

**IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCHES
CIRCUIT BENCH "A", AT TIRUPATI**

**BEFORE SHRI D. MANMOHAN, VICE PRESIDENT
AND
SHRI B. RAMAKOTAIAH, ACCOUNTANT MEMBER**

I.T.A. No. 164/HYD/2016
Assessment Year: 2010-11

The Asst. Commissioner of Income Tax, Circle-1(1), TIRUPATI	Vs	M/s. B.V. Reddy & Sons CHITTOOR [PAN: AACFB2166N]
--	----	---

(Appellant)

(Respondent)

For Revenue : Smt. Komali Krishna, DR
For Assessee : Shri S. Rama Rao, AR

Date of Hearing : 15-05-2018
Date of Pronouncement : 23-05-2018

ORDER

PER B. RAMAKOTAIAH, A.M. :

This is an appeal by Revenue against the order of the Commissioner of Income Tax (Appeals)-Tirupati, dated 19-11-2015.

The grounds raised by Revenue are as under:

"2. The Ld.CIT(A) erred in not passing a speaking order by not giving any reasons for the decision.

3. The Ld.CIT(A) erred in placing reliance on the ITAT's order for Asst. Years 2003-04 and 2004-05 and Ld.CIT(A)'s order for Asst. Year 2008-09 in appellant's case, ignoring the fact that the said orders pertained to non-charging of interest from altogether different debtors.

4. *The Ld.CIT(A) erred in not addressing the issue for consideration i.e., diversion of higher interest bearing funds to lesser – interest bearing loans to the three partners of the Assessee-firm”.*

Ground No. 1 is general in nature.

2. Briefly stated facts are that assessee, M/s. B.V. Reddy & Sons, a firm doing business as HPC dealers, financiers and Vehicle Operators, e-filed its return of income for the AY. 2010-11 on 29-09-2010 admitting NIL income. AO noticed that :

(a) Sri V. Dwarkanath Reddy, partner, has taken a loan from the firm at Rs. 17,38,18,316/_ and paid interest at Rs. 1,59,16,750/- say @ 9.15% ;

(b) Sri V. Madhusudhan Reddy, partner, has taken a loan at Rs. 12,38,03,768/- from the firm and paid interest at Rs 97,01,618/- say @ 9.83% &

(c) Sri V. Dinesh Reddy, partner, has taken a loan from the firm at Rs 18,71,89,191/- and paid interest at Rs. 1,49,99,248/-, say @8.01% whereas the assessee-firm is charging interest from the debtors at a high rate i.e. 12% and above.

(d) The sources for the above advances are from interest bearing borrowals and hence the loss incurred by the firm on account of interest paid by the partners at a lower rate is not in accordance with business principles.

Hence, AO proposed to charge the interest @ 12% on the above loans to the partners and bring to tax the difference of interest, as worked out by him, at Rs. 49,41,447/-, Rs. 51,54,834/- & of Rs. 74,63,554/- respectively on the loans to the respective partners and accordingly issued a show cause notice to assessee. AR objected for the proposed addition stating that it is so agreed by partners to so charge. Further, the firm has many credit balances on which no interest was paid which was also available for lending to partners. AO found that this explanation is not acceptable in the absence of proof. AO held that assessee has conveniently reduced its net profit, thus reduced the tax payable. In view of that AO made an addition of Rs. 1,71,59,735/- to the income returned.

2.1. Further, AO has noticed that assessee has not charged interest on the outstanding amounts from the following persons:

i. E Ramachandram Naidu	-	Rs. 3,36,000/-
ii. A Arumugam	-	Rs. 50,05,000/-
iii. R Purushotham Reddy	-	<u>Rs. 27,40,522/-</u>
Total	-	<u>Rs. 80,81,522/-</u>

AO found that these amounts have been shown as an outstanding for the last several years & all of them were brought into system either by way of deposits or loans. So, he was of the view that the amounts so outstanding without yielding any income are nothing but amounts diverted from the system. In other words, AO is of the view that the interest bearing loans were diverted as interest free advances. The above amounts were very old and no recovery proceedings have been initiated by the assessee-firm to

Sri E. Ramachandra Naidu, assessee advanced Rs. 3,00,000/- but did not offer any interest in any year on this advance. In the case of Sri R. Arumugam, the assessee-firm has offered interest till AY. 2003-04 but suddenly did not offer any interest from AY. 2004-05 onwards. In respect of Sri R. Purushotham Reddy, assessee did not furnish the details for any of the year including from which year the amount is outstanding in assessee's books etc. AO was of the view that the partners of the firm were having substantial interest with the above persons and hence not charged any interest from them and mentioned as interest free loans. Hence, he proposed to charge the interest @12% on the above outstanding at Rs. 80,81,522/- and add the sum quantified at Rs. 9,69,782/- to the returned income and accordingly issued a show cause notice. Ld.AR objected stating that all of them have been reduced to poor status, recovery of principal itself is doubtful and hence the proposed addition is not necessary. AO held that this explanation is not acceptable as there is a procedure laid down u/s. 36(2) of the Act to treat a debt as a bad debt. Therefore, he added the interest at Rs 9,69,782/- to the returned income.

3. Aggrieved by the order, assessee preferred an appeal before the Ld.CIT(A) and submitted that assessee got funds at 8.5% from M/s. B.V. Reddy Enterprises Pvt. Ltd., to an extent of Rs. 101.84 Crores and only Rs. 18.71 Crores were advanced to partners at 9 % and there is no revenue loss. Further, it was submitted that the issue was settled by the order of ITAT in earlier year. With reference to charging of interest on bad and doubtful accounts, it relied on the order of CIT(A) in earlier year.

4. Ld.CIT(A) accepted the contentions but discussed only about the second issue and deleted the additions.

5. Ld.DR submitted that the order of Ld.CIT(A) is not clear as he has not discussed the issue of charging interest at 9% at all and gave relief only after extracting the order of predecessor CIT(A) on charging of interest on bad and doubtful debts.

6. Ld.AR submitted that the issues have been crystallised by the order of ITAT in earlier years and justified the orders. It was further submitted that assessee was charging 12% on fixed term loans and 9% on current loans when term is not fixed and has source of the funds to an extent of Rs. 101.84 Crores from a sister concern; so the allegation of AO is not correct.

7. We have considered the rival contentions and perused the paper book. There is some truth in Ground No. 2 of the Revenue as the Ld.CIT(A) did not discuss the issue of charging interest at 9% on partner's balances at all in the order. The contention that it had funds available at 8.5% were not examined and there is no discussion on the issue. Therefore, ground Nos. 2 & 4 are allowed, setting aside the issue to the file of AO to examine the contentions afresh. It is also noticed that the AO calculated the interest on partners account on the balance at the end of the year which gives a distorted picture, when assessee is charging at 9% on product basis, i.e., on outstanding balances every month/day. The calculation made by AO itself is not proper. Therefore, AO is directed to examine the source of funds and charging of interest. If the borrowed funds are at higher rate of interest than what was

charged on the funds diverted to partners charged at 9%, then the excess interest can be disallowed u/s. 36(i)(iii). AO cannot bring any interest (notional or otherwise) to tax when assessee has not charged. With these directions, the issue of charging interest on partners balance was set aside to AO for examination of facts and applicable law.

7.1. Coming to the issue of charging interest on bad and doubtful recovery, this issue was held against Revenue in earlier years. In fact the ground No. 3 is not clear whether the ground pertains to this issue or not. As the issue was decided against the Revenue in earlier year, we do not see any reason to hold otherwise. The order of Ld.CIT(A) on this issue (which was discussed in the order) is confirmed. Ground is rejected.

8. In the result, the appeal is partly allowed for statistical purposes.

Order pronounced in the open court on 23rd May, 2018

Sd/-
(D. MANMOHAN)
VICE PRESIDENT

Sd/-
(B. RAMAKOTAIAH)
ACCOUNTANT MEMBER

Hyderabad, Dated 23rd May, 2018

TNMM

Copy to :

*1. The Asst. Commissioner of Income Tax, Circle-1(1),
Tirupati.*

*2. M/s. B.V. Reddy & Sons., D.No. 2-1285, B.V. Reddy
Colony, Chittoor.*

3. CIT(Appeals)-Tirupati.

4. Pr.CIT-Tirupati.

5. D.R. ITAT, Hyderabad.

6. Guard File.