

IN THE INCOME TAX APPELLATE TRIBUNAL  
Mumbai "SMC" Bench, Mumbai.

Before Shri Prashant Maharishi (AM)

I.T.A. No. 548/Mum/2024 (A.Y. 2017-18)

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| Shanti & Santosh Developers<br>Pvt. Ltd.<br>212A/213A, Commerce<br>House, 140, Nagindas<br>Master Road, Fort<br>Mumbai-400 001.<br><br>PAN : AAKCS7725F | Vs. | ITO-2(3)(2)<br>Room No. 581A<br>5 <sup>th</sup> Floor<br>Aayakar Bhavan<br>M.K. Road<br>Mumbai-400 020. |
| (Appellant)   |     | (Respondent)  |

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|-----------------------|--------------------|
| Assessee by           | Shri Vimal Punmiya |
| Department by         | Shri R.R. Makwana  |
| Date of Hearing       | 12.06.2024         |
| Date of Pronouncement | 26.08.2024         |

O R D E R

1. This appeal is filed by Shanti And Santosh Developers Private Limited (the assessee/appellant) against the appellate order passed by The Commissioner Of Income Tax, Appeals – 1, Visakhapatnam (the learned CIT – A) for assessment year 2017 – 18 dated 11/1/2024 wherein the appeal filed by the assessee against the assessment order passed by The Income Tax Officer – Ward 2 (3) (2), Mumbai under section 143 (3) of The Income Tax Act, 1961 (The Act) dated 27/12/2019, was dismissed.
2. Assessee aggrieved with the appellate order has preferred the appeal having following grievances :-
  - i. disallowance of expenses treated as penalties of Rs. 30,090,310/- paid to Bombay Municipal Corporation [ BMC] claimed as wholly and exclusively incurred for the purposes of the business and the penalties paid are

compensatory in nature and not disallowable under section 37 of the act.

- ii. deposit of Rs. 9,551,600/- made to Bombay Municipal Corporation was disallowed under section 37 of the income tax act.
  - iii. both these items were debited to the closing work in progress, the learned AO reduced the closing work in progress by the above amount. The learned CIT - A confirmed the same.
3. Brief facts of the case show that assessee is a company engaged in the business of development and construction, filed its return of income on 31/3/2018 at a total income of Rs. 653,000. This return was picked up for scrutiny by issue of notice under section 143 (2) dated 9/8/2018.
  4. During the course of assessment proceedings was asked to explain the details of closing stock. The assessee explained that property was valued through registered valuer, and it is valued at Rs. 149 Lacs hence the opening stock as on 1/4/2017 was taken at that value. The opening work in progress was Rs. 108,458,619 on 31/3/2016. Thus, the assessee was asked to explain the increase in the same. The learned AO did not agree with the working given by the assessee as to how the valuation of work in progress at the beginning of the year of Rs. 108,458,619 became closing work in progress of Rs. 149 Lacs. The departmental valuation officer was also referred for the making of the valuation of the property. SO, the valuation of the work in progress of the assessee was doubted by the ld AO.
  5. Assessee has debited the BMC expenses of Rs. 104,497,678 during the year. All these expenses were verified by the learned assessing officer and found that many of these expenditures are in the nature of penalties for late payment and towards the breaches of respective BMC Laws. Accordingly, the learned AO held that a sum of Rs.

30,090,310 is the penalty paid by the assessee and further Rs. 9,551,600 is the deposit with the BMC, which is also debited as an expenditure, not allowable and therefore he made the disallowance of the above expenditure by reducing the value of the closing work in progress. Assessment order under section 143 (3) was passed on 27/12/2019 assessing the total income of the assessee at Rs. 653,598/- but the work in progress value was reduced. The opening work in progress was considered at Rs. 108,458,716 and total work in progress at the close of the year was considered at Rs. 179,329,943. Thus, the assessee was granted the benefit of the cost incurred of only Rs. 70,871,324/- whereas the assessee has incurred the total cost of 11,05,13,235/-. The above difference is on account of the BMC penalty charges and BMC deposit charges amounting to Rs. 39,641,910.

6. Assessee aggrieved with the same preferred appeal before the learned CIT – A. The assessee filed written submission on 23/11/2023 in the form of statement of facts and requested to dispose of the appeal on the basis of the same. The learned CIT – A confirmed the action of the learned assessing officer holding that explanation 1 and 3 of section 37 (1) penalties paid by the assessee to the Bombay municipal Corporation are disallowable under section 37 (1) of the act. Thus, the order of the learned AO was confirmed.
7. Assessee is aggrieved against the appellate order, furnished written submission, a paper book containing 53 pages. The argument of the learned authorized representative is that the expenses of penalty paid to Bombay municipal Corporation is not for infraction of law but, partly Rs 253,000/- was paid for penalty for delayed a submission of documents, Rs. 7,684,146/- is for penalty for delayed payment and Rs. 12,601,564/- is paid for late payment of demand letter. None of these penalties are for violation of any law and therefore those are not disallowable under section 37 (1) of the act. He further stated that Rs.

9,551,600/- is penalty towards breach of lease agreement by the assessee and therefore same was forfeited and resulted into penalty. Accordingly same is also not disallowable under section 37 (1) of the act. Therefore, on the merits he submitted that Rs. 3,00,90,310/- is not disallowable.

8. The learned departmental representative vehemently supported the orders of the learned lower authorities and submitted that when the Bombay municipal Corporation has termed as a penalty, same is disallowable under section 37 (1) of the act and therefore there is no infirmity in the orders of the learned lower authorities. It was further submitted that assessee has never claimed that these are not for infraction of law or are merely compensatory. Evidence placed in the paper book were not before the lower authorities at all.
9. We have carefully considered the rival contention and perused the orders of the learned lower authorities.
10. The facts clearly show that the assessee company is a builder and is in the business of development and construction. It has a project ongoing. During the year, the assessee has incurred the expenditure of Rs. 10,44,97,678/- out of that the above payment for Corporation expenses are of Rs. 39,641,910. The short issue in this appeal is whether these expenditures is to be allowed to the assessee to be carried forward as the project cost in the closing stock. The only reason it is not allowed by the revenue authorities is that these are paid for infraction of law and therefore disallowable under section 37 (1) of the act. We find that: -
  - i. Assessee has paid Rs. 253,000 on 3/5/2016 for late submission of documents relating to one of the tenants. Thus, the Bombay municipal Corporation has levied a penalty.
  - ii. On 5/5/2016 there was a late payment by the assessee and therefore penalty of Rs. 7,684,146 was levied.

- iii. Further on the same date another penalty of Rs. 12,601,564 was levied.
  - iv. On 3/5/2016 a deposit of Rs. 9,551,600 was levied on the tenants for making some changes in structure.
11. The fact shows that that these are the penalties levied on the tenants but if the assessee does not make the payment of said penalty in the assessee would not get requisite permission from the Bombay municipal Corporation for redevelopment. Thus, the above payment Were made by the assessee wholly and exclusively for carrying on the business of the assessee for construction of redevelopment project.
12. Assessee has submitted the copies of the receipt at page number 45 – 53 of the paper books. Receipt shows that these are in the name of the tenants. Assessee has paid these amounts on behalf of its tenants. It is not that the assessee has violated any provisions of the law of Bombay municipal Corporation, but it has reimbursed the charges which were levied on the tenant by Bombay municipal Corporation as penalties to continue the redevelopment of the project. There is not penalty levied on the assessee it is submitted but assessee has borne such penalties.
13. According to section 37 (1) of The Act any penalties paid by the assessee for infraction of law is not allowable as deduction. Therefore, it is necessary to ascertain whether the assessee has incurred such expenses which are for infraction of law or not. It makes no difference whether assessee pays himself or reimburses to somebody else or pays on behalf of somebody, so far as the infraction springs from the business income of which is offered for taxation, such penalty is not eligible for deduction u/s 37 (1) of the Act. Thus, any penalty suffered by assessee directly or indirectly for the purposes of the business is not allowed as deduction.
14. Several judicial precedents consistently emphasize that if the penalty is imposed due to a violation of law, it cannot be claimed as a business

expense. It is held repeatedly that a penalty for breach of law during the course of trade cannot be described as a commercial loss and is not deductible. Thus, penalties paid to the Municipality are not allowable as deductions under section 37(1) of the Income Tax Act, as they are typically considered penal in nature and fall under the prohibitions outlined in the Act. This is also the crux of several decisions cited by the Id AR in his written submission.

15. It is also immaterial that such expenses are carried in the closing stock [ inventory] because opening inventory becomes cost and closing inventory is income and ultimately when revenue arises the assessee gets deduction of the same. Therefore, the argument of the assessee that what is carried forward in closing inventory in case of projects, assessee has not claimed any deduction, is incorrect and rejected.
16. As before us the assessee has furnished certain receipts of penalties which are in the name of the tenants whose property assessee is redeveloping and it is not certain whether these sums are penalty or fees for redevelopment is not clear, in absence of any orders produced. Therefore, in the interest of justice we restore these claims of the assessee back to the file of the Id AO with direction to the assessee to show with the respective orders that impugned sum are not penalty either levied on assessee or on tenants whose property is redeveloped within 90 days from the date of receipt of this order. The Id. AO may examine the same and decide the issues afresh.
17. Accordingly appeal of the assessee is allowed for statistical purposes.

Order pronounced in the open court on 26 August 2024.

Sd/-  
(Prashant Maharishi)  
Accountant Member

Mumbai : 26.08.2024

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent
3. The CIT(A)
4. CIT
5. DR, ITAT, Mumbai.
6. Guard File.

//True Copy//

BY ORDER,

(Assistant Registrar)  
ITAT, Mumbai

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