IN THE INCOME TAX APPELLATE TRIBUNAL
DIVISION BENCH 'B ', CHANDIGARH

BEFORE SHRI SANJAY GARG, JUDICIAL MEMBER
AND MS. ANNAPURNA GUPTA, ACCOUNTANT MEMBER

ITA No.935/Chd/2017
(Assessment Year : 2008-09)

M/s Metalman Auto Pvt. Ltd., E-127, Phase-V, Focal Point, Ludhiana. PAN: AABCM5441M (Appellant)	Vs.	The Addl.C.I.T., Range-1, Ludhiana. (Respondent)

Appellant by : Shri Amarjit Kamboj, CA
Respondent by : Shri Gulshan Raj, CIT(DR)

Date of hearing : 16.05.2018
Date of Pronouncement : 14.08.2018

ORDER

PER ANNAPURNA GUPTA, AM:

The present appeal has been preferred by the assessee against the order of learned Commissioner of Income Tax (Appeals)-1, Ludhiana (hereinafter referred to as CIT(Appeals)) dated 27.4.2017 relating to assessment year 2008-09.

2. Ground No.1(a) reads as under:

> *"1. Commissioner of Income Tax (Appeals)-l, Ludhiana has erred in law and on facts of the case:-*
>
> *a) By arbitrarily and wrongly confirmed the disallowance of interest Rs.35131/- made u/s 36(1) (iii) of the Income Tax Act, 1961 w.r.t. the amount of capital work in progress and advance given for purchase of machinery."*

3. Brief facts relating to the issue raised in the above ground regarding disallowance of interest amounting to Rs.35,131/- u/s 36(l)(iii) of the IT Act, is that during the course of assessment proceedings, the Assessing Officer

noticed that the assessee had made the following capital advances:-

(a) Capital work in progress amounting to Rs.31,22,096/-

(b) Advance for purchase of machinery to M/s Chakan Engineering Pvt. Ltd. amounting to Rs.6,25,000/-.

4. The assessee was asked to show whether interest pertaining to the same had been capitalized or not and if not why the said interest be not disallowed and capitalized. In response, the assessee submitted that the capital work in progress pertained to payments/ expenses on installation of Enterprises Resource Planning (ERP) Navision, for which the assessee had not availed any term loan in any year. As for the advance of Rs.6,25,000/- given to Chakan Engineering Co. Pvt. Ltd., it was submitted that the same had been given for purchase of Boarding Machine which was received in the next year, on 17.05.2008, and that the said advances had been made out of current account of the Waluj Unit of the assessee at Aurangabad, where no interest was paid on any working capital facility or for making the said advance. The Assessing Officer was not satisfied with the reply of the assessee and held that since the entire funds are from common kitty, the assessee had incurred interest expenditure on the funds which had been invested in capital work in progress and advances for machinery, relying upon various case laws especially, the decision of the Hon'ble Punjab & Haryana High Court in the case of M/s Abhishek Industries Ltd. 286 ITR 1.He therefore computed interest

pertaining to the said investments at Rs.35,131/- and disallowed the same u/s 36(l)(iii) of the Income Tax Act, 1961 (in short 'the Act').

5. During appellate proceedings before the Ld.CIT(A), the assessee raised various contentions which included the sufficiency of funds available with it by way of profits for the year being Rs.4.85 crores, share capital of Rs.1.30 crores and reserves & surplus of Rs.20.39 crores, which were sufficient for making investment in the capital work-in-progress amounting to Rs.31,22,096/- and for the advance given for purchase of boring machine amounting to Rs.6,25,000/-. The submissions of the assessee did not find favour with the CIT(Appeals) who upheld the disallowances made by holding at para 2.3 of his order as under:

> *"2.3 The appellant has justified the claim of interest as revenue expense on the ground that it is to be allowed as deduction. The appellant has placed reliance on a number of judicial decisions with regard to the issue of disallowance u/s 36(l)(iii) of the IT Act. Having considered the material placed on record, I find that appellant has failed to appreciate the fact that funds have been advanced for purchase of capital asset and therefore proportionate interest on those funds has to be capitalized. This is mandatory in view of the specific provisions as enunciated in Proviso to sec 36(l)(iii) of the IT Act. The judicial decisions relied upon by the appellant are distinguishable on facts as are found to be not on this specific issue of interest expense to be capitalized or to be allowed as revenue. Accordingly, I confirm the disallowance of Rs.35,131/- made by the Assessing Officer under this head."*

6. Before us, the Ld. counsel for assessee reiterated his contentions made before the CIT(Appeals) that in view of the sufficiency of funds available with him for making impugned

investment no disallowance of interest was warranted as per the provisions of section 36(1)(iii) of the Act. Reliance was placed on the decision of the Hon'ble Punjab & Haryana High Court in support of this proposition in the case of Gurudas Garg Vs. CIT(A), Bathinda (2015) 63 Taxman 289 and CIT Vs. Kapsons Associates (2016) 381 ITR 204.

7. The Ld. DR, on the other hand, relied upon the order of the CIT(Appeals).

8. We have heard the rival contentions and after perusing the order of the Ld.CIT(Appeals) we find merit in the contentions raised by Ld. counsel for assessee. The fact of availability of own interest free funds in the form of profits for the year amounting to Rs.4.85 crores, share capital amounting to Rs.1.3 crores and reserves & surplus amounting to Rs.20.39 crores, has remained undisputed and uncontroverted by the Revenue. The investment in capital work-in-progress and advance for machinery on account of which interest has been disallowed applying the provisions of section 36(1(iii) on account of diversion of interest bearing funds for the purpose of making these investments amounts to Rs.37.5 lacs (Rs.31.22 lacs + Rs.6.25 lacs) respectively. Clearly therefore, there were enough own funds available with the assessee for making impugned investment. Further the proposition laid down by the Hon'ble Jurisdictional High Court in the case of Gurudas Garg and M/s Kapsons Associates (supra), as pointed out by the lower authorities, is that where

sufficient own interest free advances are available, it is to be presumed that the same have been used for making interest free advances or non-business advances. The Ld. DR has not brought to our notice any contrary decision of the Hon'ble Jurisdictional High Court or the Hon'ble Apex Court in this regard. In view of the same, we agree with the Ld. counsel for assessee that no interest bearing funds can be attributed to have been used for the purpose of making impugned investment in capital work-in-progress and advance for purchase of machinery. The Revenue,we find, has not pointed out any nexus between the interest bearing funds of the assessee and the investment in the same and the disallowance has been made by giving a vague/ general statement that the funds have been found to have been advanced for the purchase of capital asset without specifying whether /which interest bearing funds have been so used. In the absence of the same and considering the totality of the facts and circumstances of the present case, we hold that no disallowance of interest is warranted in the present case as per the provisions of section 36(1)(iii) of the Act. The disallowance so made amounting to Rs.35,131/- is, therefore, directed to be deleted. Ground No.1(a) raised by the assessee is allowed.

9. Ground No.1(b) reads as under:

> *"b) By arbitrarily and wrongly confirmed the disallowance of expenses Rs.3,98,008/- u/s 14A of the Income tax Act, 1961."*

10. The facts relating to this ground of appeal relates to disallowance of Rs.3,98,008/- u/s 14A of the Act. During the course of assessment proceedings, the Assessing Officer noticed that the assessee company had made investment in mutual funds from which exempt income was being earned. The assessee was asked to provide details of the expenses incurred on making these investments and whether they had been added back u/s 14A. In response, it was submitted that the assessee had voluntarily disallowed the amount of Rs.1,36,000/- on account of section 14A disallowance. Thereafter, not satisfied with the reply of the assessee, the Assessing Officer calculated the disallowance u/s 14A amounting to Rs.5,34,008/- and after giving credit for the amount already disallowed by the assessee of Rs.1,36,000/-, the balance amount of Rs.3,98,008/- was disallowed and added to the income of the assessee.

11. Before the Ld.CIT(Appeals), the assessee raised several contentions, as reproduced in para 3.1 of the order, which briefly put were to the effect that the assessee had suomoto disallowed administrative expenses of Rs.1,36,000/-,being part of salary and telephone expenses of one of its employee for maintaining portfolio of its investments, that no interest expense was disallowable since net interest had been earned by the assessee, the interest paid in any case related to term loans and specific purpose loans and no part of borrowed funds were used for making the investment, that the investment had been made out of sale

of mutual funds and that the assessee had sufficient own funds in the form of profits for the year for making the impugned investments . The submissions of the assessee did not find favour with the Ld.CIT(Appeals) who held that the requisite conditions for invoking the provisions of section 14A were found applicable in the facts of the case and, therefore, the disallowance was rightly worked out by invoking the machinery provisions given in Rule 8D of the Income Tax Rules. The relevant findings of the CIT(A) at para 3.3 of the order is as under:

> *"3.3 Having considered the submissions made in this regard, I find that requisite conditions for invoking the provisions of sec 14A of the IT Act are found to be applicable in the facts of this case. The appellant has also not denied the same and the only difference of opinion is with regard to the computation of the amount of disallowance to be made u/s 14A of the IT Act. I find that for this purpose, machinery provision has been given in Rule 8D of the IT Rules. As regards the contention of recording the satisfaction of Assessing Officer is concerned, I find that it has been clearly complied with by the Assessing Officer on page 9-11 of the order. I do not find any infirmity in the computation made by the Assessing Officer and accordingly confirm the disallowance of Rs.3,98,008/- made u/s 14A of the IT Act."*

12. Before us, the Ld. AR reiterated the contentions made before the CIT(Appeals) regarding sufficiency of own surplus funds available with the assessee for the purpose of making investment warranting no disallowance of interest u/s 14A of the Act. Reliance was placed on the decision of the Hon'ble Punjab & Haryana High Court in the case of CIT vs Max India Ltd. in ITA no.186 0f 2013 dt.06-09-16 and the decision of the Hon'ble Gujarat High Court in the case of Principal Commissioner of Income Tax-4 vs Sintex Industries Ltd. (2017) 82 taxmann.com 171 (Guj).It was

pointed out that the SLP filed against the order of the Hon'ble Gujarat High Court was dismissed by the Apex court in its judgement reported in (2018) 93 taxmann.com 24.

13. The Ld. DR, on the other hand, relied upon the order of the CIT(Appeals).

14. We have heard the rival contentions and gone through the orders of the authorities below. We find merit in the contentions of the Ld. counsel for assessee. The fact that the investment in relation to which disallowance u/s 14A was made amounted to Rs.2,60,75,051/- while the own funds available with the assessee as stated in the earlier part of our order amounted in all to Rs.26.54 crores, in the form of profits of Rs. 4.85 crores, share capital of Rs. 1.30 crores and Reserves & Surplus of Rs 20.39 crores, is not disputed, nor has the same been controverted by the Revenue. Further we find that the Hon'ble Jurisdictional High Court in the case of Max Industries (supra) and the Hon'ble Gujarat High Court in the case of Sintex Industries(supra) has held that where sufficient own funds are available, no disallowance on account of interest is warranted u/s 14A of the Act. We have also noted that SLP against the order of the Hon'ble Gujrat High Court has been dismissed by the apex court. In view of the same, we find merit in the contention of the assessee that no disallowance of interest, in the present case, was warranted on account of sufficient own funds available with the assessee which

could be attributed to the making of impugned investments in the present case. Further, we find that the assessee had contended that the investment had been made out of sale of mutual funds held in the preceding year. It was pointed out by the Ld. counsel for assessee that mutual funds held in the preceding year amounted to Rs.8.50 crores which had been sold and invested in mutual funds in the impugned year to the extent of Rs.2.60 crores. The same was demonstrated through the schedule of investment forming part of the balance sheet showing none of the old investments of Rs. 8.5 crores appearing in the investments of the current year which show new investments of Rs.2.60 crores. Thus we find that the assessee had clearly demonstrated the attribution of the source of the investment in the mutual funds to be out of non interest bearing sources. In view of the same, there was no occasion at all to invoke the provisions of section 14A of the Act and made disallowance of interest under the same. The disallowance, therefore, made of Rs.3,98,008/- is directed to be deleted. Ground No.1(b) raised by the assessee is, therefore, allowed for statistical purposes.

15. Ground No.1(c) raised by the assessee is as under:

> *"c) By arbitrarily and wrongly confirmed the disallowance of expenses for Rs.5,79,063/- paid for purchase of diesel u/s 40A(3) of the Income Tax Act, 1961."*

16. This ground relates to the disallowance of expenses of Rs.5,79,063/- u/s 40A(3) of the Act, on account of payment made in cash exceeding the specified limit. The facts

leading to the same are that during assessment proceedings, the Assessing Officer noticed that the assessee had made payments in cash exceeding Rs.20,000/- for purchase of diesel amounting to Rs.5,79,063/-. The assessee was asked to show cause as to why this expenditure be not disallowed in view of the provisions of section 40A(3). In response, the assessee submitted that the company was purchasing diesel from a regular retail outlet, which was accepting payments by cheque. However, it was only in the event of non availability of diesel at the said out let that it purchased diesel from other outlet to whom payment had to be made in cash only. The Assessing Officer was not satisfied with the reply of the assessee stating that the situation cited by the assessee did not fall within any of the situations referred to in Rule 6DD of the Income Tax Rules, 1962. Therefore, disallowance was made of the amount paid in cash exceeding the limits specified u/s 40A(3) of the Act of Rs.5,79,063/- and added back to the income of the assessee.

17. Before the Ld.CIT(A) the assessee reiterated the contentions made before the AO stating that the cash payments were unavoidable due to urgent need of diesel for running the unit in case of power cuts. Copy of account of both the parties from whom diesel was regularly purchased and from whom purchases were made due to urgency and payment made in cash thereof, was filed. It was stated that the payments in cash had been made due to urgency in

business and the genuineness and identity of the parties not being doubted ,no disallowance u/s 40A(3) was warranted. Reliance was placed on a number of judicial decisions in this regard. Ld.CIT(A) was not convinced with the contention of the assessee and therefore upheld the disallowance made stating that the assessee had failed to substantiate the expenditure and the relevant clause of Rule 6DD whereunder the same was permissible. The relevant findings of the CIT(A) at para 4.2 of the order is as under:

> *"4.2 I have carefully considered the facts of the case, the basis of the disallowance made by the Assessing Officer and arguments of the AR and find that a disallowance of Rs.5,79,063/- has been made by the Assessing Officer u/s 40A(3) of the IT Act. The disallowance was made on the ground that cash payments have been made exceeding Rs.20,000/- in contravention to the provisions of sec 40A(3) of the IT Act. The appellant has failed to furnish any evidence to prove that payments made are covered under which clause of Rule 6DD of the IT Rules. The appellant has reiterated the submissions filed before the Assessing Officer and stated that payments were made for purchase of diesel from a dealer other than the regular dealer from whom purchases were made by cheque. The appellant has also cited a number of judicial decisions to support its contentions but the same were found to be distinguishable on facts. Further, I find that appellant has failed to bring on record any evidence even in the course of present proceedings to substantiate the expenditure incurred and the relevant clause of Rule 6DD where under the same is permissible Thus, considering all these facts, I hold that the Assessing Officer was justified in making a disallowance of Rs.5,79,063/- u/s 40A(3) of the IT Act and accordingly confirm the same."*

18. Before us Ld.Counsel for the assessee reiterated the contentions made before the lower authorities that the genuineness of the expenditure had not been doubted and the urgency also had been established for making the payment in cash, therefore, no disallowance was permissible

u/s 40A(3) of the Act. Reliance was placed on the following case laws in support of its contention:

- Gurdas Garg vs CIT(A),Bhatinda (2015) 63 taxmann.com 289 (P&H)
- Dhuri Wine vs DCIT,Circle-IV,Ludhiana(2017) 83 taxmann.com 20(Chd)

19. Ld.DR on the other hand relied on the order of the CIT(A) stating that the assessees situation did not fall in any of the conditions prescribed u/r 6DD of the Income Tax Rules, 1962 and therefore the disallowance had been rightly made.

20. We have heard the rival contentions and gone through the order of the authorities below. We find merit in the contention of the Ld.Counsel for the assessee. No disallowance u/s 40A(3) is warranted if the genuineness of the expenditure is not doubted and the business expediency for making the same in cash is duly demonstrated, even if it does not qualify under any of the situations enumerated in Rule 6DD of the Income Tax Rules, 1962, for the said purpose. The jurisdictional High Court in the case of Gurudas Garg (supra) has laid down this proposition, which has been followed by the coordinate bench of the ITAT in the case of Dhuri Wines (supra).It has been held that the situations listed in Rule 6DD are not exhaustive but are only illustrative and any situation bringing out business exigency for making the payment in cash will therefore not be excluded for the purpose of grant of immunity from the rigours of disallowance u/s 40A(3),merely because it finds

no place in the list in Rule 6DD of the Income Tax Rules,1962.

21. Having said so, we find that in the present case the assessee has filed evidence to establish the genuineness of the expenditure and also the business expediency for making the payment in cash, by filing copies of accounts of both the parties one from whom diesel was purchased in regular course and the other in urgent situations only making payment to him in cash on demand. The Revenue has not controverted the said facts. Therefore the genuineness of the expenditure and also the business expediency for making the payment in cash stands established. In this factual background and in view of the proposition of law laid down by courts as above, no disallowance u/s 40A(3) was warranted ,merely for the reason that the assessees situation did not fall in that listed in Rule 6DD of the Income Tax Rules,1962. The disallowance so made of Rs.5,79,063/- is therefore deleted. Ground of appeal No1© is allowed.

22. Ground No.1(d) raised by the assessee reads as under:

> *d) By arbitrarily and wrongly restricted the disallowance of foreign travelling expenses at Rs.87,000/-out of Rs.174966/- made by the Ld. A.O on adhoc basis."*

23. The above ground relates to disallowance of Rs.1,74,966/- out of foreign travel expenses. During the course of assessment proceedings, the Assessing Officer noticed that the assessee had debited an amount of

Rs.8,74,832/- on account of foreign travel expenses. The assessee was asked to provide the complete details of foreign travel expenses with vouchers. In response, the assessee produced date wise details of foreign traveling expenses and also stated that the tour were undertaken to explore new markets for exports, new manufacturing machines, to attend international auto expo's and to study new products, designs etc. The Assessing Officer was not totally satisfied with the reply of the assessee because the assessee did not have proper evidence to establish the claim and relevance of these expenses being incurred for business purpose. Therefore, the Assessing Officer disallowed 20% of these expenses, which worked out at Rs.1,74,966/- and added back to the income of the assessee.

24. Before the Ld.CIT(A) the assessee contended that no personal usage could be attributed to the said expense since all expenses were incurred on directors of the assessee company only. Further it was contended that the tours were undertaken to explore new markets, new manufacturing machines and to attend auto expo and that the assessee had exported goods worth Rs.32 lacs & 1.42 crores in the succeeding years on account of the same. The Ld. CIT(A) found some merit in the contention of the assessee and further restricted the disallowance to Rs.87,000/-since complete nexus could not be established between the expenses incurred and the business purpose of the travel.

25. Before us Ld.Counsel for the assessee reiterated the contention made before the CIT(A) and stated that the disallowance was purely adhoc which was not permissible in law. Reliance was placed on the following case law in support of its contention:

- M/s Vallabh Yarns Pvt. Ltd. vs JCIT ITA No.1250/Chd/2017 dated 28-03-18

26. Ld.DR on the other hand strongly supported the order of the CIT(A) stating that the restriction of disallowance to Rs.87,000/- out of total expense incurred of Rs.8,74,832/- was reasonable considering the fact that the assessee had failed to establish nexus between the expenditure incurred and business purpose of travel undertaken.

27. After considering the rival contentions we find merit in the contention of the Ld.Counsel for the assessee. The fact that the travelling was undertaken by the directors of the assessee company was established by the assessee filing details and copy of account of travelling expenses. The revenue has not controverted the said fact. Further the fact that the assessee has made considerable export sales in the immediately succeeding years of Rs.32 lacs and Rs.1.42 crores has also remained uncontroverted. Therefore there is no reason for attributing any personal/non business usage in the said expenses when the entire travel has been undertaken by the directors of the company resulting in visible increase in sales in the succeeding year. The disallowance upheld by the CIT(A) to the extent of Rs.87,000/- is purely adhoc without any basis, and is

therefore deleted. Ground of appeal No.1(d) therefore stands allowed.

28. In the result, the appeal of the assessee is allowed.

Order pronounced in the Open Court.

Sd/-	Sd/-
(SANJAY GARG)	**(ANNAPURNA GUPTA)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Dated : 14th August, 2018

Rati

Copy to:

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

Assistant Registrar,
ITAT, Chandigarh