IN THE INCOME TAX APPELLATE TRIBUNAL,
BANGALORE BENCH 'C'

BEFORE SHRI N.V VASUDEVAN, VICE-PRESIDENT
AND
SHRI B.R.BASKARAN, ACCOUNTANT MEMBER

ITA No.2412/Bang/2018
(Assessment year : 2013-14)

Shri Pampamaheshwar Ravindranath,
Flat No.105A, Block, Terrace Garden Apartments,
2nd Main Keb Road, BSK 3rd Stage,
Bangalore.
PAN No.ABTPR9384C

Appellant

Vs

The Asst. Commissioner of Income Tax,
Circle-1,
Bellary

Respondent

Assessee by : Shri Balram R Rao, Advocate
Revenue by : Smt. R.Premi, JCIT

Date of hearing : 09-03-2020
Date of pronouncement : 11-03-2020

O R D E R

PER SHRI N.V VASUDEVAN, VICE-PRESIDENT:

This is an appeal by the Assessee against the order dated 29-06-2018 of CIT(A), Gulbarga relating to assessment year 2013-14.

2. Ground no.1 and 5 raised by the assessee general in nature and calls for no specific adjudication.

3. Ground no.2 raised by the assessee reads as follows;

" 2.(a) The ld.CIT(A) as well a the authorities below failed to appreciate the fact that disallowance of contract benevolent

fund (CBF) expenses amounting to Rs.2,51,397/- was an expenditure allowable u/s 37(1) of the Act.

b) The CIT(A) as well as authorities below failed to appreciate the fact that CBF is mandatory deduction by State Government and not voluntary in nature.

4. The assessee is an individual. He carries on business as Class-I Contractor executing major portion of contract works for the State Government. In the course of assessment proceedings u/s 143(3) of the Income Tax Act, 1961 (Act) for assessment year 2013-14, the A|O noticed that in computing income from business the assessee had deducted a sum of Rs.2,51,937/- being contribution of assessee to Contractors Benevolent Fund (CBF). According to AO, the aforesaid expenditure was not for the purpose of business of the assessee and therefore cannot be allowed as deduction u/s 37(1) of the Act.

5. On appeal by the assessee the CIT(A) confirmed the order of AO holding that the contribution made by the assessee was purely out of benevolence and not for the purpose of business of the assessee. Following were the relevant observation of the CIT(A).

"I have gone through the assessment order and the submissions made by the appellant during appellate proceedings. Benevolence is the desire to help someone or a feeling of goodwill towards others. Benevolence can also refer to an act of kindness or charity. 'Benevolence Fund' is a monetary reserve kept in order to help those in need. Often, a benevolence fund is used to aid families with unexpected or high medical expenses, victims of natural disasters, the unemployed, the under-employed and others in similar circumstances. The administration of a benevolence fund is usually appointed to a committee who sees that the monies are distributed fairly and to persons truly in need. It can be understood that the fund is deducted purely for the purpose of charity. It is nothing but a donation given for a charity purpose. There is no nexus with the business. The fund is also not recognized for allowing any deduction. Thus it is not allowable expenditure. Hence, the appeal filed by the assessee is dismissed. The ground no.1 is dismissed".

6. Aggrieved by the order of CIT(A) the assessee has raised ground no.2 before the Tribunal.

7. The ld. Counsel for the assessee brought to our notice a decision of the ITAT, Bangalore Bench in the case of Shri S.Basavaraja Vs ACIT in ITA No.1888(Bang)/2017 dated 20-07-2018. The Tribunal in the aforesaid case was dealing with a case of individual who was also a Civil Contractor and whose case also contribution to CBF was disallowed by the revenue authorities. The Tribunal held that the contribution to CBF was for the purpose of business of the assessee and was of revenue in nature and had to be allowed as deduction subject to verification whether the contribution was made in accordance with notification issued by the Government of Karnataka whereby several contractors were obligated to contribute CBF. The following were the relevant observation of the Tribunal.

> *"5.We have gone through the record and considered the arguments made by both the parties. In our view the contractor is under an obligation to deduct tax by notification issued by the Government of Karnataka, dt.18.1.2007 to make the payment of CBF which is equivalent to 1% of the estimated cost of the contract and therefore this is an expenditure which is wholly and solely related to the business of the assessee. However in our view, whether actually this amount is spent by the assessee for the purposes of business is required to be verified by the A 0 with reference to the bills / running bills submitted by the assessee. In view of the above, we remand the matter back to the file of the AO with a direction to verify whether the assessee had made the contribution to CBF in pursuance to the notification dt.18.1.2007 or the corrigendum issued. If the payment of CBF is made in accordance with the said notification then the same shall be allowed after verification".*

8. We are of the view that in the light of the aforesaid decision rendered under identical facts and circumstances of the case as that of the assessee in this appeal, we are of the view that the deduction claimed has to be allowed

subject to verification as mentioned in the order of the Tribunal referred to above. The relevant ground is treated as allowed.

9. Ground no.3 raised by the assessee reads as follows;

> *" 3. (a) The learned CIT(A) as well as authorities below failed to appreciate the fact that disallowance of Reserve for NOC amounting to Rs.6,09,351/- was purely on business expenditure allowable u/s 37(1) of the Act.*
>
> *(b) The learned CIT(A) as well as authorities below failed to appreciate the fact that "Reserve for NOC" is a third party inspection charge which is mandatory deduction and purely business expenditure.*

As far as ground no.3 is concerned, the facts are that the assessee had debited a sum of Rs.6,09,531/- under the head 'Reserve for NOC". The AO held that the said expenditure was not allowable as expenditure u/s 37(1) of the Act as it was in the nature of reserve and not an accrued liability. On appeal by the asseseee, the CIT(A) confirmed the order of the AO.

10. Before us the Id.Counsel for the assessee explained that 'Reserve for NOC' also in the nature of deduction made by the State Government out of the bills of Contractors. It was explained by the Id. Counsel for the assessee that the amounts deducted on account of 'Reserve NOC' are sums which are retained by State Government from and out of the monies payable to contractors and are monies which will be appropriated, if third parties who inspect the project find defects if any, in the manner of execution of work. It was submitted by him that invariably these sums are never refunded and has to be treated as an outgoing expenditure in the business of the assessee. With reference to a specific query as to under what provision in the Contract or any other statutory provision, the assessee is obliged to contribute towards 'Reserve for NOC', the Id. Cousel for the assessee submitted that such obligations are part of the Contract entered into with the State Government. Another query was raised by the Bench as to whether the sum contributed towards 'Reserve for NOC" will be refunded to the assessee in the event of

third party certification of execution of good work being given. The learned counsel for the Assessee expressed his inability to give an answer to this query. In the circumstance, we are of the view that this issue should be remanded to the AO for fresh consideration and the assessee should demonstrate before the AO that the contribution towards 'Reserve for NOC' is based on contract between parties or is a contribution which is payable under statute or is a matter of practice while executing the Civil work for State Government. The assessee shall also establish that the sum so contributed will not be refunded to the assessee at any point of time or as to how the sum so refunded would be offered to tax as income as and when the same is received. Accordingly, the issue raised in ground no.3 is set aside for *denovo* consideration in the light of the direction given above.

11. Ground no.4 raised by the assessee reads as follows;

> *" 4.The ld. CIT(A) as well as authorities below failed to appreciate the fact that penalties paid for non-performance of contract in time amounting to Rsd.7,25,299/- was in the nature of compensatory damages and was purely business expenditure u/s 37(1) of the Act".*

12. The assessee claimed as deduction a sum of Rs.7,25,299/- under the head 'penalty and charges' The AO disallowed the claim of deduction of the aforesaid amount on the ground that it was in the nature of an expenditure incurred by an assessee as contemplated u/s 37(1) explanation-1 of the Act which reads as follows;

> "*Explanation 1.*—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or 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 in respect of such expenditure."

12. Before the CIT(A) the assessee submitted that the penalty in question was damage for non-fulfillment of requisite obligation under the contract for execution of civil work and therefore, was not penal in nature but only

compensatory. The CIT(A) however, confirmed the order of AO holding that the expenditure in question was penal in nature.

13. Aggrieved by the order of CIT(A) the assessee preferred appeal before the Tribunal.

14. The ld. Counsel for the assessee filed before us a chart giving details of the sum paid by the Assessee as also the contracts in respect of which such penalty was imposed. He brought to our notice the invoices raised by the PWD Deptt. wherein the nature of the sum deducted as reflected as penalty. The said chart is given below:

CHART FOR RESERVE FOR NOC AND PENALTY FOR DELAY IN COMPLETION WORK

SL. No	Date	Invoice	Particulars	Reserve for NOCOnR0	Penalty (in Rs)	Paper Book Pane No
1.	03/01/2012	KSWC	Holealur		5,000	5 - 7
2.	12/04/2012	KSWC	Muddebihal	50,000	20,000	8 – 10
3.	19/04/2012	KSWC	Jewargi	50,000	10,000	11 – 13
4.	19/04/2012	KSWC	Shorapura		20,000	14 – 16
5.	10/06/2012	KSWC	Belgum		20,000	17 – 19
6.	26/06/2012	SD-	Harihara		467	
7.	28/06/2012	KSWC	Kukanoor		20,605	20 – 22
8.	28/06/2012	KSWC	Bagalkot	81,311	41,831	23 – 25
9.	03/08/2012	KHB	Arakere		21,400	26 – 28
10.	07/08/2012	KSWC	Bagalkot		38,361	
11.	09/08/2012	KHSDRP	Bagalkote		1,44,808	
12.	10/09/2012	KSWC	Jewargi	25,000	10,000	29 – 30
13.	22/10/2012	KSWC	Chittapur	50,000	20,000	31-32.1
14.	22/10/2012	KSWC	Athani		5,000	33 – 35
15.	22/10/2012	KSWC	Hunugunda	50,000	30,000	

16.	15/11/2012	KSWC	Holealur		25,000	36 – 38
17.	09/11/2012	KSWC	Dharwad		10,000	39 – 41
18.	07/11/2012	KSWC	Bagalkot		10,000	42 - 44
19.	06/ 12/2012	KHDDRP	Koppal		92,000	
20.	08/01/2013	KSCMF	Hubli-1		42,795	
21.	21/01/2013	KSWC	Bagalkot		10,000	45 - 47
22.	21/01/2013	KSWC	Harihara	3,03,220	25,000	48 - 50
23.	20/02/2013	KRIES	Lachann		50,000	51 - 52
24.	25/03/2013	KRIES	Bijapur		37,000	
25.	31/03/2013	KREIS	Mudhool		16,032	

15. From the documents referred to in the chart given above, it is not possible to link the penalties levied under various bills by the PWD as a payment made by way of damages for dealy in execution of contract. In other words, the assessee was not able to link the penalty reflected in the bills as penalty for delayed implementation or delayed execution of the contract. This aspect needs detailed verification and the assessee is directed to establish this fact before the AO and for this purpose the issue is remanded to the AO for consideration fresh after due opportunity to the assessee. If the payment is established as for payment for breach of contract and then the same cannot be said to be a payment falling within the ambit of Explanation to Sec.37(1) of the Act. In this regard, the ld. Counsel for the assessee has placed reliance on the decision of the Hon'ble Supreme Court in the case of Prakash Cotton Mills (P)Ltd. Vs CIT 201 ITR 684(SC) and the aforesaid decision clearly lays down the proposition that when a payment by way of impost or by way of penalty or interest is purely compensatory and not penal in nature, the same should be allowed as expenditure u/s 37(1) of the Act. A payment of compensation for breach of contract can by no stretch of imagination be termed as penalty for infraction of law. We therefore, set aside the order of CIT(A) on this issue and

remand the issue to the file of AO for fresh consideration in the light of directions given above.

16. In the result, the appeal of the assessee is allowed for statistical purposes.

Order pronounced in the open court on 11-03-2020.

Sd/-	**Sd/-**
(B.R.BASKARAN)	**(N.V VASUDEVAN)**
ACCOUNTANT MEMBER	**VICE-PRESIDENT**

Place : Bangalore
Dated : 11-03-2020
*am

Copy to :

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

By order

Asst. Registrar