

IN THE INCOME TAX APPELLATE TRIBUNAL
KOLKATA BENCH 'D', KOLKATA

[Before Shri P.M. Jagtap, AM and Shri S.S. Viswanethra Ravi, JM]

I.T.A. No. 2114 & 2115/Kol/2016
Assessment Years: 2012-13 & 2013-14

ACIT CIR 34.....Appellant
Aayakar Bhawan,
Poorva, 7th Floor,
110, Shantipally,
Kolkata - 107.

M/s. Banwarilall Pasari.....Respondent
16, India Exchange Place,
Kolkata - 1.
[PAN: AACFB 7611 A]

Appearances by:

Shri Arindam Bhattacharjee, Addl. CIT appearing on behalf of the Revenue.
Shri S. Jhajharia, FCA appearing on behalf of the Assessee.

Date of concluding the hearing : February 15, 2018

Date of pronouncing the order : March 14, 2018

ORDER

PER P.M. JAGTAP, A.M.

These two appeals are preferred by the revenue against two separate orders of Ld. CIT(A) - 10, Kolkata both 30.08.2016 for A.Y. 2012-13 and 2013-14 and since one of the issues raised therein is common, the same have been heard together and are being disposed of by a single consolidated order for the sake of convenience.

2. First we take up the appeal of the revenue for A.Y. 2012-13, ground no 1 of which raises the issue relating to the deletion by the Ld. CIT(A) of the addition of Rs. 15,13,308/- made by the A.O. on account of disallowance out of interest.

3. The assessee in the present case a partnership firm which is carrying on the business as a stock and share broker. It also derives income from rent. The return of income for the year under consideration was filed by it on 25.09.2012 declaring a total income of Rs. 87,37,770/-. In the profit and loss account filed along with the said return, a sum of Rs. 1,54,40,021/- was debited by the assessee on account of interest expenditure. During the course of assessment proceedings, it was noticed by the A.O. that the assessee has given loans to various parties aggregating to Rs. 1,26,10,904/- on which interest was not charged. In this regard, he required the assessee to furnish the relevant details showing the purpose of giving the said loans and to explain as to why interest attributable to the said loans should not be disallowed if the same were not given for the purpose of business. According to the A.O., the assessee failed to furnish the said details. He, therefore, proceeded to make a disallowance out of interest to the extent of Rs. 15,13,308/- being interest @ 12% p.a. attributable to the loan amount of Rs. 1,26,10,904/-

4. The disallowance made by the A.O. out of interest expenditure was challenged by the assessee in the appeal filed before the Ld. CIT(A) and after considering the submissions made by the assessee as well as the material available on record, the Ld. CIT(A) deleted the disallowance made by the A.O. out of interest for the following reasons given in his impugned order:

"Having carefully examined the factual matrix, I find that the Ld.AO has disallowed a portion of the interest in notional terms, without a complete overview of the situation. It is seen that while the appellant has given interest - free loans (rather has been unable to charge interest) the assessee itself is in receipt of interest free loans have also

examined the ledger copies of the seven parties who have not been charged any interest. It is seen that the loans relate to earlier period, namely F.Y 2008-09, and continue to remain unpaid. In the case of one party, Smt Asha Jain the loan was given only during the F.Y 20LL-72, the immediate previous year. There has been no repayment of any portion of the principal by the aforementioned seven parties. Therefore, in my considered view there is certain merit in the contention put forth by the Ld. A.R that Qs the parties in question had failed to pay the principal amount of loan as well as any portion of the interest, the appellant-petitioner did not charge interest during the year. By way of documentary proof, the appellant has enclosed copies of the ledger account of the aforesaid parties from A.Ys 2009- 10 to 2013-14. It is also true that similar disallowances had not been made in any of the earlier years, or the subsequent year. A.Y. 2013-14 which is also in appeal, but that is not a deciding factor in the matter. However, I find certain merit in the claim of the appellant that when the loan itself had become doubtful of recovery, the decision of the Management not to charge interest was a plausible one. In any case, it is observed from a copy of the Audited Accounts that it is a fact that the capital of the partners will and truly exceeds the amount of such loan of Rs. 1,26,10,904/-. It is seen that the total capital of the three partners amounted to Rs. 8,32,34,131/-, the amounts being Rs. 6,11,79,231/- in the case of Sri S.K. Pasari, Rs. 54,26,019/- in the case of Sri C.K. Pasari, and Rs. 1,66,28,881/- in the case of the third partner, Sri B. Pasari. The submission of the Ld. AR that the appellant firm had an interest free unsecured loan amounting to Rs. 9,13,36,769/- being paid since more than 15 years is also of relevance, as the said amount contributes to the funds available interest – free with the firm. Therefore, I find merit in the contention of the appellant that the entire amount of loan on which no interest was charged during the year will be deemed to have come out of the capital of the partners and free of interest loan available with the appellant. Accordingly, it appears that while making the impugned disallowance, the Ld. A.O. appears to have missed sight of these material facts as available in the Books of and Financial Statements. Overall, it emerges that there were adequate interest free funds available with the appellant, and therefore, the notional interest worked out by the Ld. AO would not be applicable to the assessee, more so in a situation where there were doubtful loans which were difficult to recover. In the factual matrix, in my considered view of the matter, there were adequate interest-free funds available with the appellant, as emerges from the Capital Accounts of the Partners, and the Financial Statements

submitted by the appellant for the subject Assessment Year. It is also seen that the situation is covered by the case laws and judicial precedents filed by the appellant, more specifically by the judgment of HDFC Bank Ltd. v. DCIT & Ors. (2016) 383 ITR 529 (Bom).

In view of the factual matrix emerging in the circumstances, as well as the judicial precedents relevant in the matter, I find that the appellant firm is deserving of relief and the action of the Ld. A.O. is unsustainable. The ground is therefore allowed in favour of the appellant”.

5. The learned DR submitted that interest free loans were given by the assessee for non-business purpose as specifically found by the A.O. during the course of assessment proceedings. He contended that there was thus a clear case of diversion of interest bearing borrowed funds by the assessee for non-business purpose warranting disallowance out of interest expenditure claimed by the assessee. He contended that the Ld. CIT(A), however, did not appreciate this specific basis given by the A.O. while making disallowance out of interest and deleted the said disallowance by relying on the details furnished by the assessee for the first time before him without giving any opportunity to the A.O. to verify the same.

6. The learned counsel for the assessee, on the other hand, submitted that a detailed reply was filed by the assessee during the course of assessment proceedings vide a letter dated 28.01.2015 giving the required details. He also submitted that the relevant details showing the fund flow position were also available before the A.O. in the form of balance sheet filed along with the return of income. He invited our attention to the copy of the said balance sheet placed at page no 30 of Paper Book to show that sufficient own funds in the

form of partner's capital were available with the assessee firm to give the loans in question free of interest and contended that the Ld. CIT(A) appeal was fully justified in deleting the disallowance made by the A.O. out of interest after appreciating the said fund flow position of the assessee.

7. We have considered the rival submissions and also perused the relevant material available on record. A perusal of the letter dated 28.01.2015 filed by the assessee during the course of assessment proceedings before the A.O. clearly shows that it was specifically pointed out by the assessee that the loans in question were given to the various parties out of internal accruals. Moreover, a perusal of the balance sheet of the assessee firm as at 31.03.2012 filed along with the return of income makes it abundantly clear that sufficient own funds in the form of partners capital were available with the assessee firm at the relevant time to give the loans in question free of any interest. In our opinion, these facts and figures available before the A.O. were sufficient to show that the interest free loans in question were given in assessee firm out of its own funds and there was no diversion of interest bearing borrowed funds warranting any disallowance out of interest expenditure claimed by the assessee. We, therefore, find no infirmity in the impugned order of the Ld. CIT(A) deleting the disallowance made by the A.O. out of interest expenditure and upholding the same, we dismiss ground no 1 of the revenue's appeal.

8. In ground no 2 of its appeal in A.Y. 2012-13, the revenue has challenged the action of the Ld. CIT(A) in restricting the disallowance of Rs. 67,30,674/- made by the A.O. u/s 14A to Rs. 5,03,714/-

9. As found by the A.O. on perusal of the balance sheet of the assessee firm as on 31.03.2012, the assessee had made investment in shares, units and securities to the tune of Rs. 7,87,95,988/-, Rs. 75,41,408/- and Rs. 1,75,54,609/- respectively. The assessee had also earned dividend income of Rs. 67,00,090/- which was claimed to be exempt from tax. In computation of total income, a disallowance of Rs. 5,03,714/- was offered by the assessee on account of indirect expenses incurred in relation to the earning of exempt income as per Rule 8D(2)(iii). No disallowance on account of interest expenditure however, was offered by the assessee as per Rule 8D(2)(ii). According to the A.O., interest bearing borrowed funds were partly utilised by the assessee for making investments in shares and securities and accordingly, he made a disallowance of Rs. 62,26,960/- on account of interest as per Rule 8D(2)(ii).

10. The disallowance made by the A.O. under section 14A on account of interest as per Rule 8D(2)(ii) was challenged by the assessee in the appeal filed before the Ld. CIT(A) and after considering the submissions made by the assessee as well as material available on record, the Ld. CIT(A) deleted the same for the following reasons given in his impugned order:

"I have carefully perused and considered both, the reasoning and the action of the Ld. AO as well as the submissions made by the appellant-firm, along with the annexure, both during the scrutiny as well as during the appeal

proceedings. In an earlier year, namely the A.Y. 2010-11, a similar addition had been made by the Ld. AO, and the matter had been remanded back to the Ld. AO during the appeal proceedings to verify and ascertain whether any interest bearing funds were utilized for the purpose of investment. In that year, the Ld. AO has reported that the interest bearing funds were utilized for the purpose of the business and not for any investment. As the issues are similar, it may be worthwhile to reproduce the order of the Ld. CIT(Appeals)-XX in the case of assessee firm for the A.Y. 2010-11. The relevant part of the order in Appeal No. 25/CIT(A)-XX/Circle-34/13-14/Kol dated 11.07.2014 as follows:

'5. Grounds No. (i) and (ii) relate to disallowance of Rs. 24,47,616/- u/s 14A read with Rule 8D of the I.T. Rules. The facts of the case is that the A.O. found that the appellant earned dividend income, therefore, he invoked rule 8D and accordingly disallowed Rs. 19,75,000/- under Rule 8D(2)(ii) and Rs. 4,72,616/- under Rule 8D(2)(iii) aggregating to Rs. 24,47,616/-. However, the appellant submitted that:

- (a) Rule 8D(2)(ii) was not invocable in the matter since the entire interest expenditure was directly attributable to borrowings specifically used for taxable income or receipts.*
- (b) Rule 8D(2)(iii) was not applicable as there was no expenditure actually incurred for earning the exempt income.*

On such contention of the appellant, the issue was remanded to the A.O. and the A.O. vide his report dtd. 19.05.2014 submitted that the interest bearing loan funds were utilized only for the purpose of business and not for investment. For the purpose of investment rental income was utilized as total rental income of Rs. 3,48,90,068/- was available with the appellant. Further, the average investment taken by the A.O. of Rs. 9,45,23,277/- includes a average of stock in trade of Rs. 4,12,14,610/- also. The appellant submitted that:

- (a) The A.O. in the remand report has accepted that the investment in shares was out of rental incomes and no part of the borrowed loan was utilized in shares and hence Rule 8D(2)(ii) cannot be invoked in such respect.*
- (b) As regards the disallowance under Rule 8D(2)(iii) average investment was considered by A.O. of Rs. 9,45,23,277/- which included the average value of stock-in-trade and hence the same has to be exclude for which the appellant relied on the judgment of the jurisdictional Tribunal in the case of ACIT vs. Champion Commercial Co. 139 ITD 108 (Cal).*
- (c) The appellant also relied upon the judgment of the jurisdiction High Court which had affirmed the judgment of the Jurisdictional Tribunal in the case of REI Agro Industries Ltd. vs DCIT (2013) 144 ITD 141 in which had not earned any exempt income has to be kept out of the ambit of computation of disallowance u/s 14A read with Rule 8D. Thereby, the average*

investment of the purpose of calculating disallowance under Rule 8D comes to Rs. 5,91,13,039/-.

After going through the facts and circumstances of the case and submission of the appellant, I find merit in their argument that so far Rule 8D(2)(ii) is concerned, since, there was no borrowed fund utilized in acquiring shares, the said rule is not applicable. Further, in view of the judgment of ITAT, Kolkata Bench 'A' in the case of REI Agro Industries Ltd. vs DCIT (2013) reported in 144 ITD 141 in which it is held that 'in respect of provisions of Rule 8D(2)(iii) which provision shows that what is disallowable under rule 8D(2)(iii) is the amount equal to 1/1 percentage of the average value of investment the income from which Rs. 5,91,13,039/- for the purposes of average of investment as against Rs. 9,45,23,277/- for calculating disallowance under Rule 8D(2)(iii) of the I.T. Rule. Thereby, the appeal is partly allowed.

5. Similarly, for the A.Y. 2008-09, on a similar issue the Ld. CIT(A) – XX, Kolkata in the Appeal Order No. 166/CIT(A)-XX/Circle-34/2010-11/Kol. Dated 11.09.2013, had held as follows:

5-2 The fact of the case is that there was dividend income derived by the appellant during the year and there was also interest expenses incurred by the appellant, the A.O. invoked rule 8D and made addition of Rs. 28,75,109/-. However, the appellant argued that there was no expenditure incurred by them to earn such dividend income. The entire investment in shares was made out of own funds and no part of borrowed fund was utilized for acquiring the investment in shares. Therefore, invoking rule 8D is not correct. I find that the A.O. could not bring any material on record to establish that the interest bearing appellant could prove the fact that no interest bearing funds were utilized for purchase of shares. In view of the facts and circumstances of the case and also various judgments relied upon by the appellant in this regard, the appeal on this ground is allowed.

6. For the subject A.Y 2012-13, I find that the situation is similar, and that the Appellant has suo moto made a disallowance under Rule BD(2)(iii) of Rs.5,93,7L4/-. Therefore, very clearly and patently, there was no reason for the Ld. AO to do the same, as it would tantamount to a double disallowance. I find merit in the contention of the Ld. A.R that as regards disallowances u/s BD(2)(ii) while computing disallowance under Rule 8D(2)(ii), the Ld.AO has taken the gross interest payment of Rs.1,54,40,027/- and has disallowed Rs.62,26,950/- without considering receipt of interest of Rs. 87,t7,BB2l-. The appellant's case is well covered by the decisions of various Hon'ble Courts including the Hon'ble Apex Court that only net interest has to be taken into consideration for such purposes of making disallowance. I also find strength in the arguments placed by the Ld. A.R that even otherwise for the purposes of disallowance under Rule BD(2)(ii) only average of the investment in shares which has yielded dividend has to be included and provision of Rule 8D(2)(ii)

are not at all applicable in respect of income from mutual funds. It is seen that by adopting this method, the appellant has already made a suo moto disallowance of Rs.5,03,714/- . I also find merit in the contention of the Ld. A.R that the Ld. AO has made the disallowance without recording a positive satisfaction that the suo moto disallowance made by the appellant was not in order. In the said context, the Hon'ble Calcutta High Court, in the case of CIT vs REI Agro Ltd. which squarely applies in the case of the assessee, has given certain findings:

In the said case, during AY 2009-10 the assessee earned dividend income of Rs. 1.65 lakhs which was claimed exempt u/s 10(34) of the Act. The assessee claimed that no disallowance u/s 14A could be made because no expenditure had been incurred to earn the said dividend. It was claimed that no new investment was made during the year. It was also claimed that no loans were taken for making the investments for earning the dividend income. The AO was not convinced with the reply of the assessee and computed the disallowance at Rs. 32,43 lakhs u/s 14A by making calculation under Rule BD. This was deleted by the CIT(A). The department filed an appeal before the Tribunal which was dismissed. The Tribunal relied on J. K. Investors (Bombay) Ltd (ITAT Mum) and noted that the AO had not examined the accounts of the assessee and had not recorded satisfaction about the correctness of the claim of the assessee before invoking Rule 8D. It held that while rejecting the claim of the assessee with regard to expenditure or no expenditure, as the case may be, in relation to exempted income, the AO had to indicate cogent reasons for the same and was not entitled to disregard the assessee's claim and straightaway embark upon computing disallowance under Rule 8D.

On appeal by the department to the High Court, HELD dismissing the appeal:

"The AO disallowed the expenditure u/s 74A without first recording that he was not satisfied with the correctness of the claim as regards the claim that "no expenditure" was made by the assessee. The disallowance u/s 74A of the Income-tax Act, 7967 is plainly contrary to the provisions of the statute. The CIT allowed the appeal of the assessee and the Tribunal did not interfere. Challenging the order of the tribunal, the present appeal has been filed. We are of the opinion that no point of law has been raised. Therefore, this appeal is dismissed."

As the above judgment, is from the Hon'ble Jurisdictional High Court being the jurisdictional authority, as far as assessee's case is concerned, the ratio of decision as discussed above will in my considered opinion be directly be incidental to the instant case,

7. I have further considered the judicial references cited by the appellant, namely a decision of Hon'ble Delhi High Court dated 25.02.2015 reported in (2015) 372 ITR 694 (Del) in which also it has been very clearly held that

without recording satisfaction there could be no question of disallowance u/s 14A read with

Rule 8D. The decision of Hon'ble Delhi High Court is reported in 372 ITR 694 (Del). It was also held in the aforesaid decisions of ITAT, Kolkata Bench & Hon'ble Delhi Court that disallowance under Rule 8D(2)(ii) and 8D(2)(iii) could only be made in respect of only those investments on which dividend income has been earned. Similarly, Hon'ble Delhi Court in the case of ACB India Ltd. v. ACIT (2015) 374 ITR 108 has again held that disallowance under Rule 8D(2)(ii) / 8D(2)(iii) could only be with reference to the investment on which dividend income had been earned and this was also the view of Hon'ble Calcutta Tribunal referred above.

Overall, in the facts and circumstances of the case, I find that the Ld AO ought to restrict the disallowance u/s 14A of the Income Tax Act, 1961 to an amount of Rs. 5,03,714/- as had already been done suo moto by the appellant and the balance is directed to be deleted. In effect, this ground of appeal is allowed in favour of the appellant assessee.

11. The learned DR submitted that substantial investment was made by the assessee in shares and securities of more than Rs. 10,00,00,000/- and since the interest bearing borrowed funds were utilised for making the said investments at least partly, the disallowance on account of interest u/s 14A was required to be made as per Rule 8D(2)(ii). He contended that the Ld. CIT(A) however, appears to have overlooked this factual position and deleted the disallowance made by the A.O. on account of interest entirely on irrelevant consideration.

12. The learned counsel for the assessee, on the other hand, submitted that sufficient own funds and interest free funds were available with the assessee firm at the relevant time to cover up the entire investment made in shares and securities. In this regard, he invited out attention to the copy of the balance sheet of the assessee firm as at 31.03.2012 to point out that interest free funds in the form

of deposits and advances were available with the assessee firm in addition to the partner's capital account.

13. We have considered the rival submissions and also perused the relevant material available on record. It is observed that even though some interest free funds in the form of deposits and advances were available with the assessee firm, the same appearing under current liabilities formed part of working capital and the same, therefore, could not be treated as available to the assessee company for making investment in shares and securities. As regards the funds available in the form of partner's capital to the extent of Rs. 8.31 crores, we have already agreed with the conclusion drawn by the Ld. CIT(A) that the same were utilised by the assessee for making interest free loans of Rs. 1.26 crores. Since the total investment made by the assessee in shares and securities at the relevant time stood at more than 10 crores, it cannot be said that the said investment was entirely made by the assessee from its own funds. The interest bearing borrowed funds thus were utilised by the assessee at least partly for making investments in shares and securities and disallowance on account of interest thus was required to be made under section 14A by applying Rule 8D. However, while computing such disallowance, only net interest expenditure has to be taken into consideration and the investment in shares and securities on which exempt income was actually earned by the assessee during the year under consideration has to be taken into account. We, therefore, set aside the impugned order passed by the Ld. CIT(A) on this issue and restore the matter to the file of the A.O. for computing the disallowance to be made on

account of net interest expenditure under section 14A by applying Rule 8D(2)(ii) by taking into account only those investments on which exempt income was actually earned by the assessee during the year under consideration. Ground No. 2 of the revenue's appeal for A.Y. 2012-13 is thus partly allowed.

14. Now, we shall take up the appeal of the revenue for A.Y. 2013-14 which involves a solitary issue relating to the deletion by the Ld. CIT(A) of disallowance of Rs. 72,65,727/- made by the A.O. under section 14A of the Act Rule 8D of the Income Tax Rules 1962.

15. During the previous year relevant to A.Y. 1013-14, the assessee firm had earned dividend income of Rs. 61,19,426/- which was claimed to be exempt from tax in the return of income filed on 27.09.2013. Since no disallowance on account of expenditure incurred in relation to the said exempt income was offered by the assessee as required by the provision of section 14A, the Assessing Officer computed such expenditure by applying Rule 8D at Rs. 72,65,727/- and made a disallowance to that extent under section 14A.

16. The disallowance made by the A.O. under section 14A read with Rule 8D was challenged by the assessee in the appeal filed before the Ld. CIT(A). During the course of appellate proceedings before the Ld. CIT(A), it was submitted on behalf of that a disallowance of Rs. 4,43,517/- was already offered by it in computation of total income u/s 14A read with Rule 8D and without recording his dissatisfaction

about the said disallowance, the A.O. was not justified to make a further disallowance under section 14A read with Rule 8D. In support of this contention, reliance inter alia was placed by the assessee on the decisions of Hon'ble Delhi High Court in the case of Maxopp Investment Ltd. vs CIT 347 ITR 272 and Punjab & Haryana High Court in the case of CIT vs Abhisek Industries Ltd. 231 taxman 85. The Ld. CIT(A) found merit in this contention of the learned counsel for the assessee and in the absence of requisite satisfaction recorded by the A.O. regarding the incorrectness of the claim of the assessee in respect of disallowance offered under section 14A, he deleted the disallowance made by the A.O. under section 14A. Aggrieved by the order of the Ld. CIT(A), the revenue has preferred this appeal before the Tribunal.

17. We have heard the arguments of both the sides and also perused the relevant material available on record. The learned DR has not disputed that a disallowance of Rs. 4,43,517/- was offered by the assessee under section 14A in the computation of income filed along with the return of income for the year under consideration. He has also not been able to point out any observation or finding recorded by the A.O. in the assessment order to show his satisfaction, as regards the incorrectness of the disallowance so offered by the assessee u/s 14A having regard to the books of accounts of the assessee. As held inter alia by the Hon'ble Kolkata High Court in the case of REI Agro Ltd. (S) relied upon by the Ld. CIT(A) in his impugned order, the A.O. cannot make a further disallowance under section 14A without recording a positive satisfaction that the suo moto disallowance made

by the assessee is not in order. Respectfully following the said decision of the Hon'ble Jurisdiction High Court, we uphold the impugned order of the Ld. CIT(A) deleting disallowance made by the A.O. u/s 14A without recording the requisite satisfaction and dismiss the appeal of the revenue for A.Y. 2013-14.

16. In the result, the appeal of the revenue for A.Y. 2012-13 is partly allowed while the appeal of the revenue for A.Y. 2013-14 is dismissed.

Order Pronounced in the Open Court on 14th March, 2018.

Sd/-

(S.S. Viswanethra Ravi)
JUDICIAL MEMBER

Sd/-

(P.M. Jagtap)
ACCOUNTANT MEMBER

Dated: 14/03/2018

Biswajit, Sr. PS

Copy of order forwarded to:

1. M/s. Banwarilal Pasari, 16, India Exchange Place, Kolkata – 1.
2. ACIT CIR 34, Aayakar Poorva, 7th Floor, 110, Shantipally, Kolkata – 107.
3. The CIT(A)
4. The CIT
5. DR

True Copy,

By order,

Sr. P.S. / H.O.O.
ITAT, Kolkata