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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

R-6A

Date of Decision: 31st July, 2015

\+ **ITA 62/2007**

COMMISSIONER OF INCOME TAX ..... Appellant

Through: Mr N. P. Sahni, Senior Standing Counsel with Mr Nitin Gulati, Junior Standing Counsel.

versus

BHARAT HOTELS LIMITED ..... Respondent

Through: Mr Ajay Vohra, Senior Advocate with Ms Bhavita Kumar, Advocate.
Mr Prakash Kumar, Advocate.

CORAM:
HON'BLE DR. JUSTICE S. MURALIDHAR
HON'BLE MR. JUSTICE VIBHU BAKHRU

DR. S. MURALIDHAR, J.

1. This appeal pertains to the Assessment Year ('AY') 2000-2001.

2. It is not in dispute that Questions 1 and 2 framed by the Court by the order dated 20th November 2007 are identical to Question Nos.6, 1 and 3 in ITA No.69-73/2001 which have been answered by the judgment dated 24th July 2015. Questions 1 and 2 stand answered accordingly.

3. The further question which arises in this year is whether the ITAT was correct in law in allowing deduction of Rs.38,59,046/- being interest expenditure incurred by the Assessee in relation to construction of various hotel projects by treating the same as revenue expenditure?

4. There were three projects being undertaken by the Respondent Assessee in Srinagar, Goa and Mumbai. The Assessee had borrowed loans for the said projects. It had shown them as works in progress. In para 7.1 of the Assessment order dated 28th March 2003, the Assessing Officer (AO) noted that 75% of the total interest of Rs.1.54 crores paid on the term loan obtained from the Jammu and Kashmir Bank amounting to Rs.1,15,77,137 was capitalised. The balance of Rs. 38,59,046/- was charged to the profit and loss account as revenue expenditure. According to the AO, the Assessee did not provide any justification how 25% of the total interest paid could be claimed as revenue expenditure. This was accordingly added back.

5. While, allowing the appeal filed by the Assessee on this aspect, the Commissioner of Income Tax (Appeals) [CIT (A)] in his order dated 16th June, 2003 observed that during the AYs in question the Srinagar hotel was partially operational and partially under repair and, therefore, the

Assessee's bifurcation of capital and revenue in the ratio of 75% and 25% did not appear to be unjustified. The addition was accordingly deleted.

6. The Department's appeal being ITA No.4137/Del/2003 was dismissed by the ITAT by the impugned order dated 2nd June 2006. The ITAT was of the view that the hotel projects in Srinagar, Goa and Mumbai were in the nature of expansion of the business of the Assessee and the interest paid on loans was allowable as revenue expenditure.

7. It is contended by Mr N. P. Sahni, learned Senior Standing Counsel appearing for the Appellant, that in view of Explanation 8 of Section 43(1) of the Act, the Assessee was not entitled to deduction of interest paid on borrowings since the loan was availed for the purposes of the construction of the hotel projects of the Assessee at Srinagar, Goa and Mumbai. According to him, the Assessee should have provided the details as to how much of the amount of interest paid was relatable to the period after the asset was first put to use. In the absence of such details, the AO was justified in adding the entire amount of interest claimed as revenue expenditure.

8. In reply, it is pointed by Mr Ajay Vohra, learned Senior Counsel appearing for the Assessee, that the applicable provision is Section 36 (1) (iii) of the Act which at the relevant time, i.e. prior to the insertion of the proviso thereto with effect from 1st April 2004, allowed as deduction the amount of interest paid on loans borrowed for the purposes of business operation. Mr. Vohra referred to the decisions in ***Commissioner of Income-Tax v. Modi Industries Ltd. (1993) 200 ITR 341 (Del), Commissioner of Income-Tax v. Monnet Industries Ltd. (2011) 332 ITR 627 (Del) and Deputy Commissioner of Income-Tax v. Core Health Care Ltd. (2008) 298 ITR 194 (SC)***. He submitted that in terms of Section 36 (1) (iii), during the AY in question, the Assessee was entitled to treat the expenditure incurred in payment of interest on loans borrowed for the expansion of the existing business as revenue expenditure.

9. The decision of this Court in ***Commissioner of Income Tax v. Monnet Industries Ltd.*** (*supra*) contains a detailed analysis of the legal position. There the Assessee had set up a ferro alloys manufacturing plant in 1991 in Raipur. During the years 1994-95 and 1995-96 it set up a sugar manufacturing plant in Uttar Pradesh and raised loans for that purpose. The Assessee, *inter alia*, claimed as revenue expenditure, the payment of

interest on the loans. After discussing the decisions of the Supreme Court in ***India Cements Ltd. v. CIT (1966) 60 ITR 52*** and ***Challapalli Sugars Ltd. v. CIT (1975) 98 ITR 167***, the Court summarised the legal position as follows:

> "The upshot of the aforesaid decisions as applied by the Tribunal in instant case is that:
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> > (i) a loan taken or capital borrowed is, by itself, not a capital asset, nor does it give an advantage of an enduring nature;
> >
> > (ii) as long as a loan was taken or capital was borrowed for the purposes of business, the assessee is entitled to claim interest paid thereon as deduction under Section 36(1)(iii) of the Act;
> >
> > (iii) interest may have to be capitalized after the borrowed capital or loan taken is utilized in bringing into existence an asset at the stage of commencement of business. In other words, after the assessee's business had already commenced then the interest paid on capital borrowed or loan taken can be claimed as deduction under Section 36(1)(iii) of the Act.
> >
> > (iv) in coming to the conclusion whether the interest paid on capital borrowed or loan taken in setting up a new line of business ought to be capitalized or treated as revenue expenditure, the test as laid down by the Supreme Court in the cases of *Produce Exchange*

Corporation (supra) and *Prithvi Insurance Company* (supra) would be relevant and;

(v) lastly, as long as interest is paid on capital borrowed or loan taken in respect of new line of business which is in the same business fold for the purposes of ascertaining income under Section 28 of the Act, it can be claimed as a deduction under Section 36(1)(iii) of the Act."

10. The order dated 29th August 2012 of the Supreme Court dismissing the Revenue's appeal against the above decision of this Court is reported as ***Commissioner of Income Tax v. Monnet Industries Ltd. 350 ITR 304***.

11. With effect from 1st April, 2004, a proviso was inserted under Section 36 (1) (iii) of the Act. The said provision together with the proviso now reads as under:

"36 (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in Section 28-
(i)...
(ii).....
(iii) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession:
Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in

> the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction."

12. In ***Deputy Commissioner of Income-Tax v. Core Health Care Ltd.***(*supra*), the Supreme Court interpreted the aforementioned provision in light of Explanation 8 to Section 43(1) of the Act. In that case too, the question that arose was whether the Assessee which had installed a new machinery on which production had not yet started could claim the interest paid on borrowings for acquiring the said machinery as revenue expenditure. In that case too, the Department relied on Explanation 8 under Section 43(1) of the Act to argue that the Assessee was not entitled to claim deduction and that Section 36 (i) (iii) of the Act being general in nature had to give way to the special provision contained in Explanation 8 to Section 43(1) of the Act.

13. After analysing both the provisions, the Supreme Court came to the conclusion that Explanation 8 of Section 43(1) only applied to provisions like "Sections 32, 32A, 33 and 41 which deal with concepts like depreciation." It was observed that Explanation 8 of Section 43 (1) had no relevance to Section 36 (1) (iii). On the facts of that case since the

AYs in question were prior to 1st April 2004, the Supreme Court concluded that the proviso to Section 36 (1) (iii) of the Act would not apply. The Supreme Court on the facts of the case stated that appropriate precedent applicable was ***India Cements Ltd. v. CIT*** (*supra*) and not ***Challapalli Sugars Ltd. v. CIT*** (*supra*). The rationale for allowing the payment of interest on borrowings as revenue expenditure was explained as under:

> "It does not matter whether the capital is borrowed in order to acquire a revenue asset or a capital asset, because all that the section requires is that the assessee must borrow the capital for the purpose of his business. This dichotomy between the borrowing of a loan and actual application thereof in the purchase of a capital asset, seems to proceed on the basis that a mere transaction of borrowing does not, by itself bring any new asset of enduring nature into existence, and that it is the transaction of investment of the borrowed capital in the purchase of a new asset which brings that asset into existence. The transaction of borrowing is not the same as the transaction of investment. If this dichotomy is kept in mind it becomes clear that the transaction of borrowing attracts the provisions of Section 36 (1) (iii)."

14. In view of the clear legal position enunciated in the above decisions, the Court is of the view that as far as the present case is concerned, the Respondent Assessee was entitled to claim the payment of interest on the borrowings made in relation to the hotel projects at Srinagar, Goa and

Mumbai, which were in the nature of expansion of the business Assessee, as revenue expenditure. The question is, accordingly, answered in the affirmative i.e. in favour of the Assessee and against the Revenue.

15. The appeal is disposed of.

S. MURALIDHAR, J

VIBHU BAKHRU, J

JULY 31, 2015
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