IN THE INCOME TAX APPELLATE TRIBUNAL
"B'' BENCH: BANGALORE

BEFORE SHRI PRASHANT MAHARISHI, VICE PRESIDENT
AND
SHRI SANDEEP SINGH KARHAIL, JUDICIAL MEMBER

ITA No.1536/Bang/2025
Assessment Year: 2018-19

Nirman Sonestaa Developers 94/2,3 and 4 Bellandur Village Varthur Hobli Bengaluru 560 037 **PAN NO : AAJPN2276Q**	**Vs.**	DCIT Circle 4(1)(1) Bangalore
APPELLANT		**RESPONDENT**

Appellant by	:	None
Respondent by	:	Sri Subramanian, D.R.

Date of Hearing	:	13.11.2025
Date of Pronouncement	:	14.11.2025

O R D E R

PER SANDEEP SINGH KARHAIL, JUDICIAL MEMBER:

The assessee has filed the present appeal against the impugned order dated 28/05/2025, passed under section 250 of the Income Tax Act, 1961 ("*the Act*") by the learned Commissioner of Income Tax (Appeals), National Faceless Appeal Centre, Delhi, ["*learned CIT(A)*"], for the assessment year 2018-19.

2. During the hearing, no one appeared on behalf of the assessee, nor was any application seeking adjournment filed. Therefore, we proceed to decide the present appeal after hearing the learned Departmental Representative and perusal of the material available on record.

3. In this appeal, the assessee has raised the following grounds:-

1. *The order of the ld. CIT(A) is bad in law and against the facts and circumstances of the case.*

2. *The ld. CIT(A) erred in law in sustaining the disallowance of Rs.76,05,613/- paid as compounding fee to BBMP, by invoking explanation 1 to section 37(1), overlooking that the payment was for permitted regularization of minor deviations, and not for any offense or act prohibited by law.*

3. *The compounding fee paid to BBMP was in accordance with local municipal norms and not in the nature of a penal or deterrent punishment, but a compensatory fee to regularize deviation within permissible limits.*

4. *The appellant has duly accounted for and offered to tax the revenue arising out of the additional area constructed pursuant to the said regularization. Therefore, denial of deduction for the corresponding cost results in distorted computation of business profits.*

5. *The expenditure being directly connected with the earning of taxable income is allowable u/s 37(1). The action of the CIT(A) causes double taxation of the same source of income – revenue taxed, but related cost disallowed.*

6. *The appellant relies on the following judicial precedents; RDB Industries Ltd. v. ACIT [120 TTJ 107 (Kol)] – Payment for regulatory infraction without mens rea held allowable. Hero Cycles Ltd. v. CIT [17 DTR 281 (P&H HC)] – Routine business lapses not involving moral turpitude not hit by Explanation to Section 37(1). Kaira Can Company Ltd. [32 DTR 485] – Regularization charges not considered penal and hence allowable. DCIT v. Bharat C. Gandhi [(2011) 46 SOT 258 (Mum).]. EON Hadapsar Infrastructure (P) Ltd. [(2016) 159 ITD 532 (Pune-Trib.)] Dr. T.A. Qureshi v. CIT [(2006) 287 ITR 547 (SC)] – Supreme Court distinguished between business loss and penal expense; Explanation to Sec.37 applies only to expenses and not to loss under ordinary business principles.*

7. *The CIT(A) has erred in equating municipal regularization compounding fee with a punitive penalty, which is a misapplication of Explanation 1 to section 37(1).*

8. *The Appellant craves leave to amend, modify, or add any ground(s) at the time of hearing."*

4. The solitary grievance of the assessee is against the disallowance of the compounding fees paid by the assessee to Bruhat Bengaluru Mahanagara Palike ("*BBMP*") by invoking the provisions of Explanation 1 to section 37(1) of the Act.

5. The brief facts of the case are that the assessee is a partnership firm doing the business of construction of the flats. For the year under consideration, the assessee filed its return of income on 16/10/2018, declaring a total income of INR 2,25,55,870. The return filed by the assessee was selected for scrutiny, and statutory notices under section 143(2) and section 142(1) of the Act were issued and served on the assessee. During the assessment proceedings, it was observed that the assessee had paid compounding fees amounting to INR 76,05,613 to BBMP. Accordingly, the assessee was asked to furnish the justification for the allowability of the same in light of the provisions of Explanation 1 to section 37(1) of the Act. In response, the assessee submitted that it submitted a building plan for approval and based on the proposed plan, the BBMP granted the approval. At the time of approval, the assessee was aware that it was not possible to complete the project as per the proposed plan, as there were certain adjustments that needed to be made at the time of actual execution. Since the actual completion of the project was within the parameters of the approval, the Corporation/approving authority permitted the project to be approved with a nominal fee or compounding fee for the adjustment made by the assessee in the proposed plan. Accordingly, the assessee claimed that since the project was not declared to be illegal and was approved with the compounding fees, the expenditure is allowable under section 37(1) of the Act.

6. The Assessing Officer ("*AO*"), vide order dated 22/04/2021, passed under section 143(3) read with section 144B of the Act, disagreed with the submissions of the assessee and held that any regulation fees paid to the municipal authority for compounding of offence are in the nature of a penalty. The AO further held that the assessee is trying to make a distinction between those offences which can be compounded and those which cannot be and calls the later one as only an offence for violation of law. The AO held that just by an offence being able to be compounded does not change the nature of the act for which the compounding fees are paid, and the said offences being in violation of the rules framed are in the nature of a penalty covered under the provisions of Explanation 1 to section 37(1) of the Act. Accordingly, the AO disallowed the compounding fees amounting to INR 76,05,613 under section 37 of the Act and added the same to the total income of the assessee.

7. The learned CIT(A), vide impugned order, dismissed the ground raised by the assessee on this issue and upheld the disallowance made under the provisions of Explanation 1 to section 37(1) of the Act. Being aggrieved, the assessee is in appeal before us.

8. We have considered the submissions of both sides and perused the material available on record. We, at the outset, find that the issue of the allowability of compounding fees under section 37 of the Act came up for consideration before the Hon'ble jurisdictional High Court in CIT v/s Mamta Enterprises, reported in [2004] 266 ITR 356 (Karn.). While deciding the issue in favour of the Revenue, the Hon'ble High Court, in the aforesaid decision, observed as follows: –

> *"5. Having elaborately heard the learned counsel appearing for the parties, while we find considerable force in the submission of Sri Seshachala, we are unable to accede to the submission of Sri Kulkarni. We are unable to agree with the submission of Sri Kulkarni that since the provision in clause (b) of section 483 of Corporation Act permits compounding of the offence, once the violation is compounded, there was no offence committed in the eye of law; and the offence committed is wiped out. Section 300 of the Corporation*

Act prohibits commencement of the construction or reconstruction of a building without there being a permission granted by the Corporation for the execution of the work. Section 303 of the said Act sets out the grounds on which approval of a site for construction or reconstruction of a building or permission to construct or reconstruct of a building may be refused by the Commissioner. Section 308 of the Act confers power on the Commissioner to direct alteration of construction work commenced by the owner of a site. Section 321 of the Act confers power on the Commissioner to make an order for demolition of the building after complying with the procedure set out in the said provision, if he is satisfied that the construction or reconstruction of a building has been commenced without obtaining the permission or being carried on or has been completed otherwise than in accordance with the plans or particulars on which such permission or order was based. Section 436 of the Act, among other things, provides that if the construction or recon- struction of any building is commenced without the permission of the Commissioner, or is carried on or completed otherwise than in accordance with the particulars on which such permission was based; or is carried on or completed in contravention of any lawful order or breach of any provision of the Act or any rule or bye-law made under it, or of any direction or requisition lawfully given or made, the owner of the building who puts up such construction shall be liable on conviction to pay a fine prescribed under the said provision. However, Clause (b) of section 483 of the Corporation Act empowers the Commissioner to compound any offence committed in breach of the provisions of the Act, Rules, bye-laws or regulations which may by rules made by the Government be declared compoundable. Therefore, from the scheme of the several provisions in the Act referred to above, it is clear that nobody can put up any new construction or proceed to reconstruct the existing building without there being a sanctioned plan or permission granted by the Commissioner on that behalf; the putting up any construction without there being a sanctioned plan is made as an offence under the Act and it is treated as an act prohibited by law. No doubt, as noticed by us earlier, clause (b) of section 483 of the Corporation Act empowers the Commissioner to compound the offence. Bye-law 5.6 framed by the Corporation in exercise of the power conferred under it under section 428 of the Act enables the Commissioner set out the circumstances under which he could compound an offence. It is useful to refer to the said bye-law which reads as hereunder:

> *"5.6-1 Wherever any construction is in violation/deviation of the sanctioned plan, the Commissioner may, if he considers that the violation/deviations are minor, viz.; only when the deviations/violations is within 5 per cent of (1) the minimum set back to be left around the building; (2) the maximum plot coverage; (3) permissible floor area ration and maximum height of the building and that the demolition under Chapter XV of the Act is not feasible without affecting the structural stability, then he may regularise such violations/deviations by sanctioning of a modified plan with a levy of a suitable fee to be prescribed. The Commissioner shall come to such conclusion only after recording detailed reasons for the same. Violations/deviations under the provision shall not include the buildings which are constructed without obtaining any sanctioned plan whatsoever and also the violations/deviations which are made in spite of the same being specifically deleted or rejected in the sanctioned plan."*

6. The bye-law referred to above, read along with clause (b) of section 483, empowers the Commissioner to compound the violation or deviation of the sanctioned plan done by a person who constructs a building. Now, the question is whether, the compounding of such an offence by paying penalty as compounding fine will wipe out the offence or infraction of law committed by the assessee. In the instant case, undisputedly the assessee has put up 8th floor in an apartment without there being a sanctioned plan. Therefore there cannot be any doubt that the assessee has put up the construction in violation of the Building By-laws and therefore he has committed infraction of law and also an offence within the meaning of section 436 of the Act. The Deputy Director of Town Planning, who is the delegated authority of the Commissioner, on the request made by the assessee by means of his order dated 30-9-1982 permitted the assessee to compound the offence on payment of compounding fine. The said order reads as follows:

> *"In your letters cited above, you requested for compounding of the offences of unauthorised construction of 8th floor in two blocks in the above premises. The Administrator in his proceedings under subject No. 342 dated 29-9-1982 has approved the proposal to compound the offence by levying a compounding fine of Rs. 89,960 (Rs. Eighty nine thousand nine hundred sixty only).*
>
> *Please remit the above mentioned compound fine by means of challan for issuing the orders on the compounding of the offence."*

7. The order passed by the Deputy Director of Town Planning, referred to above, in unmistakable terms states that he had permitted for compounding of the "offences of unauthorised construction" of 8th floor in two blocks of the premises belonging to the assessee. The language employed in clause (b) of section 483, referred to above, also says that the Commissioner is empowered to "compound the offence". Under these circumstances, there cannot be any doubt what has been done is to permit the assessee to "compound the offence" committed by it by putting up unauthorised construction of 8th floor in the building in question on payment of compounding fine of Rs. 89,960. The explanation given to section 37 of the Act, as noticed by us earlier, makes it clear that the assessee who incurs expenditure for any purpose which is an offence or which is prohibited by law is not entitled for deduction of such expenditure incurred by him. The explanation declares that such an expenditure "shall not be deemed to have been incurred" for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure. It is useful to refer to the explanation given to section 37 of the Act which reads as hereunder:

> *"Explanation.—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure."*

When the explanation to section 37 of the Act defines that the expenditure incurred for any purpose which is an offence or which is prohibited by law is not entitled for deduction, it is not possible to take the view that the compounding of the offence or violation of the provisions of the Act, for the

purpose of saving the offender of the law from the consequences of the commission of such an offence or violation of law should also be given the benefit of section 37 of the Act by permitting the assessee to pay the compounding fee as the fine. In our view, the compounding of the offence under the Act could not take away the rigor of the explanation given to section 37 of the Act referred to above. The claim for deduction made by the assessee has to be considered in the light of the explanation given to section 37 of the Act and not with reference to the provision in the Corporation or the Municipal Law which permits the violator of the provisions of the Corporation or the Municipal Law to compound the offence either to save the unauthorised or illegal construction put-up or to relieve such violator of law from the consequences provided in such Corporation or Municipal Law. However, it is necessary to refer to the observation made by the Delhi High Court in the case of Lokenath & Co. (Construction) (supra) relied upon by Sri Kulkarni, which reads as follows:

> *"The charge is not on gross receipts but on profits and gains properly so called. The profits to be assessed are real profits and they must be ascertained on ordinary principles of commercial expediency. The partnership was formed for the purpose of construction of a multi-storeyed building called as Himalaya House and for the purpose of selling the major portions of the said building in the form of flats to various customers. The assessee got the original building plans sanctioned and commenced the constructions. The assessee had no right to make deviations from the sanctioned plan or to continue the construction after the sanction had lapsed. Any constructions thus made would be deemed to have been erected without a proper sanction. The Committee, however, has the power to sanction revised plans so as to regularise the deviations or give ex post facto sanction for the constructions made after the sanction had lapsed by accepting by way of compensation such sum as it may deem reasonable. It is at that stage that the assessee had to consider the question of payment on the principles of ordinary commercial trading or on grounds of commercial expediency. . . . The expenditure of payment of compensation incurred by the assessee has to be regarded as an integral part of the profit earning process the assessee. . ." (p. 644)*

8. In our view the above observation made by Delhi High Court cannot be of any assistance to the learned Counsel for the respondent to support his case as the said decision was rendered prior to amendment to section 37 of the Act by incorporating the explanation referred to above by means of Finance Act 2/98 which is made retrospective effect w.e.f. 1-4-1962. When the section itself declares the expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure, it is not possible to take the view that the expenditure incurred for compounding of the offence should be allowed. When the section is clear and unambiguous, it is not permissible for the Courts to stretch the meaning attached to the provision of law to extend the benefit to a person who violates the law or the Regulations/Rules made by the Corporation or the Municipal Authorities with impunity. Under these circumstances, the expenditure incurred to pay the penalty cannot be treated as loss in business to get the benefit. In our view, the penalty paid has enured to the benefit of the assessee to save the additional construction put up in

violation of the provisions of the Act and the By-laws framed thereunder and also the consequences of penal provision provided under the Corporation or the Municipal Law. The view we have taken above is fully supported by the decision of the Hon'ble Supreme Court in the case of Haji Aziz & Abdul Shakoor Bros. (supra), wherein the Supreme Court has observed as follows:

> *". . . If a sum is paid by an assessee conducting his business, because in conducting it he has acted in a manner which has rendered him liable to penalty, it cannot be claimed as a deductible expense. It must be a commercial loss and in its nature must be contemplable as such. Such penalties which are incurred by an assessee in proceedings launched against him for an infraction of the law cannot be called commercial losses incurred by an assessee in carrying on his business. Infraction of the law is not a normal incident of business and, therefore, only such disbursements can be deducted as are really incidental to the business itself. They cannot be deducted if they fall on the assessee in some character other than that of a trader. Therefore, where a penalty is incurred for the contravention of any specific statutory provisions, it cannot be said to be a commercial loss falling on the assessee as a trader the test being that the expenses which are for the purpose of enabling a person to carry on trade for making profits in the business are permitted but not if they are merely connected with the business.*
>
> *". . . In our opinion, no expense which is paid by way of penalty for a breach of the law can be said to be an amount wholly and exclusively laid for the purpose of the business. The distinction sought to be drawn between a personal liability and a liability of the kind now before us is not sustainable because anything done which is an infraction of the law and is visited with a penalty cannot on grounds of public policy be said to be a commercial expense for the purpose of a business or a disbursement made for the purposes of earning the profits of such business." (p. 359)*

Further, a similar view is taken by the Hon'ble Supreme Court in the case of Maddi Venkataraman & Co. (P.) Ltd. (supra). The Hon'ble Supreme Court has observed thus:

> *"In the instant case, the assessee had indulged in transactions in violation of the provisions of the Foreign Exchange (Regulation) Act. The assessee's plea is that unless it entered into such a transaction, it would have been unable to dispose of the unsold stock of inferior quality of tobacco. In other words, the assessee would have incurred a loss. Spur of loss cannot be a justification for contravention of law. The assessee was engaged in tobacco business. The assessee was expected to carry on the business in accordance with law. If the assessee contravenes the provisions of the FERA to cut down its losses or to make larger profits while carrying on the business, it was only to be expected that proceedings will be taken against the assessee for violation of the Act. The expenditure incurred for evading the provisions of the Act and also the penalty levied for such evasion cannot be allowed as deduction. As was laid down by Lord Sterndale in the case of Alexander von Glehn & Co. Ltd. [1920] 12 TC 232 (CA), it was not enough that the disbursement was made in the course of trade. It must be for the purpose of the trade. The purpose must be a lawful purpose." (p. 545)*

9. Therefore, we are clearly of the opinion that deduction permitted by the Commissioner as well as the Tribunal is totally unsustainable in law. Therefore, in the light of the above conclusion reached by us, the question referred to us by the Tribunal is required to be answered against the assessee and in favour of the Revenue. According, it is answered and this Reference Case is disposed of. However, no order is made as to costs."

8.1 We find that similar findings have been rendered by the Hon'ble jurisdictional High Court in Millennia Developers (P.) Ltd. vs. DCIT, reported in [2010] 322 ITR 401 (Karn.). The relevant findings are reproduced as follows:–

"8. The appeal is sought for admission on the following questions of law :—

(i) Whether in law, the Tribunal was justified in upholding the disallowance of payment of Rs. 4,40,500 for regularization of the deviations which were within the permissible limits, holding it as penalty and thus not liable to be allowed under section 37(1) of the Act?
(ii) Whether in law under the KMC Act the payment made for regular-ization of the deviations in the plan within the permissible margin could be held to be penalty for the purpose of disallowance under section 37(1) of the Act especially when the appellant had contracted and sold the properties in accordance with the regularized plan, the profit from which had been offered for taxation?

9. On the overall examination of the facts and legal position, we find that the authorities below have not committed any error in law, warranting a correction by this Court in exercise of appellate jurisdiction under section 260A of the Act. We say so, for the reason that the so called regularisation fee in terms of Bye-Law 6.0 of the Bangalore Mahanagara Palike Bye-Laws is a provision made for regularising the deviations/violations as enabled under section 483(b) of the Karnataka Municipal Corporation Act, 1976 which reads as under :—

> *"483. Provisions respecting institution, etc., of civil and criminal actions and obtaining legal advice.—The Commissioner may—*
> *(a) *******
> *(b) compound any offence against this Act, the rules, bye-laws or regulations which may by rules made by the Government be declared compoundable;"*

10. The language of section 483(b) leaves us with no doubt as to the nature of the expenditure as it is only an amount paid for compound an offence. The amount paid for compound an offence is inevitably a penalty in terms of section 483 itself and the mere fact that it has been described as compounding fee cannot, in any way, alter the character of the payment which payment is in the nature of penalty.

11. As it is in the nature of penalty, the law too is well-settled to hold that it can never be an amount in the nature of expenditure which can qualify for deduction under section 37 of the Income-tax Act and it is for this reason,

we have to dismiss this appeal. If an answer is warranted in respect of the questions referred above, we answer the same against the assessee and in favour of the revenue.

12. The appeal is dismissed."

8.2 Therefore, respectfully following the decisions of the Hon'ble jurisdictional High Court cited supra, we do not find any infirmity in the findings of the learned CIT(A) on this issue, and accordingly, the same are upheld. As a result, the grounds raised by the assessee are dismissed.

9. In the result, the appeal by the assessee is dismissed.

Order pronounced in the open court on 14th Nov, 2025

Sd/-	**Sd/-**
(Prashant Maharishi)	**(Sandeep Singh Karhail)**
Vice President	**Judicial Member**

Bangalore,
Dated 14th Nov, 2025.
VG/SPS

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The DR, ITAT, Bangalore.
5 Guard file

By order

Asst. Registrar,
ITAT, Bangalore.