IN THE INCOME-TAX APPELLATE TRIBUNAL
BANGALORE BENCH 'B', BANGALORE

BEFORE SHRI VIJAY PAL RAO, JUDICIAL MEMBER
AND
SHRI G. MANJUNATHA, ACCOUNTANT MEMBER

ITA No.845(Bang.)/2015
(Assessment year : 2011-11)

M/s Prestige Estates Projects Ltd.
The Falcon House, No.1, Main Guard Cross Road,
Bangalore-560 001
PAN No.AABCP8096K Appellant

Vs

The Deputy Commissioner of Income-tax,
Central Circle-1(1)
Bangalore Respondent

And
ITA No.850(Bang)/2015
(Assessment year : 2010-11)
(By Revenue)

Date of hearing : 09-05-2016
Date of pronouncement : 13-05-2016

Appellant by : Shri Padamchand Khincha, CA
Respondent by : Dr. Sibichan K Mathew, CIT

O R D E R

PER SHRI G. MANJUNATHA, AM;

These are cross appeals foiled by the assesee and revenue directed against the common order of CIT(A)-11, dated 03-05-3013 and pertains to assessment year : 2010-11. Since the facts are identical and issues are common they are heard together and disposed by way of common order for the sake of convenience.

2. The brief facts of the case are that the assessee is a limited company engaged in the business of real estate and as builders and developers filed its return of income for the assessment year 2010-11 on 14-10-2010 declaring total income of Rs.70,64,77,400/-. The return of income was processed u/s 143(3) of the IT Act and subsequently, the case was selected for scrutiny and accordingly, notice u/s142(1) & 143(2) of the IT Act, was issued. In response to the notice, the ld. AR of the assessee appeared from time to time and furnished the details called for.

3. During the course of assessment proceedings, the AO notice that the assessee has received rental income from Forum, Eva Mall and UB City and treated the same under the head "Income from business", against which various expenditures have been claimed. Therefore, issued show cause notice to the assessee asking why the rental income from properties shall not be treated as income from house property. In response to the notice, the assessee submitted that it is in the business of letting out of properties and earning rental income and the same has been considered as business receipts for all these assessment years. The assessee further submitted the jurisdictional ITAT in assessee's own case for assessment year 2005-06 to 209-10 has held rental income from

malls is chargeable to tax under the head " profits of business and not under the head 'income from house property". Therefore, requested to allow the income as claimed by the assessee under the head" income from business or profession". The AO after considering the submissions of the assessee held that the income derived by the assessee by letting out properties to tenants is akin to any landlord tenant relationship therefore, the rental income from properties should be treated as income from house property and not under the head "income from business" as claimed by the assessee. While doing so, the AO relied upon the decision of the Hon'ble Supreme Court in the case of M/s Shambu Investment Pvt. Ltd Vs CIT (2003) 263 ITR 143, wherein it has been held that income derived by the assessee by letting out the furnished premises on monthly rental basis to various parties along with furniture, fixtures, lights, air-conditioners etc., for being used as payable space and also provided them common services like watch and ward, electricity and water was assessable as income from house property.

4. Similarly, the AO noticed that the assessee has received hire charges of fit-outs fitted to the properties let out to the tenants and considered under the head 'income from other sources", after claiming related expenditure being depreciation and other

expenditure. Therefore, issued show cause notice and asked to explain why the hire charges received towards fit-outs shall not be treated as income from house property. In response to show cause notice, assessee submitted that the hire charges received towards fit-outs fitted to the building in respect of fit-outs let out independently let out and a separate agreement was entered with the tenants therefore, it cannot be considered as composite letting out of premises alongwith building and other fit-outs. The assessee further submitted that the jurisdictional ITAT in assessee's own case for assessment year 20005-06 to 2009-10 has held that rental income from letting out of fit-outs is taxable under the head "income from other sources". Therefore, requested to consider income as claimed by the assessee.

5. The AO after considering the submissions of the assessee held that the fit-outs which forms part of integral part of the structures which was let out by the assessee and owned and let out by the assessee they should constitute part of the rent and is to be treated as "income from house property'. With these observations re-computed the income after allowing deduction u/s 24(a) as against the income declared by the assessee under the head "income from other sources".

6. Aggrieved by the assessment order, the assessee preferred an appeal before the ld. CT(A), before the ld. CIT(A) the assessee reiterated the submissions made before the AO. The assessee further submitted that merely because, income is attached to immovable property it cannot be the factor for assessing such income as income from house property. It was further submitted that the income from letting out of the property by way of commercial exploitation and as an organized commercial activity accompanied by professional services amenities or facilities is chargeable to tax as business income and not as "income from house property". The assessee further submitted that the jurisdictional ITAT in assessee's own case for the assessment year 2004-05 has held that rental income from malls is chargeable to tax under the head "Profit and gains of business and not under the head "income from house property".

7. As regards the rental income from the fit-outs, it is submitted that the assessee has earned rental income from fit-outs which are independently provided to the tenants and a separate agreement has been entered with the tenants. The activity of letting out of fit-outs is a commercial exploitation of property. Therefore, it cannot be considered as composite letting out of land and building alongwith the fit-outs. The assessee further submitted that the

jurisdictional ITAT in assessee's own case for the assessment year 2005-06 to 2009-10 held that the hire charges from fit-outs are taxable under the head" Income from other sources". Therefore, the AO erred in not appreciating the fact that the issue had been already decided in favour of the assessee by the jurisdictional ITAT. The ld. CIT(A) after considering the submissions of the assessee held that the income received by the assessee from letting out of Malls is assessable under the head" Income from profits and gains of business" and not under the head "Income from house property". Similarly, a rental receipt from letting out of fit-outs is assessable under the head "Income from house property". Aggrieved by the CIT(A)'s order, revenue is in appeal before us.

8. The ld. DR submitted that the ld. CIT(A) is not justified in holding that the rental income received by the assessee from Malls is assessable under the head" Income from business or profession" and not as income from house property, despite a specific agreement between the landlord and the tenant, contemplating a landlord relationship and rental income being paid every month as held by the Hon'ble Apex Court in the case of Shambhu Investment (P)Ltd Vs CIT (2003) 263 ITR 143(SC). The ld. DR further submitted that the predominant object of the assessee is to let out the properties and earn rental income and therefore, the rental income

earned by the assessee from letting out the properties cannot change the character of income merely because, it is in the activity of letting out properties. It is further argued that the though the jurisdictional ITAT, in the assessee's own case for the assessment year 2005-06 held that the rental receipts from letting out the Malls is assessable under the head " Income from business", the fact emanate from the agreement clearly suggests that it is mere letting out of properties and the resultant income should be assessed under the head "Income from house property".

9. On the other hand, ld. AR of the assessee submitted that the issue involved in this appeal is squarely covered by the decision of the Hon'ble ITAT in assessee's own case for the assessment year 2005-06 to 2009-10 and the ITAT held that the income received by the assessee from letting out of Malls is assessable under the head "Profit and gains of business or profession". The ld. AR further submitted that the Hon'ble High Court of Karnataka in assessee's own case for the assessment year 2009-10 has held the issue in favour of assessee. Therefore, the order of the ld.CIT(A) should be upheld.

10. We have heard both parties and have gone through the material available on record. The first issue that came up for our

consideration is whether the income received from letting out of Malls is assessable under the head "Income from business or profession" or under the head " Income from house property". A similar issue had come up for consideration before the co-ordinate Bench of this Tribunal in assessee's own case for the assessment year 2005-06 and the co-ordinate bench of the Tribunal, under similar circumstances held that the income received from letting g out of Mall is assessable under the head" Profits and gains of business or profession". The relevant portion is reproduced hereunder;

> " 2. Assessing of the rentals from Forum Mal and Eva Mall as income from "Profits and gains from business/profession".
>
> *i) The revenue's submissions was very blunt to the effect that the CIT(A) erred in directing the AO to assess the rental receipt from Forum Mall and Eva Mall as income from "profits and gains from business" and the CIT(A) grossly erred by ignoring the fact that the sample agreement in respect of the rental receipt clearly establishes a typical landlord – tenant relationship between the assessee and tenants and, therefore, the income received as rental receipts should have been ordered to be treated as income from "house property".*
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> *ii) At the outset, we would like to point that an identical issue had cropped up before the Hon'ble*

Tribunal for the AY: 2005-06 in the assessee's own case wherein the Hon'ble Tribunal had, after hearing the arguments of rival parties, analyzing the issue at length, extensively quoting, chiefly, the rulings of the Hon'ble Apex Court as well as the jurisdictional Hon'ble High Court in a number of cases on a similar issue, observed thus-

"5.1 We had discussed this issue while considering the ratio of law as laid down by the Hon'ble Apex Court in the case of Sultan Brothers (Supra). The Hon'ble Apex Court had held that there should be no consideration of primary and secondary lettings in construing the section 12(4) of 1922, which has analogy to 56(iii) of IT Act of 1961. In this case, the letting of building is along with letting machinery, plant or furniture required for ancillaries services and therefore, we hold that the alternative plea of the appellant that in case the income is not to be assessed under the head "income from house property" then it is required to be assessed under the head income from other sources" this is without prejudice to our basic finding that in the instant case, the income from Mall is assessable under the head "income from business".

iii) In conformity with the finding of the Hon'ble Tribunal referred above, we direct the AO to assess the income from Mall under the head "Income from business". It is ordered accordingly".

11. Considering the facts and circumstances of the case and also respectfully following the co-ordinate bench decision, we are of the view that the income received by the assessee for letting out of Malls

is assessable under the head "Income from profits and gains of business or profession". The CIT(A), by following ITAT, decision in assessee own case for the earlier assessment year allowed the claim of the assessee. We do not see any error in the order of the CIT(A). Therefore, we inclined to upheld the CIT(A) order and reject the ground of revenue.

12. The next issue that came up for our consideration is whether the income received from letting out of fit-outs independently is assessable under the head "Income from other sources" or Income from house property. The ld. AR of the assessee at the time of hearing submitted that the issue is covered by assessee's own case for the assessment year : 2006-07 and the ITAT, under similar circumstances held that the income received from letting gout of fit-out is assessable under the head " Income from other sources". We have gone through the case laws relied upon by the assessee and in the light of the facts of the present case and find that the co-ordinate bench of this Tribunal under similar circumstances held that the issue is in favour of the assessee. The relevant portion of the order is re-produced hereunder;

> *" 3) Direction of CIT(A) to AO to assess the hire charges in respect of fit-outs as income from other sources.*

i) Nevertheless, the revenue's brief submission was that the CIT(A) had grossly erred in directing the AO to assess the hire charges in respect of fit-outs which were laid out to tenants as income from "other sources'.

i) Yet again, we find a solace from finding of the Hon'ble Tribunal in the assessee's own case for the assessment year 2005-06 on similar issue wherein the Hon'ble Tribunal was pleased to observe that-

"6.1 This issue has been decided by this Tribunal in the case of the assessee for the assessment year 2004-05. The Tribunal vide order dated 29th May, 2009 in ITA NO.851/Bang/2008 vide para-14 of the order held that the facts and circumstances brought on record by the assessing authorities and the ld. counsel indicate that the intention of the assessee for rendering the same as income from other sources ought not to have been disturbed as in ealier years". Hence, the receipts on letting of it is to be taxed under the head "income from other sources" on the basis of the decision of the Tribunal in the earlier year and also on the basis of the principal of consistency. Once the rental income on letting out I taxed under the head "income from other sources", then the assessee will be entitled for depreciation".

iii) As the issue before us is similar which has been decided by the Hon'ble Tribunal referred supra in the assessee's own cased for the preceding assessment year, we have no hesitation in directing

the AO to treat the hire charges in respect of fit-outs let out to the tenants as income from "Other sources". It is ordered accordingly.

13. The Ld. AR further submitted that the issue has been travelled to the Hon'ble High Court of Karnataka, in the case of CIT Vs M/s Prestige Estate Projects Ltd., in ITA No.119/2014 under similar circumstances held that the rental income received by the assessee from letting out of Malls and fit-outs is assessable under the head 'Income from business and Income from other sources". The relevant portion of the order is re-produced hereunder;

"….2. Similar question arose for consideration before this Court in ITA No.73/2014 which was decided on 01-04-2014 following the judgment of this Court in the case of CIT-III Vs Velankani Information Systems (P)Ltd., reported in (2013) 218 Taxman 88 (Kar.). In the aforesaid decision this Court has observed as under;

"" 26…….If the intention s to exploit commercial property by putting up construction and letting out for the purpose of getting rental income, then notwithstanding the fact that the furniture and fittings are provided to the lessee, the income from the building fall under the head 'Income from house property'. But if the assessee is in the business of taking land, putting up commercial buildings thereon and letting out such buildings with all furniture as his profession or

business, then notwithstanding the fact that he has constructed a building and he has also provided other facilities and even if there are two separate rental deeds, it does not fall within the heading of income from house property. Therefore, firstly what is the intention behind the lease and secondly what are the facilities given along with the buildings and documents executed in respect of each of them is to be seen. Thirdly, it is to be found out whether it is inseparable or not. If they are inseparable and the intention is to carry on the business of letting out the commercial property and carrying at complex commercial activity and getting rental income therefrom, then such a rental income falls under the heading of profits and gains of business or profession".

3. In that view of the matter, we do not see any merit in this appeal. As the substantial questions of law raised in this appeal are already answered in the aforesaid decision, this appeal is dismissed".

14. Considering the facts and circumstances of the case and also respectfully following the Co-ordinate Bench decision, we are of the view, that the income received from letting out of fit-outs is assessable under the head "Income from other sources". The CIT(A) by relied upon ITAT decision in assesee's own case directed the AO to assess the rental receipts from fit out under the head "Income from other sources". We do not see any error or infirmity in the order

of CIT(A). Therefore, we inclined to upheld the CIT(A) order and reject the grounds raised by the revenue.

15. In the result, the appeal filed by the revenue is dismissed.

ITA No.845(Bang.)/2015

16. The first issue that came up for our consideration from assessee appeal in ITA No.845/B/2015 is disallowance of compounding fee. During the course of assessment proceedings, the A.O. disallowed compounding fees of Rs.56,48,800/-. The AO was of the opinion that the expenditure incurred by the assessee is in the nature of penalty which is not allowable u/s 37(i) of the IT Act, 1961. It is the contention of the assessee that the expenditure incurred by way of compounding fees is paid to the local authorities for regularizing the violations in the sanctioned plan. The assessee further contended that it had paid compounding fees to BBMP on various projects to compound the irregularities in sanction of plan and paid the fees for regularizing the construction. The assessee further submitted that it is not a fine or penalty paid in respect of an offence prohibited under any law in force, but it is only payment of fees to compound the irregularities for violation of sanction plan under the Municipal Acts. Therefore, compounding fees paid cannot be considered as fine or penalty.

17. The AO after considering the explanation of the assessee held that the assessee has incurred compounding fee to regularize unauthorized construction which nothing but a fine or penalty for violation of the Municipal Act. Therefore, the same cannot be allowed as deduction while computing the income under the head " Profits and gains of business or profession". Aggrieved by the assessment order, the assessee preferred appeal before the ld.CIT(A), who after considering the assessee's own case for the assessment year 2006-07, upheld the disallowance made by the AO.

18. The ld.AR, at the time of hearing fairly accepted that the issue is decided against the assessee in assessee's own case for the assessment year 2006-07. However, submitted that the lower authorities have erred in not appreciating the impugned expenditure incurred towards regularization of construction made in excess of sanction plan and which was within curable limits therefore, the compounding fees paid to regularize the deviations from sanctioned plan cannot be considered as fine or penalty for violation of any law in force. The ld. AR further submitted that the payment of compounding fees is neither prohibited by law or an offence. The BBMP has received occupancy certificate in respect of construction after regularizing the said deviations and once the

occupancy certificate is issued the offence no longer remains. Therefore, requested to delete the addition made by the AO. On the other hand, ld. DR strongly supported the order of the ld. CIT(A). The ld. DR further argued that the issue in question is covered against the assessee by assessee's own case for the assessment year 2006-07. The ITAT, in assessee's own case for the assessment year 2006-07 has held that the compounding fees is in the nature of fine or penalty cannot be allowed as deduction.

19. We have heard both parties and have gone through the material on record. The AO disallowed the compounding fees for the reason that the expenditure incurred by the assessee is in the nature of fine or penalty for violation of any law in force. It is the contention of the assesee that the compounding fee paid to BBMP to regularize the deviations from the sanctioned plan is not a fine or penalty for violation of any law. The assessee further contended that it has paid the compounding fee which is within the permissible limits allowed under the provisions of Municipal Act. The BBMP has regularized the deviation by collecting prescribed fees as per the provisions of Municipal Act and issued occupancy certificate to the projects. Therefore, it cannot be considered as fine or penalty. We have considered the submissions of the assessee and orders of the

authorities below. At the time of hearing, the ld. DR submitted that the very same issue has been decided against the assessee in assessee's own case for the assessment year 2009-10. The ITAT, in assessee's own case for the assessment year 2009-10 in ITA No.78/B/2013 upheld the disallowance of compounding fees. The relevant portion is reproduced hereunder;

> "3. At the time of hearing, the learned counsel for the assessee submitted that the very same issue had come up for consideration before the 'C' Bench of this Tribunal for assessment year 2007-08 in ITA No.962/Bang/2011 and vide orders dated 14/9/2012, the Tribunal had decided the issue against the assessee by following the decision of this tribunal in the assessee's own case for the assessment year 2001-02 and 2003-04. The relevant portion of the order of the tribunal is at para 5 to 6 of the assessment order. The same is reproduced hereunder for easy reference:
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> "*5. Having heard both the parties and having considered the rival contentions and the relevant materials on record, we find that the Tribunal at para 3.16 to 3.18 has held as under :*
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> *"3.16 The issue before us has been considered by the Karnataka High Court in the case of Mamta Enterprises (supra). The question of law referred to the jurisdictional High Court was as under:-*

"Whether on the facts and in the circumstances of the case, the Appellate Tribunal is right in law in holding that the payment of the compounding fees is not a penalty for infraction of law and hence allowable".

At page 361, the Hon'ble High Court has referred to the order issued in the case of Mamta Enterprises. In the instant case also, the order which has been issued by the Commissioner while granting occupancy certificate, is that the assessee has paid the compounding fine. Before the Hon'ble High Court it was contended by the appellant's counsel that construction of a building in violation of the sanctioned plan cannot be treated as a violation of a serious nature, which is prohibited by law or amounting to commission of an offence. The Hon'ble jurisdictional High Court after observing as under held that byelaws empower the Commissioner to compound the violation or deviation of the sanctioned plan by a person who constructs a building:-

"Having elaborately heard 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 the 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 may be refused by the Commissioner. Since 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 reconstruction 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 byelaw 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, byelaws 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 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. Byelaw 5.6 framed by the Corporation in exercise of the power conferred under it under section 428 of the Act enables the Commissioner to set out the circumstances under which he could compound an offence. It is useful to refer to the said byelaw which reads as hereunder:

"5.6.1 Whether 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% of (1) the minimum set back to be left around the building (2) the maximum plot coverage (3) permissible floor area ratio 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 regularize 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 inspite of the same being specifically deleted or rejected in the sanctioned plan".

The byelaws 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".

After holding that the amount paid is compounding of an offence, the Hon'ble jurisdictional High Court held that such an expenditure is not to be deemed to have been

incurred for the purpose of business or profession and no deduction or allowance can be made in respect of such an expenditure. Thus, the decision of jurisdictional High Court is squarely applicable in the instant case.

3.17 The Hon'ble M.P. High Court in the case of National Textile Corporation Ltd. v CIT 286 ITR 496 had an occasion to consider as to whether the Tribunal could comment on the decision of the High Court and having done so, whether judicial proprietary permitted the Tribunal to ignore the decision and take its own view are question of law which have to be referred to the High Court. While allowing the matter to be referred, the Hon'ble MP High Court observed at page 498 as under:-

"In our considered opinion the manner in which the Tribunal has dealt with the issue so far as precedents of judicial propriety in following decisions of the High Court are concerned, the same should have been referred to this Court for examination. It is, in our humble opinion, on issue which the High Court alone has to decide and not for the Tribunal to decide. We have our own reservations as to whether the Tribunal could make a comment on the decision of the High Court and having done so, whether judicial propriety permitted the Tribunal to ignore the decision and take its own view. All these issues need to be decided by the High Court in a reference under section 256(1) ibid".

3.18 Hence, when a similar issue has been decided by the jurisdictional High Court, then that decision is binding on us and that is to be followed in order to abide with the judicial discipline. Hence, we hold that the amounts paid as compounding fine for regularization of violation/ deviation are not allowable expenditure. We also uphold the finding of the learned CIT(A) that in case the compounding fine/penalty paid for regularization of violation/deviation is ultimately held as fees then provision of section 43B will be applicable and the amount

will be deductible as per the provisions of section 43B. This disposes of appeal for the assessment year 2001-02".

4. Respectfully following the decision of the co-ordinate bench which is in the consonance with the decision of the Hon'ble jurisdictional High Court, this appeal of the assessee is dismissed.

20. Considering the facts and circumstances of the case and also keeping in view the judicial discipline, by following the coordinate bench decision, in assessee's own case for assessment year 2009-10 we upheld the disallowance of compounding fees.

21. The next issue that came up for our consideration is deduction u/s 80-10B of IT Act, 1961. The assessee has raised alternative plea that if the compounding fees is not allowed as deduction, the same has to be considered for deduction u/s 80-IB(10) of the IT Act, 1961. The ld. AR submitted that the assessee is eligible for deduction u/s 80-IB(10) of the Act, therefore, any disallowance of expenditure which results in enhancement of eligible profit which is allowed as deduction u/s 80-IB(10) of the Act, 1961. In support of his arguments relied upon the decision of the ITAT of Delhi Bench in the

case of DCIT Vs Shree Ganesh Developers & Builders 6C, Cross Road, Dehradun in ITA No.3763/Del/2011.

22. On the other hand, ld. DR submitted that any expenditure which is incurred in the nature of fine or penalty which is allowable as deduction u/s 37(i) of the Act is not eligible for deduction u/s 80-IB(10) of the IT Act, 1961. The ld. DR invited our attention to the explanation provided to sec.37 of the IT Act and submitted that any expenditure incurred by the assessee for any purpose which is an offence and 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 for the purpose of such expenditure. Therefore, he submitted the enhanced profit shall not be treated as eligible profit for the purpose of deduction u/s 80IB(10) of the IT Act, 1961. The ld. D.R further submitted that the assessee has raised this ground for the first time before the ITAT and the facts of which were before the lower authorities therefore, the issue may be set aside to the file of the AO. for re-examination.

23. We have heard both parties and perused the material on record. The assessee had made an alternative plea in case, the compounding fee is not allowable as deduction, the same may be considered for deduction u/s 80-IB(10) of the IT Act, 1961. It is

further contended that the assessee is carrying out eligible business and claiming deduction u/s 80-IB(10) of the IT Act, 1961 therefore, any disallowance of expenditure would result in enhancement of eligible profit. Since, the assessee is eligible for deduction u/s 80-IB(10) of the IT Act and the enhanced profit should be allowed as deduction u/s 80-IB(10) of the IT Act, 1961. We find force in the argument of the assessee for the reason that any disallowance of expenditure would certainly enhance the profits of eligible business. If assessee is carrying on eligible business, then, the total profits of the business shall be eligible for deduction under the provisions of Act. In the present case, there is dispute about the activity of the assessee which is eligible for deduction under sec.80-IB(10) of the IT the Act, 1961. However, the assessee has raised the issue before the Tribunal for the first time. The lower authorities have not had an occasion to consider the plea of the assessee in the light of the provisions of sec.80-IB(10) of the Act. Therefore, we deem it appropriate to remit the issue to the file of the AO and direct the AO to examine the claim of assesee in the light of the provisions of sec.80-IB(10) of the IT Act, 1961. Accordingly, we set aside the issue to the file of the AO and direct the AO to re-compute the deduction available u/s 80-IB(10) of the Act, in accordance with the provisions of the Act.

24. The next issue that came up for our consideration is the disallowance u/s 14A of the IT Act, 1961. The AO disallowed proportionate interest expenditure and indirect expenditure u/s 14A of the IT Act r.w. rule 8D(2)(ii) and 8D(2)(iii). The AO was of the opinion that the assessee has earned dividend income and claimed exempt u/s 10(34), but failed to disallow expenditure relatable to exempt income. The AO further held that in view of the amended provisions of sec.14A read wit Rule 8D, disallowance of proportionate expenditure in respect of interest and other expenditure is mandatory, where the assessee has earned exempt income. It is further observed that in the case of direct expenditure, any expenditure incurred directly to earn exempt income should be disallowed in full. In case of other expenditure where the direct nexus is not established to earn the exempt income, the proportionate expenditure as prescribed under Rule 8D should be disallowed. It is the contention of the assessee that it has utilized the borrowed funds for the purpose of investments in shares to earn exempt income. Therefore, no disallowance can be made u/s 14A of the IT Act, 1961. It is further submitted that to invoke the provisions of sec.14A of the IT Act, the AO has to prove that the assessee has invested the interest bearing funds to earn exempt income. The

assessee had own funds to cover up the investments, therefore, no disallowance can be made towards interest expenditure.

25. We have heard both parties and have perused the material on record. The AO disallowed the interest expenditure by invoking provisions of sec.14A of the IT Act r.w. Rule 6D. The AO disallowed the amount for the reason that the assessee has earned exempt income, but failed to allocate the relatable interest and other indirect expenditures on pro-rata basis. The AO was of the opinion that the assessee has not proved to the satisfaction of the AO that it has not utilized the borrowed funds for the purpose of investments in shares. The AO further opined that as per the amended provisions of sec.14A of the Act, there is no distinction between the direct and indirect expenditure. In case, where there is exempt income, the relatable expenditure in respect of interest and other indirect expenditure should be disallowed. It is the contention of the assessee that the AO was not correct in disallowing the interest as it has not utilized the borrowed funds for the purpose of investments of shares of companies. The assessee further contended that it has enough surplus funds in the form of share capital and reserves to cover the investments made in shares to earn the exempt income.

26. The question before us is whether the interest and other indirect expenditure relatable to earning exempt income is disallowable u/s 14A of the IT Act, 1961. The fact in respect of earning exempt income is not in dispute. The only dispute is whether is there any direct nexus between earning exempt income and utilization of interest bearing funds in shares. The assessee has filed a paper book containing financial statements for the relevant financial year. On verification of the financial statement, we find that the assessee share capital and reserves which is in excess of investments made in shares. Therefore, we are of the view that the AO was not correct in disallowing the proportionate interest by invoking provisions of Rule 8D of IT Rules, 1962. As regards the disallowance of administrative expenditure, the AO has disallowed proportionate administrative expenditure by invoking the provisions of Rule 8D (2)(iii). Although, the assessee contended that it has not invested borrowed funds for the purpose of investments in earning exempt income, the assessee cannot get away with the plea it did not incur any administrative expenditure for day today management and monitoring such investment portfolios. Therefore, we are of the view that once there is exempt income relatable administrative expenditure should be disallowed in proportion to the exempt income. The AO after considering the relevant facts,

disallowed the administrative expenditure by invoking provisions of Rule 8D(2)(iii) of IT Rules, 1962. Therefore, we upheld the disallowance made by the AO in respect of administrative expenditure.

27. In the result, the appeal filed by the Revenue is dismissed and the appeal filed by the assessee is partly allowed for statistical purposes.

Order pronounced in the open Court on the 13th May, 2016.

Sd/-	**Sd/-**
(VIJAY PAL RAO)	**(G. MANJUNATHA)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Place: Bangalore
Dated: 13-05-2016
am*

Copy to :

1. The Assessee
2. The Revenue
3. CIT(A)
4. CIT
5. DR

By Order

AR, ITAT, Bangalore