

आयकरअपीलीयअधिकरण, 'ए' न्यायपीठ,चेन्नई  
**IN THE INCOME TAX APPELLATE TRIBUNAL**  
**"A" BENCH, CHENNAI**

श्री एन.आर.एस. गणेशन, न्यायिक सदस्य एवंश्री एस जयरामन, लेखा सदस्य केसमक्ष

**BEFORE SHRI N.R.S. GANESAN, JUDICIAL MEMBER AND**  
**SHRI S. JAYARAMAN, ACCOUNTANT MEMBER**

**आयकर अपील सं./I.T.A. No. 209/Mds/2017**

**निर्धारण वर्ष/Assessment Years : 2012-13**

Assistant Commissioner of Income Tax,  
Corporate Circle -1(2),  
Chennai – 600 034.

M/s. Carburettors Ltd.,  
Vs. Raheja Towers, 7<sup>th</sup> Floor,  
Sigma Wing No. 177,  
Anna Salai, Chennai – 600 002.

**[PAN: AAACC 1299E]**

**(अपीलार्थी/Appellant)**

**(प्रत्यर्थी/Respondent)**

अपीलार्थीकीओरसे/Appellant by

: Shri. R. Sivaraman, Advocate

प्रत्यर्थीकीओरसे/Respondent by

: Shri. Sreenivas, JCIT

सुनवाईकीतारीख/Date of Hearing

: 06.06.2017

घोषणाकीतारीख/Date of Pronouncement

: 05.09.2017

**आदेश / O R D E R**

**PER S. JAYARAMAN, ACCOUNTANT MEMBER:**

The Revenue filed this appeal against the order of the Commissioner of Income Tax (Appeals)-1, Chennai in ITA No. 46/CIT(A)-1/2015-16 dated 01.11.2016

2. M/s. Carburettors Ltd., is engaged in the business of promoting companies. In the assessment made for the assessment year 2012-13, the AO found that out of the borrowed unsecured loan of Rs. 35 crores from Central Bank of India, the assessee invested Rs. 23,01,44,989/- in the equity shares of M/s. Ucal Fuel Systems Ltd., a sister concern and further advanced Rs. 4,98,55,767/- as loan to the same concern. This year, the company has received interest of Rs. 57,59,356/- towards the loan advanced to its sister concern & others and a dividend of income Rs. 4,32,80,356/-. Against them, it has claimed interest expenditure of Rs. 69,27,134/-. The AO found that in the earlier year, the assessee company treated this Rs. 24 crores as a loan and offered interest income on it. However, later on, the loan was converted into equity shares of Rs. 23,01,44,989/- as on the year ending 31.03.2010. On such fact, he held that the assessee's action is nothing but diversion of loan into equity and hence the income received by the assessee in the earlier year as interest has been shifted from taxable item (i.e., interest) to non-taxable item (i.e., dividend). Since, the assessee did not have any business link with its sister concern, relying upon the decision of the Kerala High Court in the case of Smt. Leena Ramachandran vs. CIT, Thrisur (2011) (10 Taxman.com 2009), the AO rejected the claim that the investment in sister concern is for commercial expediency and disallowed the expenses relating to earning exempted income u/s. 14A. The AO was of the view that on the dividend income arising on such investments, disallowance has to be made in

consonance with the provisions of u/s. 14A r.w.r. 8D. The AO, then proceeded to work out the interest expenditure incurred directly in relation to the investment at Rs. 45,54,986/- and quantified the proportionate disallowance at Rs. 11,51,481/- under Rule 8D(ii) and thus, disallowed at Rs. 57,06,467/-. Aggrieved, the assesee filed an appeal before the CIT(A). The CIT(A), inter alia, held that the appellant pleaded that the entire funds invested in the sister concern was of business prudence and not with the objective of earning dividend. Reliance was placed on butterss its case in this regard. The case laws relied upon included those of M/s. S.A. Builders vs. CIT (SC) in Civil Appeal No. 5811 of 2006 etc. As on 31.03.2012 the appellant held 1,08,20,089 equity shares of Rs. 10 each of M/s. UCAL with an acquisition cost of Rs. 2301.45 lakhs and 7,850 equity shares of Rs. 10 each of M/s. Bharath Technologies Auto Components Ltd (BTACL) with an acquisition cost of Rs. 1,51 lakhs. Both UCAL and BTACL are group companies of the appellant. The appellant being the promoter and single larger shareholder of UCAL a listed company. The disallowance u/s. 14A r.w. Rule 8D was specially contested placing reliance on the case laws of the Jurisdictional ITAT in the case of EIH Hotels Ltd Vs. DCIT, ITA No. 1503 & 1624/Mds/2012 dated 17.07.2013 (Chennai Tribunal), DCIT vs. M/s. Amalgamations Ltd in ITA No. 811 & 1712/Mds/2015 order dated 16.09.2015 and 29.09.2015, Cheminvest Ltd vs. CIT 378 ITR 33 order dated 02.09.2015 in ITA No. 749/2014 decided by the Hon'ble Delhi High Court and

jurisdictional Tribunal ACIT vs. M. Baskaran in ITA No. 171/Mds/2013 order dated 31<sup>st</sup> of July, 2014. In EIH Hotels (Supra) it was held by the ITAT that where investments were made by the assessee in the subsidiary company the same are not to earn capital gains or dividend income. They were made to promote the subsidiary company. The assessee not being in the business of investment, such investments were made on account of business expedience. The dividend earned by the assessee from investment in subsidiary company is purely incidental. Therefore the investment made by the assessee in its subsidiary are not to be reckoned for disallowances u/s. 14A r.w. Rule 8D. In DCIT vs. Amalgamations Ltd (supra) it was held similarly reliance being placed in the ratio in EIH Associated Hotels vs. CIT. In ACIT vs. M. Baskaran (Supra) the facts related to the assessee which had not received any exempt income. The ITAT held therein that disallowance u/s. 14A could not be sustained in such circumstances. In Cheminvest Ltd vs. CIT (supra) the Hon'ble Delhi High Court held that disallowance u/s. 14A envisages that there should be an actual receipt of income which is not includible in the total income, during the relevant previous year for the purpose of disallowing any expenditure incurred in relation to the said income. In other words, s. 14A will not apply if no exempt income is received or receivable during the relevant previous year (Para 23). The investments admittedly out of borrowed funds were for strategic investments in subsidiary company i.e., UCAL. Therefore, the interest attributable to the borrowing has to be kept out while working out the

disallowance under Rule 8D. Similarly, as the appellant has not earned any income from dividend from its investments made in BTACL during the year, no disallowance can be computed under Rule 8D. Respectfully following the ratios above, it is held that the disallowance u/s. 14A r.w. Rule 8D made by the AO cannot be upheld. The AO is directed to delete the addition. Aggrieved against this order, the Revenue filed this appeal, inter alia, with the following grounds:

*2. The learned CIT(A) has erred in holding that disallowance u/s.14A will not apply if no exempt income is received or receivable during the year.*

*2.1 The learned CIT(A) erred in deleting the disallowance effected u/s.14A without appreciating the fact that the assessee had investments in shares and mutual funds, capable of earning exempt income, thereby attracting the provisions of Sec.14A read with rule 80*

*2.2 The CIT(A) failed to appreciate that sub section (1) of Sec.14A clearly states that no deduction shall be made in respect of expenditure incurred in relation to the income which does not form part of total income under the Act.*

*2.3 The CIT(A) failed to appreciate that there was no commercial expediency involved and the assessee had utilized the borrowed funds for investing in the equity shares of its sister concerns with a view to earning of dividends. Therefore, the disallowance by the A.O. of the claim of interest expenditure on earning of the exempt income was required to be upheld.*

*2.2 The learned CIT(A) failed to appreciate the fact that even in the absence of exempt income, if exempt income bearing investments are available in a particular year, the provisions of Sec.14A read with Rule 80 shall have applicability and the Assessing Officer is bound to disallow the expenditure thus worked out.*

*2.3 The CIT(A) failed to appreciate that the Hon'ble Bombay High Court in the case of Godrej & Boyce has held that the provisions of sub sections (2) and (3) of Section 14A of the Income Tax Act 1961 are constitutionally valid and that the provisions of Rule 80 of the Income Tax Rules as inserted by the Income Tax (Fifth Amendment) Rules 2008 are not ultra vires the provisions of Section 14A, more particularly sub section (2) and do not offend Article 14 of the Constitution;*

3. We heard the rival submissions and gone through the orders of the lower authorities. The assessee is promoting companies and it has no other activity other than borrowing loans and investing them in its sister concern and lending to them. Its income comprises of interest and dividend only. As pointed out by the Assessing Officer, the assessee has borrowed interest bearing money, originally lent it on interest and admitted such interest income. But, subsequently it changed part of its loan as equity shares, thereby the corresponding interest income was not admitted, although, it has admitted dividend income on the investments. The Assessing Officer has held that since the assessee has made investments in equity shares, in relation to which interest expense is incurred, it is to be disallowed, as the same is incurred for the purpose of earning exempted income. Further, the assessee has not produced evidences in support of its claim, on the nature of business income that would be realized out of Controlling interest. Further, 'Controlling interest' is not an asset as considered by the Supreme Court in the case of Vodafone India Ltd. Therefore, the claim of the assessee cannot be accepted.

He further held that the assessee company do not have any business link with its sister concern. Hence, relying upon the decision of the Kerala High Court which distinguished the Apex Court decision in the case of S.A. Builders Ltd. Vs. CIT 288 ITR 1 (SC), he rejected the assessee's claim that the investment in sister concern is for commercial expediency. On the other hand, the CIT(A) has allowed the appeal on the ratios of EIH Hotels Ltd Vs. DCIT, ITA No. 1503 & 1624/Mds/2012 dated 17.07.2013 (Chennai Tribunal), Cheminvest Ltd vs. CIT 378 ITR 33 order dated 02.09.2015 in ITA No. 749/2014 decided by the Hon'ble Delhi High Court and the jurisdictional tribunal decision in ACIT vs. M. Baskaran in ITA No. 171/Mds/2013 order dated 31<sup>st</sup> of July, 2014. We have gone through the above orders. The first distinguishable fact is that the assessee has received dividend income during this assessment year, while in the cases referred by the CIT(A), none of them received dividend during the year under dispute. In the case of EIT Hotels Ltd., that assessee was not into the business of investments and it has made out a case that it had invested out of its own funds (non-interest bearing funds) and such investments were made in its subsidiaries which were in the line of business of that assessee. In the assessee's case, it is an investment company. It has invested its money out of borrowed funds on which it is claiming interest. It has not established, that but for receipt of interest and dividend from the companies in which it invested/lent its money, what other benefits it got. Thus, this case does not fall within the scope of ratios relied on by the CIT(A).

The relevant portion of the Kerala High Court's decision reported in 399 ITR 296 (Kerala) in the case of CIT vs. Smt. LeenaRamachandran is extracted as under:

*"On facts we find that the interest paid by the assessee during the previous year for the funds borrowed for acquisition of shares in the company was at the rate of 24% p.a. and the total interest paid in the accounting year alone is as much as Rs.17,44,310/-. It is on record that assessee had received only a dividend income of Rs.3 lakhs and no other benefit is derived from the company for the business carried on by it. The disallowance prohibited under Section 14A is expenditure incurred for earning any income which does not constitute total income of the assessee. In other words, any expenditure incurred for earning any income which is not taxable under the Act, is not an allowable expenditure. Dividend income is exempt under Section 10(33) of the Income Tax Act and so much so, dividend earned by the assessee on the shares acquired by her with borrowed funds does not constitute total income in the hands of the assessee. So much so, in our view, disallowance was rightly made by the Assessing Officer. In fact, the Tribunal itself has estimated disallowance of Rs.2 lakhs by applying Section 14A. We do not know how the Tribunal can restrict the disallowance to Rs.2 lakhs and allow balance above Rs.15 lakhs when the whole borrowed funds were utilised by the assessee for purchase of shares in the company. In our view, the reasoning given by the Tribunal for disallowance of Rs.2 lakhs i.e. by applying Section 14A, squarely applies for the interest paid on borrowed funds because it is on record that the entire funds borrowed were utilised for acquisition of shares by the assessee in the company. In fact, in our view, assessee would be entitled to deduction of interest under Section 36(1)(iii) of the Act on borrowed funds utilised for the acquisition of shares only if shares are held as stock in trade which arises only if the assessee is engaged in trading in shares. So far as acquisition of shares is in the form of*

*investment and the only benefit assessee derived is dividend income which is not assessable under the Act, the disallowance under Section 14A is squarely attracted and the Assessing Officer, in our view, rightly disallowed the claim. As already pointed out, the Calcutta High Court decision which pertains to the period prior to introduction of Section 14A, has no application. The decision of the Supreme Court also does not apply because in this case apart from investment in shares of the company, there is nothing to indicate that the assessee's business was fully linked with the business of the leasing company or that assessee's business is solely dependent on the business of the leasing company. In fact, the whole transaction was a total fiasco in as much as, as against Rs.17,44,310/- paid towards interest on borrowed funds serviced at the rate of interest of 24% p.a., the dividend income received by the assessee during the previous year was a meagre sum of Rs.3 lakhs. This only shows that the business carried on by the leasing company was not very substantial to justify the assessee's investment through borrowed funds. Therefore, in our view, the principle of commercial expediency gone into by the Supreme Court does not apply to the facts of this case. Therefore, we hold that the Tribunal in principle rightly held that the utilisation of borrowed funds for acquisition of shares will not entitle the assessee for claiming deduction of interest paid on such borrowed funds. However, we hold that the Tribunal was not justified in allowing the claim in excess of Rs.2 lakhs. For the same reasoning applied by the Tribunal, the assessee is not entitled to deduction of any amount towards interest paid on funds borrowed by way of fixed deposits taken for acquisition of shares in the company, which helped the assessee only to earn some dividend. Consequently we allow the appeal by reversing the order of the Tribunal and by restoring the disallowance confirmed in first appeal."*

In our view, the above ratio fully applies in this case and hence, the CIT(A) order is set aside and the order of the AO is restored.

4. In the result, the Revenue's appeal is allowed.

Order pronounced on Tuesday, the 5<sup>th</sup> day of September, 2017 at Chennai

<b>Sd/-</b> (एन.आर.एस. गणेशन) ( <b>N.R.S. GANESAN</b> ) न्यायिकसदस्य/ <b>Judicial Member</b>	<b>Sd/-</b> (एसजयरामन) ( <b>S. JAYARAMAN</b> ) लेखासदस्य/ <b>Accountant Member</b>
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चेन्नई/Chennai,

दिनांक/Dated: 05<sup>th</sup> September, 2017

**JPV**

आदेशकीप्रतिलिपिअग्रेषित/Copy to:

1. अपीलार्थी/Appellant
2. प्रत्यर्थी/Respondent
3. आयकरआयुक्त (अपील)/CIT(A)
4. आयकरआयुक्त/CIT
5. विभागीयप्रतिनिधि/DR
6. गार्डफाईल/GF