim stay against recovery of service tax. Since the High Court has granted interim stay, the assessee has treated service tax collected amounting to Rs.54,78,681 as its liability for the year under consideration. However, the same has been paid in the subsequent financial year when the issue has been resolved by the Hon'ble High Court. Therefore, such unpaid liability towards service tax cannot be considered as income of the assessee within the meaning of section 2(24)(x) r.w.s. 43B of the Income-tax Act, 1961.

5. The CIT(A), after considering relevant submissions of the assessee rejected all arguments of the assessee in respect of disallowance of expenditure incurred in relation to exempt income u/s 14A by holding that although the assessee has made various arguments including the theory of mixed funds, failed to furnish necessary evidences including bank statements and cash flow statement to prove that as on the date of investment, it is having sufficient own funds to cover up investment made in partnership firm. Therefore, the AO was right in quantifying disallowances by invoking rule 8D(2)(ii). The Ld.CIT(A) also rejected

alternative plea of the assessee by holding that there is no fault in the computation of the average value of investments and average value of assets. The investment considered in rule 8D computation is only in respect of investments in the firm from which tax exempt income is earned. However, the presumption underlying the rule 8D(2) computation is that the pro-rata cost for already available funds is considered as having been incurred for making investments which has resulted in tax free income. Since the AO has rightly taken total interest debited in the P&L account and also applied the principles prescribed u/r 8D(2)(ii), there is no error in the quantification made by the AO towards disallowance of interest. With these observations, the CIT(A) confirmed addition made by the AO towards disallowance of expenses incurred in relation to exempt income.

6. Insofar as disallowance of service tax unpaid liability, the CIT(A) observed that service-tax charged on sale consideration is a trading receipt and such service tax is not paid to the government account within the prescribed time allowed under the Act, hence, as per the provisions of section 43B, the same has to be disallowed. Though the assessee claims that service-tax was not paid to the government account due to the operation of interim stay by the High Court, fails to prove that there was no such written agreements with the customers on refund of service

tax in case the issue has been decided in favour of the customers. The CIT(A) further observed that the assessee itself admitted that the service tax collected from buyers was ultimately paid to the government in FY 2011-12; therefore, there is no merit in the arguments of the assessee that the same was treated as liability because of operation of interim stay of Hon'ble High Court. Therefore, he opined that the service tax is a trading receipt and, therefore, part of income for AY 2011-12 and any failure to deposit service tax within the prescribed time attracts disallowance provided u/ 43B and accordingly, the AO was right in making addition towards unpaid service tax liability u/s 43B. Aggrieved by the order of CIT(A), the assessee is in appeal before us.

7. The first issue that came up for our consideration from assessee's appeal is disallowance of expenditure incurred in relation to exempt income of Rs.2,32,25,915 u/s 14A of the I.T. Act, 1961 r.w.s. 8D(2) of I.T. Rules, 1962. The Ld.AR for the assessee submitted that the Ld.CIT(A) was erred in confirming addition made by the AO u/s 14A without appreciating the fact that the AO has not recorded his satisfaction having regard to the books of account of the assessee that the assessee has incurred any expenditure in relation to exempt income; but, failed to make suo moto disallowance on such expenses. In the absence of any satisfaction in the assessment order, invoking rule 8D(2)

to determine the disallowance is incorrect. The Ld.AR referring to the provisions of section 14A(2) submitted that the provision is very clear inasmuch as that if the AO, 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 the income which does not form part of the total income under this Act, shall determine disallowance by invoking rule 8D(2) by applying prescribed method. In this case, there is no iota of evidence in the assessment order of any kind of satisfaction arrived at by the AO having regard to the accounts of the assessee. Therefore, the Ld.CIT(A) was completely erred in confirming addition made by the AO. The Ld.AR further referring to the decision of Hon'ble Supreme Court in the case of Maxopp Investments Ltd vs CIT (2018) 402 ITR 640 (SC) submitted that the Hon'ble Supreme Court has categorically observed at para 41 of the order that before applying the rule, AO needs to record satisfaction that having regard to the account of the assessee, suo moto disallowance u/s 14A was not correct. In this regard, he relied upon the decision of Hon'ble Bombay High Court in the case of Godrej & Boyce Mfg Co Ltd vs ACIT 328 ITR 81(Bom). The Ld.AR further submitted that alternatively, the assessee has its own interest free funds in the form of share capital and reserves which is more than the value of investments in partnership firm which

yielded exempt income. Therefore, once there is mixed funds including interest bearing funds, a general presumption is drawn that the interest free funds are utilized for making investments in securities yielding exempt income. The assessee has proved with evidence that interest free funds are more than its investments and hence, the AO was completely erred in determining disallowance of interest expenses u/r 8D(2)(ii). In this regard, he relied upon the decision of Hon'ble Bombay High Court in the case of Reliance Utilities & Power Ltd vs CIT 338 ITR 340 (Bom).

8. On the other hand, the Ld.DR strongly supported the order of the CIT(A) and submitted that the Ld.CIT(A) has rejected all arguments of the assessee in the light of provisions of section 14A and Rule 8D(2) to uphold the addition made by the AO in respect of disallowance of expenses. Therefore, there is no merit in the arguments of the assessee that the AO has not recorded his satisfaction having regard to the accounts of the assessee before invoking rule 8D(2) of I.T. Rules, 1962. Insofar as alternative submissions of the assessee that it is having own interest free funds which is sufficient to explain investments in partnership firm which yielded exempt income is also found not acceptable by the Ld.CIT(A) for the reason that the assessee has failed to furnish any kind of evidence including bank statement and cash flow

statement to prove availability of funds as on the date of investments. Therefore, the CIT(A) was right in confirming addition made by the AO and his order should be upheld.

9. We have heard both the parties, perused the materials available on record and gone through the orders of authorities below. The AO has disallowed expenses incurred in relation to exempt income u/s 14A by invoking rule 8D(2). According to the AO, the assessee has earned exempt income from partnership firm which was claimed exempt u/s 10(2A); however, failed to make any suo moto disallowance of expenditure incurred in relation to exempt income. The AO further observed that the assessee has made investments in M/s Vijay Associates, a partnership firm for an amount of Rs.38.53 crores. The AO also observed that the assessee has borrowed huge loans and advances on which claimed interest expenses of Rs.104.20 crores. The assessee also incurred various expenditure towards employee cost and other general overhead expenses. Therefore, the claim that no expenses were incurred for earning exempt income including interest is not correct. According to the AO, disallowance contemplated u/s 14A shall be determined in accordance with prescribed method provided u/r 8D of Income-tax Rules, 1962.

10. It is the contention of the assessee that the AO has not recorded his

satisfaction having regard to the books of account of the assessee in respect of expenditure incurred in relation to exempt income which is a pre-condition for invoking Rule 8D(2) which is very clear from the provisions of sub section (2) of section 14A of I.T. Act, 1961. Unless the AO records his satisfaction about incorrectness of claim of the assessee or that no such expenditure has been incurred for earning exempt income, then the AO has to categorically record his satisfaction that the assessee has incurred such and such expenditure which is directly relatable to earning exempt income. The assessee further contended that there is no iota of evidence in the assessment order about AOs satisfaction in respect of incorrectness of claim of the assessee. The assessee has filed relevant evidences before the AO to prove that share of profit earned from partnership firm which is claimed exempt u/s 10(2A) is made out of interest free funds and also no specific expenditure has been incurred to earn such exempt income. When the assessee claims that no part of expenditure is relatable to exempt income, then the AO has to record his satisfaction having regard to the books of account of the assessee that the assessee has incurred particular expenditure to earn such exempt income. In this case, the AO has not arrived at his satisfaction having regard to the accounts of the assessee, hence, determination of disallowance contemplated u/s 14A by invoking Rule

8D(2) is incorrect.

11. The provisions of section 14A provides for disallowance of expenditure incurred in relation to exempt income which does not form part of total income under this Act. Sub section (2) of section 14A makes it clear that the AO shall determine the amount of expenditure incurred in relation to such income which does not form part of total income under this Act and in accordance with such method, as may be prescribed, if the AO, 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. The method of computation is provided for determination of disallowance contemplated u/s 14A u/r 8D(2), but before resorting to Rule 8D(2), the AO has to arrive at a satisfaction having regard to the accounts of the assessee that the claim of the assessee that no expenditure has been incurred in relation to exempt income or disallowance made by the assessee is incorrect and the assessee has incurred expenditure which is directly attributable to earning exempt income. In the absence of any specific satisfaction by the AO in the assessment order, then invoking Rule 8D(2) to compute disallowance contemplated u/s 14A is incorrect. This legal proposition is supported by the judgement of Hon'ble Bombay High Court in the case

of Godrej Boyce & Mfg Co Ltd vs CIT (supra) wherein the Hon'ble High Court observed that the AO needs to record his satisfaction having regard to the books of account of the assessee that no expenditure has been incurred by the assessee in relation to exempt income is incorrect. This legal proposition is further supported by the decision of Hon'ble Supreme Court in the case of Maxxopp Investments Ltd vs CIT (supra) wherein in para 41 of the order, the Hon'ble Court observed that the AO needs to record satisfaction that having regard to the accounts of the assessee, suo moto disallowance u/s 14A was not correct. It will be in those cases, where the assessee, in his return has himself apportioned but the AO was not accepting the said apportionment. In that eventuality he has to record his satisfaction to this effect. Further, while recording such a satisfaction, nature of loan taken by the assessee for making the investment in shares is to be examined by the AO. In this case, on perusal of the facts available on record, though the AO in a cryptic manner said that "I am not satisfied with the claim of the assessee that no expenses were incurred for earning exempt income and the expenditure relates to the exempt income is to be determined as per Rule 8D(2) of the Income-tax Act, 1962", filed to record a satisfaction having regard to the accounts of the assessee that the assessee has incurred particular expense in relation to earn exempt income. Since the

AO has not recorded his satisfaction in the assessment order before determining disallowance contemplated u/s 14A of the Act, invoking Rule 8D(2) to compute such disallowance is not in accordance with law.

12. Coming to the alternative argument of the assessee, the assessee made an alternative argument that its own interest free funds in the form of share capital and reserves, interest free unsecured loans and advances received from customers is more than value of investments made in partnership firm which yielded exempt income and hence, once the assessee has proved that its own funds are more or it is having a mixed fund, including interest bearing funds, then a general presumption is drawn that investment in tax exempt securities / share or investments is out of interest free funds. Therefore, no disallowance can be made u/s 14A r.w.r. 8D(2)(iii). We find that the Hon'ble Bombay High Court in the case of CIT vs Reliance Utilities & Power Ltd (supra) has taken a view that if there are funds available both interest free and overdraft and / or loans, then a presumption would arise that investment would be out of the interest free funds generated or available with the company, if the interest free funds are sufficient to meet the investments. In this case, the assessee has filed necessary evidences to prove that its interest free funds are more than its investments in partnership firm which yielded exempt income and accordingly, the AO was erred in determining

disallowances by invoking Rule 8D(2)(ii) of Income-tax Rules, 1962 in respect of interest expenditure.

13. In this view of the matter and respectfully following the decisions of Godrej & Boyce Mfg Co Ltd vs CIT (supra) and the Hon'ble Supreme Court in the case of Maxxopp Investments Ltd vs CIT (supra), we are of the considered view that disallowances computed by the AO by invoking Rule 8D(2) of Income-tax Rules, 1962 without recording his satisfaction as required u/s 14A(2) of the Act is incorrect. Hence, we direct the AO to delete addition made towards disallowance of expenses incurred in relation to exempt income u/s 14A of the Income-tax Act, 1961.

14. The next issue that came up for our consideration is addition towards unpaid service tax liability u/s 43B of the Income-tax Act, 1961. During the course of assessment proceedings, the AO observed that the assessee has charged service tax from its customers to whom it has sold flats under construction and collected service tax thereon; however, the same has not been paid to the government account, therefore, called upon the assessee to explain as to why unpaid service tax liability shall not be disallowed under the provisions of section 43B of the Act. In response to show cause notice, assessee vide letter dated 22-02-2014 submitted that though it has collected service tax from few customers on sale of flats, the same has not been remitted to the government account

for the reason that the levy of service tax on builders has been challenged before the jurisdictional High Court, by Maharashtra Chamber of Housing Industry and the Hon'ble High Court vide its order dated 23-07-2010 granted interim stay from coercive collection of tax by the department till the regular appeal filed by the association on the constitutional validity of levy of service tax is decided. Since the Hon'ble Bombay High Court has seized the matter and also granted interim stay from recovery of taxes, the assessee has treated service tax collected from customers as current liability; however, the same has been paid in the subsequent financial year as soon as the Hon'ble High Court has decided the issue of constitutional validity of levy of service. The assessee further submitted that it has treated service tax collected from its customers as liability without claiming it as expenditure in the P&L Account, therefore, the same cannot be disallowed u/s 43B.

15. The AO, after considering relevant submissions of the assessee and also relying upon the decision of Hon'ble Supreme Court in the case of Chouringhee Sales Bureau Pvt Ltd vs CIT 87 ITR 542 (SC) observed that service tax collected from customer is a trading receipt which needs to be treated as part of its business receipts and also to be routed through P&L account. Mere treatment of such receipts in its books of account under the head 'current liability' is not a ground for the assessee

to take shelter from payment of service tax to the government. Though the jurisdictional High Court gave interim stay from coercive collection of taxes, did not specifically asked assesses not to pay collected taxes to the government account. Since the assessee has collected service tax from its customers, irrespective of whether the assessee has routed the service tax through P&L account, the service tax charged and collected by the assessee from its customers is in the nature of business receipts and hence, if assessee fails to remit such receipts on or before the due date specified u/s 43B, then it is liable for disallowable and accordingly made addition of Rs.54,78,681.

16. The Ld.AR for the assessee referring to the judgement of Hon'ble Bombay High Court on the issue of constitutional validity of levy of service tax on builders submitted that there is a valid and sound reason for the assessee to treat service tax collected from its customers as 'current liability' for the impugned year, therefore, the AO was incorrect in holding that such service tax liability is a trading receipt for the year under consideration without appreciating the fact that the issue has been challenged before the Hon'ble High Court and the High Court granted interim stay from coercive collection of taxes. The Ld.AR further submitted that the assessee never treated service tax collected as its trading receipts and also no claim has been made towards such liability,

therefore, the same cannot be considered as unpaid liability and disallowed u/s 43B. In this regard relied upon the decision of Hon'ble Delhi High Court in the case of CIT vs Noble & Hewitt India Pvt Ltd (2008) 305 ITR 324 and the decision of Hon'ble Bombay High Court in the case of CIT vs Ovira Logistics Pvt Ltd (2015) 377 ITR 129 (Bom).

17. On the other hand, the Ld.DR strongly supporting the order of the CIT(A) submitted that the lower authorities have brought out clear facts in the light of decision of Hon'ble Supreme Court in the case of Chouringhee Sales Bureau Pvt Ltd vs CIT (supra) that service tax collected from customers is a trading receipt which ought to have been routed through P&L account. Irrespective of the fact that whether such liability is routed through P&L account or not as long as it is in the nature of trading receipt, the assessee needs to treat such liability through its P&L account and also paid such taxes on or before the due date specified under respective provisions. Since assessee has failed to pay taxes before the due date, AO has rightly disallowed unpaid service tax liability u/s 43B and his order should be upheld.

18. We have heard both the parties and perused the material available on record. There is no dispute with regard to the fact that the assessee has not paid service tax collected from few customers. The assessee claims that it has collected service tax from its customers under protest

on the pretext of return of such service tax to the customers, if the jurisdictional High Court has decided the issue of constitutional validity of service tax liability on builders in favour of the builders' association. The assessee further claimed that it has treated service tax collected from customers under the head 'current liability' because the Hon'ble High Court has granted interim stay for coercive collection of tax till disposal of the regular appeal filed by the association challenging constitutional validity of levy of service tax. The assessee further claimed that it has paid service tax collected from customers in the next financial years as soon as the Bombay High Court has decided the issue on levy of service tax on builders, therefore, argued that there is a valid and sound reason for treating service tax collected from customers as 'current liability' for the impugned financial year. The AO disallowed service tax liability on the ground that service tax collected from customers is in the nature of trading receipts which needs to be routed through P&L account and also paid on or before the due date prescribed under the provisions of the Act to the government account. The AO further observed that irrespective of that, the fact that whether the assessee has routed service tax collected from customers through P&L account or not, the character of receipt does not change as long as it is in the nature of trading receipts and the assessee ought to have routed it through P&L account and also paid

such taxes on or before the due date.

19. The AO has disallowed unpaid service tax liability under the provisions of section 43B for the reason that the assessee has not remitted service tax collected from its customers before due date of furnishing return of income u/s 139(1) of the Act. The assessee claims that it has appropriated service tax collected from its customers under the head 'current liabilities' and such treatment is on the basis of interim stay granted by Hon'ble Bombay High Court on a case filed by Maharashtra Chamber of Housing Industry challenging the constitutional validity of levy of service tax. Since the Hon'ble High Court has granted interim stay from coercive collection of tax, the assessee has treated service tax collected from its customers as 'current liability' under the pretext of promising its customers to refund such service tax collected from them in case the levy of service tax has been quashed by the jurisdictional High Court. Therefore, there is a valid reason for treating such liability as 'current liability' for the impugned year.

20. Having heard both sides, we find force in the arguments of the assessee for the reason that it is not a case of the AO that the assessee has collected service tax from its customers on sale of flats and not remitted such service tax to the government account even though such receipts has been treated as part of its business receipts. The assessee

has categorically proved that it has not claimed deduction towards service tax in its books of account. Once, any taxes or duties, which is not routed through P&L Account and also not claimed any deduction towards such taxes, then there is no reason for the AO to disallow such taxes under the provisions of section 43B of the Income-tax Act, 1961. This legal proposition is supported by the decision of Hon'ble Bombay High Court in the case of CIT vs Ovira Logistics Pvt Ltd (supra) wherein the Hon'ble High Court, after considering the judgement of the Hon'ble Delhi High Court in the case of CIT vs Noble & Hewitt India Pvt Ltd (supra) held that section 43B does not contemplate liability to pay service tax before actual receipt of the funds in the accounts of the assessee. The Hon'ble Delhi High Court in the case of CIT vs Noble & Hewitt India Pvt Ltd (supra) held that when assessee did not debit the amount in the P&L account as an expenditure and nor he made the claim of deduction in respect of the said amount, the question of disallowing the deduction not claimed would not arise. In this case, on perusal of facts available on record, we find that the assessee has treated service tax collected from customers under the head 'current liability' and such treatment is based on the interim order passed by the Hon'ble jurisdictional High Court in Writ Petition No.1456 of 2010. Therefore, we are of the considered view that there is a valid and sound

reason for the assessee to keep service tax collected from its customers under the head 'current liability'. We further observe that the assessee has remitted service tax collected from customers in the subsequent assessment year as soon as the issue of constitutional validity has been decided by the Hon'ble High Court. Therefore, we are of the considered view that the AO was erred in disallowing unpaid service tax liability u/s 43B. Hence, we direct the AO to delete addition made towards unpaid service tax liability.

21. In the result, appeal filed by the assessee is allowed.

Order pronounced in the open court on 20th June, 2018.

Sd/-

sd/-

(Joginder Singh)	(G Manjunatha)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Mumbai, Dt : 20th June, 2018

Pk/-

Copy to :

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

/True copy/

By order

Sr.PS, ITAT, Mumbai