IN THE INCOME TAX APPELLATE TRIBUNAL "K" BENCH, MUMBAI
BEFORE SHRI G.S. PANNU, AM AND SHRI RAVISH SOOD, JM

आयकर अपील सं./I.T.A. No. 8540/Mum/2010
(**निर्धारण वर्ष** / Assessment Year: 2006-07)

Strides Shasun Limited [Formerly Known as Strides Acrolab Limited], 201 Devarata, Sector 17, Vashi, Navi Mumbai – 400 703.	**बनाम**/ Vs.	The Asst. Commissioner of Income Tax Circle-10(3) Mumbai
स्थायीलेखासं./जीआइआरसं./PAN/GIR No. AADCS8104P		
(Appellant)	:	**(Respondent)**

अपीलार्थी की ओर से/ **Appellant by**	:	Shri. Nitesh Joshi
प्रत्यर्थी की ओर से/**Respondent by**	:	Shri. N.K Chand, CIT

सुनवाई की तारीख/ **Date of Hearing**	:	20/01/2017
घोषणा की तारीख/ **Date of Pronouncement**	:	31/03/2017

आदेश / O R D E R

PER RAVISH SOOD, JUDICIAL MEMBER

The present appeal has been filed by the assessee against the order passed by the A.O under Section 143(3)(ii) r.w.s. 144C(13) of the Income-tax Act 1961 (for short 'Act'), dated 27.10.2010, which had been passed pursuant to the directions of the Dispute Resolution Panel-II, Mumbai (DRP), dated

21.09.2010. The assessee assailing the aforesaid order had raised the following grounds of appeal before us :-

1. "The Ld. Asst. Commissioner of Income Tax-10(3), Mumbai, hereinafter referred to as the "Assessing Officer", erred in making disallowance of Rs.94,96,899/- under section 14A of the I-T Act.

Your appellant submit that, on the facts and in the circumstances of their case, no such disallowance is called for.

Without prejudice to the above, it is submitted that, the disallowance of Rs.94,96,899/- as made by the Assessing Officer under section 14A is highly excessive and unreasonable.

2. The Assessing Officer erred in making an addition of Rs.29,83,988/- towards Transfer Pricing adjustments under section 92CA(3) of the I-T Act.

Your appellant submit that, on the facts and in the circumstances of their case, no such addition to total income and/or adjustment under section 92CA(3) of the I-T Act is justified.

3. The Assessing Officer erred in disallowing a sum of Rs.6,46,24,948/- on an estimated basis towards interest in respect of investments in overseas companies.

Your appellant submit that, on the facts and in the circumstances of their case, no such disallowance out of interest in respect of overseas investments is called for.

Without prejudice to the above, and, in the alternative, the appellants submit that, interest on overseas investments is an allowable deduction under section 57(iii) of the I-T Act.

Your appellant craves leave to add to, to after or amend the afore-stated Grounds of Appeal."

2. Briefly stated, the facts of the case are that the assessee company which is engaged in the business of manufacturing and trading of pharmaceuticals had e-filed its return of income on 28.11.2006 declaring total loss of Rs.15,86,12,551/-, which was processed as such under Section 143(1) of the 'Act'. The case of the assessee was thereafter taken up for scrutiny proceedings under Sec.143(2). The A.O after considering the facts of the case and submissions made by the assessee during the course of the assessment proceedings, therein passed a draft assessment order under section 143(3) r.w.s. 144C(1) of the 'Act' on 21.12.2009, therein proposing to make certain variations to the total income of the assessee, which to the extent relevant to the present appeal are briefly culled out as under:-

Sr.No.	Particulars	Amount
1.	Disallowance under Sec.14A.	Rs.94,96,899/-
2.	Determination of 'Arms Length price' (ALP) under Sec.92CA(3)	Rs.29,83,988/-

3.	Disallowance of interest pertaining to investment in overseas companies.	6,46,24,948/-

The A.O thereafter deliberating on certain issues assessed the loss of the assessee at Rs.2,93,94,730/-, while for computed the 'book profit' u/s 115JB at Rs.35,18,63,657/-.

3. The assessee being aggrieved with the assessment order had therein carried the same in appeal before us. During the course of hearing of the appeal, it was at the very outset submitted by the Ld. Authorized Representative (for short 'A.R') that the DRP vide its directions given under Sec. 144C(5) had therein directed the A.O to ascertain whether there was a proximate connection between the expenditure incurred and the income not forming part of total income, and only thereafter proceed with and compute and disallow such direct and indirect expenditure which had proximity with earning of the income exempted under Sec. 10 of the 'Act'. It was submitted by the Ld. A.R that to facilitate the aforesaid process, the assessee as directed by the DRP was only subjected to the obligation of furnishing the details of direct and indirect expenditure with the A.O, on his own, within a period of 7 days of the receipt of the directions, without waiting for any intimation as regards the same from the A.O. That in the backdrop of the aforesaid facts it was submitted by the Ld. A.R that the A.O failed to effect strict compliance with the directions of the DRP and loosing sight of the fact that the DRP had placed the onus on the A.O to establish the proximity of the direct and the indirect expenditure with the earning of the exempt income,

had however proceeded with most arbitrarily and drawn adverse inferences in the hands of the assessee for the reason that the latter had failed to disprove the existence of any proximity between the incurring of the interest expenditure claimed as an expenditure by the assessee in its 'P & Loss a/c' and the earning of the exempt income, by observing as under:-

> *"In respect of the disallowance u/s. 14A, the assessee company has submitted that there is no direct/indirect expenditure directly attributable or which has the proximity with the earning of exempted income. While the contention regarding direct expenditure is found to be based on the facts, the contention regarding indirect expenditure is vague and contradictory to the facts of the case. The investments in Indian subsidiaries of the assessee company are made out of the funds of the business, which are a mix of own funds as well as the interest bearing borrowed funds. The assessee has not been able to prove that the interest expenditure claimed in the P&L a/c is incurred wholly and exclusively for the purpose of business and that the interest bearing funds have been utilized for the purpose of business without being utilized towards the said investments. The incurring of interest expenses, the mixed nature of the funds of the business and the parking of such mixed funds in the investments, income from which does not or shall not form part of the total income, proves the incorrectness of the assessee's claim that there is no indirect proximate expenditure pertaining to earning of the exempted income."*

It was submitted by the Ld. A.R that the A.O had gravely erred by traversing beyond the directions of the DRP had wrongly shifted the onus as was cast upon him pursuant to the directions of the DRP for establishing the proximity of the incurring of the direct and indirect expenditure with the earning of the exempt income, as directed by the DRP. The Ld. A.R submitted that the disallowance of Rs.94,96,899/- made by the A.O under Section 14A not being found to be in confirmity with the directions of the DRP, thus could not be sustained as such and was liable to be vacated. That it was further submitted by the Ld. A.R that in the backdrop of the fact that the assessee had sufficient interest free funds available with it by way of share capital, reserves and surplus along with cash accruals over the years, no disallowance of the interest expenditure was called for in its hands u/s 14A. The Ld. A.R in support of his aforesaid contention relied on the order passed by the Tribunal in its own case for A.Y. 2002-03, marked as ITA No. 1727/Mum/2006, dated 16.12.2015, wherein the Tribunal deleting the disallowance of interest expenditure made by the A.O under Sec. 14A had therein followed its earlier order so passed in the case of the assessee for A.Y. 2001-02 in ITA No. 6487/Mum/2004, dated 03.08.2012, and therein observed that as the assessee was having substantial interest free funds by way of share capital of the company, therefore relying on the judgment of the **Hon'ble High Court of Bombay** in the case of **CIT Vs. Reliance utility and Power Ltd. (2009) 313 ITR 340 (Bom),** had held that no disallowance in respect of interest expenditure was called for in the hands of the assessee, by observing as under:-

"Coming to the investments in the shares of Dena Bank in financial year 1996-1997 it is observed that the share capital of the company far exceeds the amount of investment in shares as at the end of such financial year. The Hon'ble jurisdictional High Court in the case of CIT v. Reliance Utilities and Power Ltd. [(2009) 313. ITR 340 (Bom)] has held that if there be interest free funds available to the assessee sufficient to meet its investments and at the same time loan has been raised, it can be presumed that the investments were made from interest free funds. While reaching this conclusion the Hon'ble jurisdictional High Court considered the judgment of the Hon'ble Supreme Court in the case of East India Pharmaceutical Works Ltd Vs. CIT (1997) 224 ITR 627(SC)]. In view of the aforesaid precedent of the Hon'ble jurisdictional High Court, it is apparent that no interest bearing funds can be said to have been deployed by the assessee for the purposes of making investment in the shares of these three companies, from which exempt dividend income was earned. It is axiomatic that where investment is made out of assesses own funds and not out of borrowed funds, there can be no disallowance u/s 14A. Our view is fortified by the judgment of the Hon'ble jurisdictional High Court in the case of CIT vs. K. Raheja Corporation Put. Ltd., a copy of this judgment dated 8th October, 2011, has been placed on record. In view of the foregoing discussion, we are of the considered opinion that the learned CIT(A) was not justified in sustaining the disallowance at Rs.17.65 lac u/s 14A in respect of the investments made by the assessee in

the shares of three domestic companies. The ground raised by the assessee is allowed and that of the Revenue is dismissed."

4.1 The ld. A.R in further support of his aforesaid contention that where an assessee is having substantial interest free funds which are found to be more than the investment made in tax free securities, therein no disallowance of interest under Section 14A would be called for in its hands, placed reliance on the judgment of the **Hon'ble jurisdictional High Court** in the following cases:-

(i) CIT Vs. HDFC Bank Ltd. (2014) 366 ITR 505 (Bom)

(ii) HDFC Bank Ltd., Mumbai Vs. DCIT-2(3), Mumbai (CWP no. 1753 of 2016- A.Y 2008-09, dated 25.02.2016).

It was further submitted by the Ld. A.R that the A.O while framing assessment under Sec. 143(3) in the hands of the assessee for A.Y. 2004-05, had not carried out any disallowance under Section 14A, and to support his aforesaid contention placed on record the copy of the assessment order passed for A.Y. 2004-05.

4.2 We have heard the authorized representatives of both the parties, perused the orders of the lower authorities and the material produced before us. We have given a thoughtful consideration to the facts of the case and are of the considered view that the issue involved in the present case is squarely covered by the order passed by the Tribunal in the case of the assessee itself for A.Y. 2001-02 and A.Y. 2002-03, wherein the coordinate bench of the Tribunal had held that if an assessee is

having substantial interest free funds which far exceeds the amount of investments made in tax free securities, therein no disallowance of interest under Sec. 14A would be called for in the hands of the assessee. We further find that the aforesaid issue as averred by the Ld. A.R stands settled and is found to be no more *res integra* in light of the judgments of the **Hon'ble jurisdictional High Court** in the case **of : CIT Vs. HDFC Bank Ltd. (2014) 366 ITR 505 (Bom)** and **HDFC Bank Ltd. Vs. DCIT-2(3), Mumbai (CWP no. 1753 of 2016, dated 25.02.2016).** Thus in the backdrop of the aforesaid facts read in light of the settled position of law, we herein restore the matter to the file of the A.O, who is directed to verify the aforesaid contention of the Ld. A.R that the interest free funds by way of share capital, reserves and surplus and cash accruals over the years, so available with the assessee during the year under consideration, far exceeded the amount of investments in the tax free securities, and in case the said claim is found to be in order, then in light of our aforesaid observations no disallowance with respect to the interest expenditure would be called for in the hands of the assessee under Sec. 14A of the 'Act'. Before parting, we may also record another plea of the assessee to the effect that the only dividend income received is Rs. 600/- from shares which as submitted by the Ld. A.R had already been transferred, and as such the same were not a part of the investments in the 'balance sheet' of the assessee for the year under consideration. It was submitted by the Ld. A.R that the dividend had been received merely because the transferees had not got the shares transferred, which thus would imply that no dividend income has been received in the

year under consideration, so there cannot be any disallowance u/s 14A of the 'Act' in the backdrop of the judgment of the **Hon'ble High Court of Delhi** in the case of : **Cheminvest India Vs. CIT (2015) 378 ITR 33 (Del).** We thus in light of the aforesaid alternative contention of the assessee, therein direct that the A.O shall also consider the same while readjudicating the issue in the course of the set aside proceedings. The **'Ground of appeal no. 1**' raised by the assessee before us is thus allowed for statistical purposes.

4. That the Ld. A.R further adverting to the addition of Rs.29,83,988/- made by the A.O vide his order passed under Section 143(3)(ii) r.w.s 144C(13) in pursuance to the directions received from the TPO in respect of notional interest on the 'debit balance' of the advances made by the assessee to its AEs, which thereafter had been upheld by the DRP, therein submitted that the said issue was covered in favor of the assessee by the order passed by the Tribunal in the case of the assessee for A.Y 2003-04 and A.Y 2004-05. The Ld. A.R taking us to the facts leading to the issue under consideration therein submitted that the assessee had in the normal course of carrying on its pharmaceutical business had made advances to its AEs, which were purely in the nature of trade advances and made out of commercial expediency, therefore in the backdrop of the said facts no disallowance was called for in its hands in light of the ratio of the judgment passed by the **Hon'ble Supreme Court** in the case of **S.A builders Vs. CIT and another (2007) 288 ITR 1(SC)**. Thus in the backdrop of the aforesaid factual matrix, it was submitted by the Ld. A.R that though no notional interest in

respect of such advances was liable to be disallowed, but however the A.O acting as per the directions of the DRP proceeded with and carried out disallowances as regards the following 'debit balances' of the foreign subsidiaries:-

S.No.	Name of Subsidiary/Associate	Amount outstanding as on 31.03.2006
1.	Infrabra – Brazil	Rs. 1,27,91,537/-
2.	Strides Latina	Rs. 46,39,139/-
3.	Solara Mexico	Rs. 1,03,35,335/-
4.	Cellofarm Ltd.	Rs. 13,46,162/-
	Total	**Rs. 2,91,12,173/-**

,and made an addition of Rs.29,83,988/- in the hands of the assessee. It was submitted by the Ld. A.R that the issue involving identical facts had been adjudicated by the Tribunal in the assessee's own case for A.Y. 2003-04 and A.Y. 2004-05. The Ld. A.R therein averred that in the backdrop of the observations of the Tribunal arrived at in the case of the assessee for A.Y. 2003-04 and A.Y. 2004-05, wherein the Tribunal after observing that as the assessee had not charged interest on outstanding receivables from the overseas subsidiaries, arms length price of the same had to be determined, had therein concluded that LIBOR rate plus 300 points would be the appropriate interest rate applicable to the international transactions relating to advancement of interest free loan /extended credit facility to the overseas A.Es. That on the other hand the Ld. D.R heavily relied on the order passed by the A.O under Section 143(3)(ii) r.w.s. 144C(13), and therein submitted that the adjustments of

Rs.29,83,988/-made in respect of the notional interest of outstanding advances to subsidiaries companies had rightly been made by A.O/TPO.

5.1 We have heard the authorized representatives for both the parties, perused the orders of the lower authorities and the records produced before us. We have given a thoughtful consideration to the facts of the case and are of the considered view that there is no dispute to the fact that though the assessee had incurred cost by availing credit facility, it however had advanced funds free of interest to its subsidiaries. We thus in the backdrop of the aforesaid facts are of the considered view that it can safely be concluded that certainly a benefit had accrued to the subsidiaries on account of cost incurred on credit facility which has been shifted by the assessee to its subsidiaries. Thus we are of the considered view that in the totality of the facts of the present case the principle of commercial expediency would not come into play, and as the assessee had not charged interest on the outstanding receivables from the overseas subsidiaries, the ALP of the same had rightly been determined by the A.O/TPO. Having held so, we now advert to the rate of interest which is liable to be attributed to such transactions entered into by the assessee with its AE's. We are of the considered view that the disallowance of interest on outstanding advances to subsidiary companies, as observed by us hereinabove, had also came up in the case of the assesssee for the aforementioned preceding years. We are of the considered view that finding no reason to take a departure from the view taken by the Tribunal in

the case of the assessee in the aforesaid preceding years, the disallowance of interest during the year on the similar footing be computed at LIBOR + 300 points. We thus in the backdrop of our aforesaid observations herein direct the A.O to compute the disallowance of notional interest on advances given by the assessee to its overseas subsidiaries at LIBOR + 300 points for the year under consideration. We thus in order to facilitate giving effect to our aforesaid directions, therein restore the aforesaid issue to the file of the A.O, who is directed to recompute the disallowance of interest as directed hereinabove. The **'Ground of appeal no. 2'** so raised by the assessee before us is thus partly allowed.

6. That the ld. A.R taking us to the disallowance of Rs. 6,46,24,948/- towards interest on notional basis in respect of investments made by the assessee in overseas companies, therein submitted that the said issue was squarely covered in favor of the assessee by the order passed by the Tribunal in the assesseee's own case for A.Y 2003-04 and AY 2004-05. It was submitted by the Ld. A.R that the Tribunal vide its consolidated order passed in the case of the assessee for the aforesaid years had allowed the interest expenditure under Sec.36(1)(iii) in the hands of the assessee, by observing as under:-

> *"We have considered the submissions of the parties and perused the material available on record. It is evident from the orders of the Departmental Authorities, though the assessee had contended that borrowed funds were utilized for acquiring fixed asset and working capital, whereas,*

interest free funds available through reserve and surplus and internal accruals were utilized for advance to the subsidiary but the Assessing Officer had rejected such claim of the assessee and disallowed proportionate expenditure from the interest cost alleging utilization of borrowed funds towards investment in shares of foreign subsidiary. It has been brought to our notice by the learned Authorized Representative by furnishing a summary of cash flow that during the financial year 2002-03, the total interest free funds to the assessee by way of internal accruals and infusion of equity was to the tune of Rs.14,93,70,838/-, whereas the Investment made in subsidiary was to the tune of Rs.14.30,50,843/-,thereby still leaving a surplus interest free funds available with the assessee of Rs.63,19,996/-. Moreover, the assessee has contended before the Departmental Authorities and also has stated before us, borrowed funds were utilized for the purpose for which they were availed by investing in fixed assets and working capital. Aforesaid, contentions of the assessee was not considered by the Departmental Authorities with any genuineness. When the Assessing Officer makes the disallowance of interest expenditure on the allegation that borrowed funds were utilized for the purpose of investment in subsidiary, the burden is on the Assessing Officer to establish the nexus between the borrowed funds and the investments made. Establishment of such nexus assumes more importance when it is found that along with borrowed funds, assessee had sufficient interest free funds available

with him to make the investment. In such situation, as held by the Hon'ble Jurisdictional High Court in Reliance Utilities Pvt. Ltd. (supra), subsequently followed in HDFC Bank Ltd. (supra), the presumption would be investment in subsidiary has been made out of own surplus funds available with the assessee. In the present case, the fact that assessee has sufficient interest free funds available with it, has not been controverted by the Department. In such circumstances, following the ratio laid down by the Hon'ble Jurisdictional High Court as referred to above no disallowance in terms of section 36(1)(iii) can be made on account of interest attributable to investment/advance made in overseas subsidiary. Another aspect of the issue is whether the advance/investment made is on account of commercial expediency. It is seen from the material placed on record that the assessee had made investment for establishment of the overseas subsidiary to expand its market in other geographical locations. It is not disputed by the Departmental Authorities that as a result of aspect of overseas subsidiary, there is substantial increase in sales in such geographical location. Therefore, the contention of the assessee, that overseas subsidiaries are acting as the marketing arms of the assessee cannot be disputed or denied. Moreover, it is seen from the record that the assessee has regular business transactions with overseas subsidiary by supplying raw material, etc, for manufacture of goods. Further, the assessee has also sold finished goods to the A.Es. All these factors clearly establish that there is a business/trade relationship

between the assessee and overseas subsidiary. That being the case, it cannot be said that investments made are not wholly and exclusively for the purpose of business. Thus, any interest expenditure attributable to such investment / advance to overseas subsidiary would be allowable under section 36(1)(iii) as it is wholly and exclusively for the purpose of business. As held by the Hon'ble Supreme Court in S.A. Builders (supra) and subsequently reiterated in Hero Cycles Ltd. (supra), commercial expediency has to be seen through the position of a prudent businessman and the Assessing Officer cannot step into the shoes of a businessman to find out the necessity or reasonableness of expenditure incurred. Thus, in our view, for the afore stated reason, no disallowance out of interest expenditure can be made. As far as the findings of the learned Commissioner (Appeals) that assessee is eligible for deduction under-section 57(iii), we are of the view that only because the assessee accepted the decision of the learned Commissioner (Appeals) in assessment year 2002-03, for whatever may be the reason that will not deprive the assessee from claiming deduction of interest expenditure under section 36(1)(iii). It may be a fact that in assessment year 2002-03, considering that there was enough interest income against which the interest expenditure could be set-off, hence there is no impact on the tax liability, the assessee might have accepted the decision of the learned Commissioner (Appeals), Moreover, it may be a fact that at relevant point of time, the assessee did not had the benefit of decision of the Hon'ble Jurisdictional High Court

which could have led the assessee not to accept the decision of the learned Commissioner (Appeals). Thus, on over all consideration of the facts and circumstances of the case, we allow assessees claim by deleting the addition of Rs.8,05,87,632/-. Thus, we allow the ground raised by the assessee in cross objection and dismiss the ground raised by the department."

Per contra, the Ld. D.R relied on the orders of the lower authorities and therein submitted that the disallowance of notional interest on investments made by the assessee in its subsidiary companies had rightly been made by the A.O.

6.1 We find that during the year under consideration the DRP observing that as the AEs of the assessee were functioning as independent entities although in the form of subsidiaries of the assessee, and that the said entities would indeed have to incur a cost for the capital so received from its parent company, i.e the assessee, therefore a disallowance on notional basis of interest in respect of such overseas investments made by the assessee was justifiably called for in the hands of the assessee, following which directions of the DRP the A.O had carried out a disallowance of Rs.6,46,24,948/- in the hands of the assessee. We have heard the authorized representatives of both the parties, perused the orders of the lower authorities and the material produced before us. We find that the assessee had submitted before the lower authorities, as well as before us, two fold contentions, as under:-

(i). That as the investments had been made by the assessee out of commercial expediency and wholly and exclusively for the purposes of its business, thus no disallowance of interest on notional basis is called for in the hands of the assessee.

(ii). Alternatively, the investments having been made by the assessee out of its own funds, therefore no disallowance out of interest expenses on a notional basis could justifiably be made in the hands of the assessee.

We have given a thoughtful consideration to the facts of the case and are of the considered view that as observed by us hereinabove, the facts involved in the present case are identical to those which were there before the Tribunal in the case of the assessee for A.Y 2003-04 and A.Y 2004-05. We find that the coordinate bench of the Tribunal while disposing of the appeals of the assessee for the aforementioned preceding years vide its consolidated order dated. 20.04.2016, had deleted the disallowance on notional basis of interest in respect of such overseas investments, after appreciating the contentions advanced by the assessee on both the issues which had been averred by the assessee in the course of the proceedings for the year under consideration, viz. (i). Investments had been made by the assessee out of commercial expediency and wholly and exclusively for the purposes of its business, and (ii).The investments were made by the assessee out of its own funds. We thus in the absence of any averment by the Ld. D.R which could go to prove that the facts involved in the case of the assessee were distinguishable as against those for the aforesaid preceding

years, or could go to dislodge the aforesaid two fold contention of the assessee in support of its contention that no disallowance on notional basis of interest in respect of the overseas investments made by the assessee was called for in the hands of the assessee, thus following the aforesaid consolidate order of the Tribunal passed in the case of the assessee for A.Y. 2003-04 and A.Y. 2004-05, therein delete the disallowance of Rs.6,46,24,948/- made by the A.O on account of disallowance on notional basis of interest in respect of overseas investments made by the assessee in its foreign subsidiaries. The **Ground of appeal no. 3** so raised by the assessee before us is thus allowed.

7. The appeal of the assessee is thus partly allowed in terms of our aforesaid observations.

Order pronounced in the open court on 31/03/2017.

Sd/-	Sd/-
(G.S Pannu)	(Ravish Sood)
लेखा सदस्य/Accountant Member	न्यायिक सदस्य / Judicial Member

मुंबई Mumbai; दिनांक Dated : 31.03.2017

<u>आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to</u> :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent
3. आयकर आयुक्त(अपील) / The CIT(A)
4. आयकर आयुक्त / CIT – concerned
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard File

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई **/ ITAT, Mumbai**