



Compounding fee paid to the municipal corporation for regularising a building plan is allowable as business deduction under Section 37 of the Income-tax Act

Background

Recently, the Hyderabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Keerthi Estates (P) Ltd¹ (the taxpayer) held that compounding fee paid to the municipal corporation for regularising a building plan is allowable as deduction under Section 37 of the Income-tax Act, 1961 (the Act) since the project was completed and the deviations are within the limits, for which the municipal corporation has approved the project. The compounding fees paid to the municipal corporation is neither in the nature of offence nor prohibited by law.

The Tribunal observed that at the time of approval, the corporation and the builders were aware that it is not possible to complete the project as per the proposed plan as there are certain adjustments that were needed to be made at the time of actual execution. As long as the actual completion of the projects are within the parameters of approval, the corporation/approving authorities permit the projects as approved with the nominal fine or compounding fee. If the projects are illegal, which is an offence and cannot be cured, the whole project cannot be approved by the approving authorities, as the same is the subject matter of public safety.

Facts of the case

- During the Assessment Year (AY) 2011-12, the taxpayer paid compounding fine of INR86.60 lakh to Bangalore Municipal Corporation to regularise the building plan. The taxpayer while computing its income claimed the deduction of the said compounding fee. The Assessing Officer (AO) while passing the assessment order under Section 143(3) of the Act has allowed the said amount and did not dispute the allowability of compounding fine.

- The Commissioner of Income Tax (CIT) in exercise of powers under Section 263 of the Act observed that the assessment order passed under Section 143(3) of the Act is erroneous and prejudicial to the interests of revenue as the AO has not disallowed the amount of INR86.60 lakh which was paid by the taxpayer towards 'compounding fine' and penalty to the Bangalore Municipal Corporation. The CIT held that the amount paid towards compounding fine and penalty is not allowable for a deduction as per Explanation of Section 37(1) of the Act.

Tribunal's decision

- The Tribunal observed that the decision with respect to the compounding fine is divided among the various courts. The Punjab and Haryana High Court² and the Karnataka High Court³ have held that similar penalty is in the nature of an offence. However, the other benches of the Tribunal have given divergent views.
- In our considered view, the builders submitted a building plan for approval and based on the proposed plan, the municipal corporation gives approval. It is a fact that at the time of approval, the corporation and the builders aware that it is not possible to complete the project as per the proposed plan as there are certain adjustments need to be made at the time of actual execution.

¹ Keerthi Estates (P) Ltd v. DCIT (ITA No. 271/Hyd/2016) – Taxsutra.com

² Nahar Spinning Mills Ltd. v. CIT [2014] 49 Taxmann.com 565 (P&H)

³ CIT v. Mamta Enterprises [2003] 266 ITR 356 (Kar)

- As long as the actual completion of the projects are within the parameters of approval, the corporation /approving authorities permit the projects as approved with the nominal fine or compounding fee. This is the reason, the corporation has the clause intact in the rules books. If the projects are illegal, which is an offence and cannot be cured, the whole project cannot be approved by the approving authorities, as the same is the subject matter of public safety.
- The penalty can be classified into two types, i.e., one charged for violation of law in the nature of the offence, which cannot be pardoned by compounding and the second is charged for violation of certain rules which are not in the nature of offences and can be cured by compounding.
- In the case of housing/commercial projects, the corporation aware that there will be certain deviations at the time of approval and no project can be completed without any deviation. The question is the extent of the deviation. In case it is within the permissible limits, the approving authorities, allow with compounding the deviation by levying compounding fees.
- In the present case, the project was completed, and the deviations are within limits, for which the Bangalore Municipal Corporation has approved the project by compounding fees, which is not in the nature of offence nor prohibition of any law. Therefore, it is allowable as a deduction under Section 37(1) of the Act.

Our comments

The compounding fee paid by builders/developers to the municipal corporation for regularising the construction has been a matter of debate before the Courts/Tribunal.

The Mumbai Tribunal in the case of Radhaballabh Silk Mills (P.) Ltd.⁴ held that the amount paid by the taxpayer for regularising the construction was nothing but a penalty to regularise unauthorised construction carried out without obtaining approval from the municipal corporation. Therefore, the expenditure was clearly hit by Explanation to Section 37(1) of the Act.

However, the Pune Tribunal in the case of EON Hadapsar Infrastructure (P.) Ltd.⁵ held that compounding fee paid for some technical violations without committing any offence is an allowable business expenditure. Even though the said decision is not directly on the subject matter, it is equally important while construing the law with respect to compounding fee paid by builders to the municipal corporation for some technical violations.

The Hyderabad Tribunal in the present case has held that compounding fee paid to the municipal corporation for regularising a building plan is not in the nature of offence nor prohibited by law. Therefore, it is allowable as a deduction under Section 37 of the Act.



⁴ Radhaballabh Silk Mills (P.) Ltd v. DCIT [2007] 12 SOT 423 (Mum)

⁵ EON Hadapsar Infrastructure (P.) Ltd. v. ACIT [2016] 71 taxmann.com 115 (Pune)

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