

## Interest paid on loan taken for purchase of land used as stock-in-trade to be allowed as revenue exp.

**Summary – The High Court of Bombay in a recent case of Jayantilal Investments., (the Assessee) held that where assessee, engaged in construction business, purchased plot of land out of borrowed funds for implementation of a project, since plot of land was purchased in course of business of assessee, same formed part of its stock-in-trade, and, therefore, interest paid on borrowings for purchase of said land was to be allowed as revenue expenditure**

### Facts

- The assessee partnership firm was engaged in construction activity. The assessee had taken a loan to purchase open plot of land for its project named, 'LS'. The assessee had claimed an amount paid as interest on said loan as revenue expenditure.
- The Assessing Officer held that purchase of plot of land was capital in nature. Hence, interest must also be capitalized. Thus, he disallowed the deduction on amount being interest paid on loan for acquisition of land.
- On appeal, the Commissioner (Appeals) found that interest paid on borrowings for purchase of land was allowed as revenue expenditure in the earlier assessment years and it was only in the subject assessment year that the Assessing Officer for the first time treated the same as work-in-progress and capitalized the same. He held that the interest paid on the loan taken for the purpose of its stock-in-trade, *i.e.*, plot of land for the 'LS' project had to be allowed as expenditure to determine its income. Consequently, he deleted the disallowance made by the Assessing Officer.
- On further appeal, the Tribunal held that crucial question to be decided was whether the assessee could be said to have commenced work on project 'LS' during the previous year relevant to subject assessment year. On facts it held that the assessee had not shown any work had commenced on LS project plot of land during the previous year relevant to the subject assessment year. Thus, the Tribunal concluded that the Assessing Officer was justified in coming to conclusion that interest expenditure in respect to 'LS' project (plot of land) could not be allowed as revenue expenditure.
- On appeal to the High Court:

### Held

- The assessee had also made alternate submission to the effect that the plot of land which was purchased out of borrowed funds on which interest was paid, forms part of its stock-in-trade, therefore, interest paid on purchase of stock-in-trade is to be allowed as revenue expenditure. This was negated by the Assessing Officer on the ground that purchase of plot is necessarily capital in nature and, therefore, interest thereon is also to be capitalised. However, the fact is that the loan on which interest is paid was taken for purchase of plot of land in the course of its business of assessee. This fact is undisputed therefore, the interest had been paid to acquire stock-in-trade. In the above circumstances as held by the Commissioner (Appeals), the same has to be allowed as revenue

expenditure. However, the Tribunal in the impugned order has completely ignored the above findings and applied the test of the Assessing Officer namely that it is only if work is commenced on LS project, would the same be allowed as revenue expenditure and not otherwise. This specifically on the basis of the manner in which accounts are maintained by the appellant. In fact revenue also supports the impugned order on the basis of the manner of accounting followed by the assessee. The entries in the books of account will not determine the assessee's entitlement to deduction. This has to be examined on the touchstone of the provisions of the Act.

- In view of section 36(1)(iii) as existing prior to amendment with effect from 1-4-2004 all interest paid in respect of capital borrowed for the purpose of business or profession has to be allowed as deduction while computing income under head 'income from business'. Prior to amendment made on 1-4-2004, there was no distinction based on whether the borrowing is for purchase of capital asset or otherwise, interest was allowable as deduction in determining the taxable income. It was only after introduction of proviso to section 36(1)(iii) with effect from 1-4-2004 that the purpose of borrowing, i.e., acquisition of assets then interest paid would be capitalized. In this case, concern is with the assessment year 1988-89, i.e., prior to amendment by addition of proviso to section 36(1)(iii). Therefore, the interest paid on the borrowings to purchase the plot of land for LS project is allowable as a deduction under section 36(1)(iii) as it was incurred for the purposes of its business.
- The revenue's submission is that the deduction under section 36(1)(iii) will not be available as no income has been earned in respect of LS project. This cannot be appreciated. It is an undisputed position that the appellant-assessee has filed return of income declaring income under the head income from business. The assessee has various projects executing construction projects and, therefore, interest expenditure is to be allowed as deduction to arrive at profits and gains of business or profession of builders carried out by the assessee. It is not a case where the only project of the assessee was the LS project. Admittedly, in this case the business of the assessee as developer had already commenced and income offered to tax. There is no merit in the revenue's objection that these are issues of fact, which this Court should not go into as the finding of fact, by the Tribunal is final.
- In the above view, substantial question of law is answered in negative, i.e., in favour of the appellant-assessee and against the respondent-revenue.