

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES : SMC : NEW DELHI

BEFORE SHRI R.S. SYAL, VICE PRESIDENT

ITA No.5244/Del/2017
Assessment Year : 2011-12

Shilpa Memani,
1-1/16, Shanti Mohan House,
Ansari Road,
Darya Ganj,
New Delhi.

Vs. ACIT,
Circle-24(1),
New Delhi.

PAN: AAJPM6234F

Assessee By : Ms Charu Goyal, CA
Deptt. By : None

Date of Hearing : 18.12.2017
Date of Pronouncement : 18.12.2017

ORDER

This appeal by the assessee arises out of the order passed by the CIT(A) on 25.05.2017 in relation to the assessment year 2011-12.

2. No one was present on behalf of the Revenue. In fact, the Revenue has filed *en bloc* adjournment applications for all the cases listed today. *Ex consequenti*, there is no one in the Court Room to represent the Revenue. The ld. AR seriously objected to the grant of adjournment in his case. As such, I am not inclined to accept the adjournment application filed for the Revenue and proceeding to dispose of the appeals on merits *ex parte qua* the Revenue.

3. The first issue raised in this appeal is against the confirmation of part disallowance u/s 14A of the Income-tax Act, 1961 (hereinafter called 'the Act').

4. Briefly stated, the facts of the case are that the assessee earned exempt dividend income amounting to Rs.92,842/-. Since no disallowance was offered u/s 14A, the Assessing Officer, after recording satisfaction, computed disallowance u/s 14A as per Rule 8D(2) at Rs.1,75,884/-, comprising of Rs.1,03,406/- under clause (i), Rs.39,558/- under clause (ii)

and Rs.32,920/- under clause (iii). The ld. CIT(A) reduced the disallowance to the extent of the exempt income earned by the assessee during the year to the tune of Rs.92,842/-. The assessee is aggrieved against the confirmation of disallowance to this extent.

5. I have heard the ld. AR and perused the relevant material on record. Page 6 of the paper book is the assessee's balance sheet for the year in question. Total investment made by the assessee in PMS and shares stands at Rs.74,15,901/- and Rs.2,58,124/-. As against that, the assessee's capital at the close of the year stood at Rs.2.97 crore as against the opening capital of Rs.2.26 crore. This shows that investment in securities yielding exempt income was made out of own funds of the assessee.

6. I have heard the ld. AR and perused the relevant material on record. Section 36(1)(iii) provides for deduction of interest of the amount of interest paid in respect of capital borrowed for the purpose of

business or profession. The essence of this provision is that the interest should be allowed so long as the capital borrowed, on which such interest is paid, is used for the purpose of business or profession. If, however, an assessee is having its own interest free surplus funds and such funds are utilised as interest free advances even for a non-business purpose, there cannot be any disallowance of interest paid on interest bearing loans. The Hon'ble Bombay High Court in *CIT vs. Reliance Utilities and Power Ltd. (2009) 313 ITR 340 (Bom)*, has held that where an assessee possessed sufficient interest free funds of its own which were generated in the course of relevant financial year, apart from substantial shareholders' funds, presumption stands established that the investments in sister concerns were made by the assessee out of interest free funds and, therefore, no part of interest on borrowings can be disallowed on the basis that the investments were made out of interest bearing funds. In that case, the AO recorded a finding that a sum of Rs.213 crore was invested by the assessee out of its own funds and Rs.1.74 crore out of borrowed funds. Accordingly, disallowance of interest was made to the tune of Rs.2.40 crore. The assessee argued that

no part of interest bearing funds had gone into investment in those two companies in respect of which the AO made disallowance of interest. It was also argued that income from operations of the company was Rs.418.04 crore and the assessee had also raised capital of Rs.7.90 crore, apart from receiving interest free deposit of Rs.10.03 crore. The assessee submitted before the first appellate authority that the balance-sheet of the assessee adequately depicted that there were enough interest free funds at its disposal for making investment. The Id. CIT(A) got convinced with the assessee's submissions and deleted the addition. Before the Tribunal, it was contended on behalf of the Revenue that the shareholders' funds were utilized for the purchase of its assets and hence the assessee was left with no reserve or own funds for making investment in the sister concern. Thus, it was argued that the borrowed funds had been utilized for the purpose of making investment in the sister concern and the disallowance of interest was rightly called for. The Tribunal, on appreciation of facts, recorded a finding that the assessee had sufficient funds of its own for making investment without using the interest bearing funds. Accordingly, the order of CIT(A) was

upheld. When the matter came up before the Hon'ble High Court, it was contended by the Department that the shareholders' funds stood utilized in the purchase of fixed assets and hence could not be construed as available for investment in sister concern. Repelling this contention, the Hon'ble High Court observed that : *“In our opinion, the very basis on which the Revenue had sought to contend or argue their case that the shareholders' fund to the tune of over Rs.172 crore was utilized for the purpose of fixed assets in terms of the balance-sheet as on March 31, 1999, is fallacious.”* In upholding the order of the Tribunal, the Hon'ble High Court held that: *“If there be interest free funds available to an assessee sufficient to meet its investment and at the same time the assessee had raised a loan, it can be presumed that the investments were from the interest free funds available”*. Thereafter, the judgment of the Hon'ble Supreme Court in the case of *East India Pharmaceutical Works Ltd. Vs. CIT (1997) 224 ITR 627 (SC)* and also the judgment of the Hon'ble Calcutta High Court in *Woolcombers of India Ltd. Vs. CIT (1981) 134 ITR 219 (Cal)* were considered. It was finally concluded that: *“The principle, therefore, would be that if there are funds available*

both interest free and overdraft and/or loans taken, then a presumption would arise that the investments would be out of interest free funds generated or available with the company, if the interest free funds were sufficient to meet the investment”. Consequently the interest was held to be deductible in full.

7. From the above judgment, it is manifest that there can be no presumption that the shareholders’ fund of a company was utilized for purchase of fixed assets. If an assessee has interest free funds as well as interest bearing funds at its disposal, then the presumption would be that investments were made from interest free funds at its disposal. Similar view has been taken by the Hon'ble Dehi High Court in *CIT vs. Tin Box Company (2003) 260 ITR 637 (Del)*, holding that when the capital and interest free unsecured loan with the assessee far exceeded the interest free loan advanced to the sister concern, disallowance of part of interest out of total interest paid by the assessee to the bank was not justified.

8. Applying the above proposition in the context of section 14A, the Hon'ble Karnataka High Court in *CIT & Anr vs. Microlabs (2016) 383*

ITR 490 (Kar) has held that when investments are made from common pool and non-interest bearing funds are more than the investment in tax free securities, no disallowance of interest expenditure u/s 14A can be made. This view has been taken by following the judgment of the Hon'ble Bombay High Court in *CIT vs. HDFC Bank Ltd. (2014) 366 ITR 515 (Bom)*. It is further observed that this issue is no more *res integra* in view of the recent judgment delivered by the Hon'ble Supreme Court in *Godrej & Boyce Manufacturing Company Ltd. vs. DCIT (2017) 394 ITR 449 (SC)*, in which it has been held that when interest free funds in the form of share capital and reserves are more than investment, then no disallowance of interest can be made u/s 14A.

9. Adverting to the facts of the instant case, I find that the Assessing Officer has taken value of investments yielding exempt income at Rs.76.74 lac. As against this, the assessee's capital fund at the close of the year stands at Rs.2.97 crore. This shows that the assessee's capital fund is far in excess of the amount of investments in securities yielding

exempt income, thereby requiring no disallowance under clause (ii) of rule 8D(2).

10. Turning to clause (iii) of Rule 8D(2), it is seen that the Assessing Officer computed disallowance at Rs.32,920/- by considering the average of value of investments on the opening and closing date of the year.

11. The Hon'ble jurisdictional High Court in *ACB India Ltd. vs. ACIT (2015) 374 ITR 108 (Del)* has held that value of tax exempt investments should be considered instead of total investments for adopting average value of investments of income which is not part of the total income. The effect of this decision is that while making disallowance under Rule 8D(2)(iii), it is only the average of those investments which have yielded exempt income are to be taken into consideration and not the average of all investments as has been done by the AO in this case. Adverting to the facts of the instant case, it is seen that the disallowance has been made in ignorance of the above mandate of law as approved by the Hon'ble Delhi High Court. I, therefore, set

aside the impugned order and direct the computation of correct amount of disallowance under clause (iii) of Rule 8D(2).

12. As regards the computation made under clause (i) of rule 8D(2), the Id. AR submitted that such calculation suffers from infirmities which have not been sorted out by the Id. first appellate authority as well. She submitted that certain expenses which do not relate to exempt income have also been considered. Without going into the details of such expenses, I consider it expedient to set aside the impugned order on this score as well and remit the matter to the file of Assessing Officer for deciding this issue as per law, after allowing reasonable opportunity of being heard to the assessee.

13. It is made clear that if the disallowance under clauses (i) and (iii) of Rule 8D(2) exceeds the amount of exempt income, then, the disallowance should be restricted to the extent of exempt income as has been sustained in the first appeal. If, however, this exercise results in some further relief to the assessee, the same should be granted.

14. The only other issue in this appeal is against enhancement of income to the tune of Rs.1,87,141/- u/s 57(iii) of the Act.

15. The facts apropos this issue are that the Id. CIT(A) found during the course of appellate proceedings that the assessee earned interest income of Rs.14,74,195/- on fixed deposits with the bank. Out of such amount, deduction was claimed for a sum of Rs.1,87,141/-, being the amount paid to the bank on overdraft facility and the remaining amount was offered to tax. Notice of enhancement was issued u/s 251 of the Act. After entertaining the assessee's reply that the fixed deposits were pledged as security with the bank as a pre-condition for availing overdraft facility, the Id. CIT(A) taxed interest at the gross level u/s 57(iii). To fortify his view, reliance was placed on certain decisions recorded on para 5.4 of the impugned order. The assessee is aggrieved against the impugned order.

16. In my considered opinion, the issue raised through this ground is no more *res integra* in view of the judgment of the Hon'ble Supreme Court in the case of *CIT vs. Dr. V.P. Gopinathan (2001) 248 ITR 449*

(SC) in which it has been held that interest on loan taken by the assessee from bank on the security of fixed deposits cannot be reduced from his income by way of interest on the fixed deposits placed by him in the bank. Reliance of the Id. AR on certain decisions contrary to that of the Hon'ble Apex Court in the case of *Dr. V.P. Gopinathan (supra)* cannot be sustained. I, therefore, uphold the impugned order on this score.

17. In the result, the appeal of the assessee is partly allowed for statistical purpose.

Order Pronounced in the open Court on 18.12.2017.

Sd/-

[R.S. SYAL]
VICE PRESIDENT

Dated, 18th December, 2017.

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Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT (A)
5. DR, ITAT

AR, ITAT, NEW DELHI.