

**IN THE INCOME TAX APPELLATE TRIBUNAL  
MUMBAI BENCH "F" MUMBAI**

**BEFORE SHRI MAHAVIR SINGH (JUDICIAL MEMBER) AND  
SHRI N.K. PRADHAN (ACCOUNTANT MEMBER)**

**ITA No. 3357/MUM/2012  
Assessment Year: 2008-09**

M/s. U.B. Cotton Pvt. Ltd.  
7<sup>th</sup> Floor, Indian Globe Chambers,  
142, W.H. Marg. Fort  
Mumbai – 400001

Vs. DCIT 2(3)  
Aayakar Bhavan,  
M.K. Rd. Churchgate  
Mumbai

**PAN No. AAACU5526C**

**(Appellant)**

**(Respondent)**

Assessee by: Shri Nitesh Joshi, AR  
Revenue by: Shri B.S. Bist, DR

Date of Hearing : 29/03/2017  
Date of pronouncement: 31/05/2017

**ORDER**

**PER N.K. PRADHAN, AM**

This is an appeal filed by the assessee. The relevant assessment year is 2008-09. The appeal is directed against the order Commissioner (Appeals) – 6, Mumbai and arises out of assessment made u/s 143(3) of the Income Tax Act, 1961 (the 'Act').

2. The 1<sup>st</sup> ground of appeal raised by the assessee in this appeal is that the Ld. CIT(A) erred in confirming the action of the A.O. making disallowance u/s 14A.

2.1. The Assessing Officer (A.O.) has noted that the assessee earned a dividend income of Rs.14,27,836/- and claimed the same as exempt from income tax. The assessee has paid interest of Rs.24,566/- on overdraft and

interest of Rs.17,46,699/- to others. The A.O. made disallowance of Rs.2,47,464/- u/s 14A r.w.r. 8D of the Income Tax Rules, 1962. Aggrieved by the order of the A.O. the assessee filed an appeal before the Ld. CIT(A). We find that the Ld. CIT(A) agreed with the computation made by the A.O. and dismissed the appeal filed by the assessee.

2.2. The Ld. Counsel of the assessee submits that the investment during the year were from the surplus available and thus, the investments were not out of borrowed funds. Therefore, it is stated that no disallowance u/s 14A be made. Without prejudice to the above, the Ld. Counsel further submits that the working under Rule 8D has been wrongly calculated in so far as the total assets have been considered net off current liabilities and provisions which is not contemplated under the Rule 8D.

2.3. *Per contra*, the Ld. DR relied on the order passed by the Ld. CIT(A).

2.4. We have heard the rival submissions and perused the relevant material on record. Rule 8D was notified by CBDT by the IT (Fifth Amendment) Rules, 2008 with effect from 24.03.2008. Rule 8D has three sub-rules as under:

- Rule 8D(1) provides when the method stipulated by Rule 8D(2) is to be applied by A.O. for computing the disallowance under section 14A.
- Rule 8D(2) sets out the presumptive artificial method to compute disallowance.
- Rule 8D(3) defines 'total assets' for the purpose of Rule 8D(1).

2.5 In *Avon Cycles Ltd. vs. CIT* (2015) 53 taxmann.com 297 (P&H), it is held that where funds utilized by assessee were mixed funds and part of it was invested in earning tax free dividend income, it was held that the interest paid on borrowed fund was also relatable to interest on investment made in tax free funds. Therefore, interest expenditure relatable to investment in tax free funds was to be computed under provisions of Rule 8D (2)(ii).

2.6 In *CIT vs. HDFC Bank Ltd.* (2014) 366 ITR 505 (Bom) it is held that the presumption laid down in *CIT vs. Reliance Utilities & Power Ltd.* (2009) 313 ITR 340 (Bom) with regard to investment in tax-free securities coming out of the assessee's own funds in case they are in excess of the investments made in securities (notwithstanding the fact that the assessee concerned may also have taken some funds on interest) applies, when applying section 14A of the Act. It is reiterated again in *HDFC Bank Ltd. vs. DCIT* (2016) 383 ITR 529 (Bom).

2.6. In view of the above, the order of the Ld. CIT(A) on the above issue is set aside and the same is restored to the file of the A.O. to make an order keeping in mind the principles delineated here-in-above after giving a reasonable opportunity of being heard to the assessee. Thus, 1<sup>st</sup> ground of appeal is allowed for statistical purposes.

3. The 2<sup>nd</sup> ground raised by the assessee in this appeal is that the Ld. CIT(A) erred in confirming the addition of Rs.29,97,477/- as unproved purchases.

3.1. The A.O. issued notices u/s 133(6) to the suppliers and found that notices sent by speed post to seven parties aggregating to Rs.2,06,51,426/- were returned back with the remark 'unserved' by the postal authorities. Therefore, he made in addition of Rs.2,06,51,426/-. Aggrieved by the order of the A.O., the assessee filed an appeal before the Ld. CIT(A). We find that the assessee filed additional evidences before the Ld. CIT(A), who sent a copy of it to the A.O. to make enquiry and send a remand report. In the remand proceedings, the A.O. issued fresh notices u/s 133(6) to the said seven parties. The A.O. then after verification sent a remand report vide letter dated 12.03.2012 and a supplementary report vide letter dated 09.04.2012 to the Ld. CIT(A). The assessee in the proceedings before the Ld. CIT(A) filed confirmation in respect of Ashirwad Broker, Lalitbhai Dalal,

Madhav Broker and also enclosed the letter filed on 18.04.2012 in response to A.O.s remand report. The assessee submitted before the Ld. CIT(A) that the A.O. should not have taxed sales of alleged unproved purchases. The Ld. CIT(A) has observed that in the case of Ashirwad Broker, Lalitbhai Dalal, Madhav Broker, the assessee has submitted hand written letter supposedly written by them in Gujarati and filed english translation of the same. The Ld. CIT(A) observed that there was nothing to suggest that the letter was written by the said party. Also there is no evidence to prove that the said party existed at all. Further none of the transaction has taken place through banking channels and all three have written that they have acted as broker between the appellant and various farmers; hence, no financial transaction has taken place with both parties. Therefore, the Ld. CIT(A) restricted the disallowance to Rs.29,97,477/-.

3.2. Before us, the Ld. Counsel of the assessee relies on the order of the ITAT 'F' Bench Mumbai in assessee's own case for the A.Y. 2007-08 (ITA No. 6642/Mum/2013).

3.3. On the other hand, the Ld. DR supports the order passed by the Ld. CIT(A).

3.4. We have heard the rival submissions and perused the relevant material on record. We find that the transactions with Ashirwad Broker, Lalitbhai Dalal, Madhav Broker do not figure in the order passed by the Tribunal in the assessee's own case for the A.Y. 2007-08. Therefore, the issue in instant appeal is to be decided on its own facts. The Hon'ble Supreme Court in *State of Kerala vs. Shaduli Grocery Dealer* AIR 1977 SC 1627, recognized the importance of oral evidence by holding that the opportunity to prove the correctness or completeness of the return of income necessarily carries with it the right to examine witness and that includes equally the right to cross-examine witness. Thus, the order of the

Ld. CIT(A) on the above issue is set aside and the same is restored to the file of the A.O. to pass an order after examining the above three parties and allowing the assessee to cross-examine them. The assessee is directed to file the relevant details before the A.O. Thus, the 2<sup>nd</sup> ground of appeal is allowed for statistical purposes.

4. The 3<sup>rd</sup> ground raised in this appeal is that the Ld. CIT(A) erred in confirming the disallowance of commission of Rs.94,59,161/- paid to the managing director and the executive director u/s 36(1)(ii) of the Act.

4.1. The A.O. observed that the assessee had paid to its two director viz. Mr. U.B. Thakkar and Ms. R.U. Thakkar commission of Rs.69,56,066/- and Rs.25,03,905/- respectively. The A.O. also noted from the details of share holding that Mr. U.B. Thakkar held 10,000 shares of the face value of Rs.10,00,000/- and Ms. R.U. Thakkar held 3000 shares of face value of Rs.3,00,000/-. As per provisions of section 270(1)(4) of the Companies Act, 1956 a director has to acquire shares of the value of at least Rs.5,000/- within a period shorter than six months of his date of appointment as director in the company. Being a person holding shares of the assessee-company, the director becomes entitled to dividend which again is the appropriation of the profits. The A.O. therefore relied on the decision in *Loyal Motors Service Co. Ltd. vs. CIT* 14 ITR 647 (Bom.) and disallowed u/s 36(1) (ii) the commission of Rs.94,59,161/- paid to the employee-directors.

4.2. Aggrieved by the order of the A.O., the assessee preferred an appeal before the Ld. CIT(A). We find that the Ld. CIT(A) dismissed the appeal of the assessee on the above issue for the reason that Mr. U.B. Thakkar holds 50% shares and Ms. R. U. Thakkar holds 15% shares of the company. The accumulated profits of the company from F.Y. 2002-03 to 2007-08 is at Rs.6.42 crores and *nil* amount of dividend was paid in the last six financial years. Mr. U. B. Thakkar was entitled to dividend of Rs.3.21 crores and Ms.

R.U. Thakkar dividend of Rs.96.36 lacs. The Ld. CIT(A) thus held that the so-called working of commission was nothing but percentage of some sales by the company. There was nothing to suggest that the sales were due to personal efforts of Mr.U.B. Thakkar and Ms. R.U. Thakkar and not on behalf of working of the directors of the company. Therefore, the Ld. CIT(A) confirmed the addition of Rs.94,59,161/- made by the A.O.

4.3. Before us, the Ld. Counsel of the assessee submits that by merely becoming a share holder, someone does not become entitled to dividend. It is only if the company declares dividend then all the share holders become entitled to the same and not merely the director. As per him the commission was paid to the directors for the services rendered. The Ld. Counsel further submits that the two directors were not the only share holders, but there were other share holders in the company who were not paid any commission since they had not rendered any services to the company. Further it is submitted that in case the disallowance is sustained, then the same cannot be taxed in the hands of the directors in their personal capacity as it would amount to double taxation, which is not permissible under the law.

4.4. The Ld. DR relies on the order of the Ld. CIT(A).

4.5. We have heard the rival submissions and perused the relevant material on record. We find that the same issue arose before the ITAT 'F' Bench Mumbai in assessee's own case for the immediate preceding assessment year 2007-08. The Tribunal observed that (i) the Ld. CIT(A) has rightly held that the A.O. has not demonstrated that the expenditure incurred was excessive, (ii) the directors have declared the commission in their return of income and are being assessed to tax at maximum marginal rate. Therefore, the Tribunal dismissed the appeal filed by the revenue on the above issue.

Facts being similar, we follow the order of the Co-ordinate Bench and allow the appeal filed by the assessee on the above ground.

5. The 4<sup>th</sup> ground of appeal relates to charging interest u/s 234C. The same being mandatory though consequential, we order accordingly.
6. In the result appeal is partly allowed.

**Order pronounced in the open court on 31/05/2017.**

Sd/-

(MAHAVIR SINGH)  
JUDICIAL MEMBER

Mumbai:

Dated: 31/05/2017

*Rahul Sharma, Sr. P.S.*

Sd/-

(N.K. PRADHAN)  
ACCOUNTANT MEMBER

**Copy of the Order forwarded to :**

1. The Appellant
2. The Respondent.
3. The CIT(A)-
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//

BY ORDER,

(Dy./Asstt. Registrar)  
**ITAT, Mumbai**