

Compounding fee paid to RBI isn't in nature of penalty; eligible for deduction

Summary – The Pune ITAT in a recent case of EON Hadapsar Infrastructure (P.) Ltd., (the Assessee) held that Compounding fee paid by assessee as per direction of RBI for some technical violations without committing any offence is an allowable business expenditure

Facts

- The assessee was engaged in the business of development and selling of real estate.
- The assessee claimed deduction on account of the compounding fees paid to RBI.
- The explanation of the assessee was that it had availed the ECB from the company Porto Mauritius for which, the Reserve Bank of India had granted permission. However, RBI noticed that the lender was not recognized for some technical reasons and had asked the assessee to pay compounding fees of Rs. 45 lakhs as against maximum amount of Rs. 30 crores.
- The assessee further explained that the compounding fees was debited as bank charges and was to be allowed as deduction.
- The Assessing Officer observed that the assessee knew that Porto was not a recognized lender and still it borrowed the loans from the said company. Hence, the claim of assessee that it was a bona fide mistake was incorrect. The Assessing Officer, thus, disallowed compounding fees and added same to the income of the assessee.
- On appeal, the Commissioner (Appeals) confirmed the order of the Assessing Officer and held that the compounding fee paid by the assessee came within mischief of Explanation to section 37(1).
- On appeal by the assessee:

Held

- The issue arising is in relation to the claim of expenditure of Rs. 45 lakhs. The assessee had applied to the Reserve Bank of India for raising ECB loans. In order to avail the aforesaid ECB loans from Reserve Bank of India, necessary documents/evidences as required under FEMA Act have to be provided to Reserve Bank of India, who in turn, approves the same by way of issuing LR number, consequent to which, the assessee is entitled to raise ECB loans in foreign currency. The assessee is a company which was promoted by V and S. The assessee had raised ECB loans from Porto Mauritius, which was wholly owned company of V and S. The assessee entered into loan agreements and raised ECB loans after receiving the permission from Reserve Bank of India. Total loan raised by the assessee was US\$ 23 lakhs equivalent to Rs. 1,00,843 lakhs. The lender company Porto was wholly owned company of promoter directors of assessee company. The Reserve Bank of India after taking note of the arrangement noted that the lender was not the recognized lender in terms of guidelines for ECB under the provisions of FEMA Act, 1999. In view thereof, Reserve Bank of India approved pre- payment of all three ECBs raised by the assessee. However, proceedings were

initiated against the assessee for non-compliance with the Rules/Regulations/Directions under FEMA Act, 1999. Under the Reserve Bank of India guidelines, a Circular is issued by Reserve Bank of India on compounding of contraventions under FEMA Act, 1999.

- It is the case of assessee that the compounding in its case was on account of amount of loss caused to any authority/exchequer as a result of such contravention. The perusal of compounding order passed by the authority reflects that the authority had held the assessee to have contravened regulations 3 and 6 of Notification No. FEMA.3/2000-RB by availing external commercial borrowings amounting to Rs. 10.08 crores without prior approval of the Reserve Bank of India. The duration of contravention was 3 years 7 months approximately. In terms of section 131 of FEMA Act, 1999, where any person contravened any provisions of the Act, he shall be liable to penalty up to thrice the sum involved in such contravention. The Competent Authority noted that though in terms of section 131 of FEMA Act, the penalty could be up to Rs. 30,25,29,000/-, but however, after considering the matter and rationale behind the compounding provisions, submissions of assessee and entire facts and circumstances of the case, a lenient view was taken on the amount for which contravention was to be compounded and it was held that the payment of Rs. 45 lakhs would meet the ends of justice. The perusal of the said order passed by Competent Authority reflects that as against the contravention of provisions to the extent of Rs. 30.25 crores, after considering the totality of the facts and circumstances and various provisions of compounding, the assessee was asked to pay compounding fees of Rs. 45 lakhs. In other words, the compounding fees charged to the assessee was not in the form of any penalty for committing an offence but was compensatory amount charged to the assessee for failing to comply with provisions of FEMA Act. It may be clarified that the provisions of FEMA Act, 1999 itself provides for a measure to be taken by the authorities by charging compounding fees in respect of contravention, if any. Where the amount paid by the assessee is compensatory payment and was not by way of any penalty levied under the provisions of FEMA, then such amount is to be allowed as deduction in the hands of assessee.
- Now, coming to the stand of authorities below that such payment is covered by Explanation to section 37(1). The said stand of Commissioner (Appeals) has no merit. The Explanation to section 37(1) was inserted in respect of any expenditure incurred for any purpose which was an offence or which was prohibited by law. The Circular of Reserve Bank of India itself provided that where the assessee had committed an irregularity while dealing in foreign earnings or expenditure outgoes, then such an action of applicant could be compounded as per Rules and Regulations provided in the said Circular. It is not a case where the assessee has been held to have committed an offence or the amount has been paid for purpose, which was prohibited in law, hence the provisions of Explanation to section 37(1) are not attracted. In view thereof, the assessee is entitled to the claim of deduction under section 37(1).