IN THE INCOME TAX APPELLATE TRIBUNAL
COCHIN BENCH, COCHIN
BEFORE S/SHRI CHANDRA POOJARI, AM & GEORGE GEORGE K., JM

ITA No.155/Coch/2017
Assessment Year : 2012-13

M/s. Combined Foods Private Limited, 28/3030, Elamkulam, Cheruparambath Road, Kadavanthara, Kochi-682 020. [PAN:AAACC 9366N]		The Principal Commissioner of Income-tax, Kochi-1.
Assessee-Appellant		**Revenue-Respondent**

Assessee by	Shri P.M. Veeramani, CA
Revenue by	Shri Shantham Bose, CIT(DR)

Date of hearing	17/12/2018
Date of pronouncement	27/12/2018

O R D E R

Per CHANDRA POOJARI, AM:

This appeal of the assessee is directed against the order passed u/s. 263 of the Act by the Pr. CIT, Kochi dated 15/03/2017 and pertains to the assessment year 2012-13.

2. The facts of the case are that the assessee is engaged in the business of manufacture of ice creams. For the assessment year 2012-13, the assessee filed return of income admitting a total income of Rs.67,92,620/-. The assessment u/s. 143(3) was completed vide order dated 23/03/2015, determining the total

income at Rs.99,44,117/-. After going through the records, the CIT observed that the assessment order passed by the Assessing Officer was erroneous in so far as it was prejudicial to the interest of the revenue for the reasons mentioned below:

1. Assessing Officer omitted to consider the disallowance u/s. 36(1)(iii) in respect of interest paid on borrowed funds in capital work in progress.

2. Disallowance of expenses u/s. 14A read with Rule 8D in respect of dividend income from investment in equity shares was omitted to be considered.

3. Assessing Officer's omission to examine the issue on the taxability of income on account of lapsed liability of freezer deposits.

Accordingly, the CIT issued notice u/s. 263 proposing for revision of assessment u/s. 263 of the Act . The CIT was not satisfied with the reply of the assessee. He observed as follows:

1) Disallowance u/s. 36(1)(iii)

Assessing Officer in the assessment order passed had not considered the applicability of the provisions of section 36(1)(iii) in respect of interest paid on borrowed funds in capital work-in-progress. It is seen from records that Assessing Officer had not verified the claim and passed a detailed speaking order on this issue. In response to the show cause notice on this issue assessee contends that no loans were utilized during the year for capital work-in-progress and hence disallowance U/s 36(1)(iii) is not attracted. Since the AO had not verified the claims and passed a speaking order on this issue, this issue is remanded to AO for verification

of the claim and passing of a detailed speaking order in accordance with law after affording due opportunity to the assessee.

2) Disallowance of expenses u/s. 14A A read_with Rule 8D

In the assessment order passed AO had omitted to examine the applicability of section 14A r.w. rule 8D in respect of dividend income from investments in equity shares. In response to the show cause notice on this issue, assessee contends that no borrowed funds were utilized for investment for earning tax free income. It was further stated that there was no fresh investments during the year. Since the Assessing Officer had not verified the details and passed a speaking order on this issue, this issue is remanded to AO for denovo consideration and passing a speaking order in accordance with law after affording due opportunity to the assessee.

3) Income on account of lapsed liability of freezer deposit

It is seen from records that income on account of issue of taxability of income on account of lapsed liability of freezer deposit of Rs. 29,72,034 /- was not examined with reference to statutory provisions of actual cost as per explanation 10 to Section 43(1) of IT Act. In reply to show cause notice the assessee contends that 1TAT, Cochin Bench, Cochin in the assessee's own appeal had deleted the addition towards the lapsed

liability on freezer deposits. The applicability of Section 43(1) - Explanation 10 had not been examined by AO. Therefore, this issue is remitted to AO for considering the factual position and passing necessary orders in accordance with law after affording due opportunity to the assessee.

3. Before us, the assessee challenged the legality of exercise of jurisdiction u/s. 263 of the Act by the CIT.

4. The Ld. DR relied on the order of the CIT.

5. We have heard the rival submissions and perused the record. Section 263 of the Income-tax Act seeks to remove the prejudice caused to the revenue by the erroneous order passed by the Assessing Officer. It empowers the Commissioner to initiate suo moto proceedings either where the Assessing Officer takes a wrong decision without considering the materials available on record or he takes a decision without making an enquiry into the matters, where such inquiry was prima facie warranted. The Commissioner is well within his powers to treat an order as erroneous on the ground that the Assessing Officer should have made further inquiries before accepting the wrong claims made by the assessee. The Assessing Officer cannot remain passive in the face of a claim, which calls for further enquiry to know the genuineness of it. In other words, he must carry out

investigation where the facts of the case so require and also decide the matter judiciously on the basis of materials collected by him as also those produced by the assessee before him. The Assessing Officer was statutorily required to make the assessment under Section 143(3) after scrutiny and not in a summary manner as contemplated by Sub-section (1) of Section 143. The Assessing Officer is therefore, required to act fairly while accepting or rejecting the claim of the assessee in cases of scrutiny assessments. The Assessing Officer should protect the interests of the revenue and to see that no one dodged the revenue and escaped without paying the legitimate tax. The Assessing Officer is not expected to put blinkers on his eyes and mechanically accept what the assessee claims before him. It is his duty to ascertain the truth of the facts stated and the genuineness of the claims made in the return. The order passed by the Assessing Officer becomes erroneous when an enquiry has not been made before accepting the genuineness of the claim which resulted in loss of revenue.

5.1 In the present case, the Assessing Officer has not enquired into and no proper efforts were made to find out the true position with reference to the issue raised by the CIT. Without making any enquiry at all, the Assessing Officer accepted the assessee's claim. The failure on the part of the Assessing Officer to make necessary enquiry rendered the assessment order erroneous which also resulted in loss to the revenue. The CIT had observed in his order that the issue is to be decided by the Assessing Officer after fresh examination. Hence, the

order of the CIT cannot be held as erroneous. The CIT's approach was correct. If the CIT had recorded that it was an income not arising out of business, then further enquiry by the Assessing Officer would have been influenced by that observation. Further, CIT had only observed that no proper enquiry has been made that resulted in erroneous order and further it resulted in loss of revenue. Hence the Assessing Officer has to pass the order after hearing the assessee. Therefore, the CIT exercised his power conferred u/s. 263 of the Act in setting aside the assessment and remanded the case back to the file of the Assessing Officer to make enquiry into the issue and decide the same. As such, the CIT remitted the issue back to the file of the Assessing Officer for de novo consideration.

5.2 Further, even before us the assessee has not explained the correct position of law on this issue. Being so, we find no merit in the argument of the Ld. AR. This ground of appeal of the assessee is rejected.

6. The second ground in this appeal is with regard to disallowance made u/s. 36(1)(iii) of the Act.

7. The Ld. AR submitted that the Assessing officer vide his notice dated 21.1.2015 had asked for complete books of account with bills and vouchers which were produced. It was submitted that the assessee filed

detailed reply vide letter dated 19.2.2015 and further details called for during hearing were furnished vide letters dated 23.2.2015 and 27.3.2015. In particular vide notice dated 21.1.2015, the AO had called for an examined the details of all bank accounts, loans and after examining all the records did not make any disallowance either under section 36(1)(iii) or under section 14A. The Ld. AR submitted that the only reason given by Commissioner of Income Tax in the revision order under section 263 was that the AO had not passed a speaking order on the two issues, the CIT had concluded that the AO had omitted to examine the same. In this connection, the Ld. AR relied on the judgment of the Kolkota High Court in the case of CIT vs J L Morrison (India) Ltd wherein it was held as under:

"85. Whether the assessment order dated March 28, 2008, was passed with- out application of mind is basically a question of fact. The learned Tribunal has held that the assessment order was not passed without application of mind. The records of the assessment including the order-sheets go to show that appropriate enquiry was made and the assessee was heard from time to time. In deciding the question the court has to bear in mind the presumption in law laid down in section 114 clause (e) of the Evidence Act :

*"that judicial and official **acts** have been regularly performed;"*

86. Therefore, the court has to start with the presumption that the assessment order dated March 28, 2008, was regularly passed. There is evidence to show that the Assessing Officer had required the assessee to answer 17 questions and to file documents in regard thereto. It is difficult to proceed on the basis that the 17 questions raised by him did not require application of mind. Without application of mind the questions raised by him in the annexure to the notice under section 142(1) of the Act could not have been formulated.

87. The Assessing Officer was required to examine the return filed by the assessee in order to ascertain his income and to levy appropriate tax on that basis. When the Assessing Officer was satisfied that the return filed by the assessee was in accordance with law, he was under no obligation to justify as to why was he satisfied. On the top of that the Assessing Officer by his order dated March 28, 2008, did not adversely affect any right of the assessee nor was any civil right of the assessee prejudiced. He was as such under no obligation in law to give reasons.

88. The fact, that all requisite papers were summoned and thereafter the matter was heard from time to time coupled with the fact that the view taken by him is not shown by the Revenue to be erroneous and was also considered both by the Tribunal as also by us to be a possible view, strengthens the presumption under clause (e) of section 114 of the Evi-dence Act. A prima facie evidence, on the basis of the aforesaid presumption, is thus converted into a conclusive proof of the fact that the order was passed by the Assessing Officer after due application of mind."

7.1 Hence, it was submitted that the CIT was not correct in his conclusion that the issues were not examined by the AO because there was no speaking order on these issues. During the course of hearing before the CIT, it was submitted that the assessee had furnished the details of the bank accounts. It was explained that no fresh loans were taken during the year for the acquisition of any assets and all the term loan accounts were continuing from the earlier year. It was submitted that there was no disallowance u/s 36(1)(iii) even during the earlier year as may be observed from the assessment order for AY 2011-12 enclosed. Thus, according to the Ld. AR, there was no error in the assessment order warranting revision under section 263 of the Act.

8. The Ld. DR relied on the order of the CIT).

9. We have heard the rival submissions and perused the record. We have also gone through the case law cited before us. Section 36(1)(iii) reads as follows:

> *The deductions provided for in the following clause shall be allowed in respect of the matter dealt with therein, in computing referred to in section 28;*
>
> *(iii) the amount of interest paid in respect of capital borrowed for the purposes of the business or profession."*

9.1 With effect from 1/4/2003, the proviso was inserted by Finance Act, 2003,which reads as follows:

> *"Provided that any amount of the interest paid in respect of capital borrowings for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction."*

9.2 As per the new proviso, the interest would not be allowable till the new asset is brought to use. Such interest is to be capitalized. In other words, due to the above proviso u/s.36(1)(iii) inserted with effect from 1/4/2004, applicable from the assessment year 2004-05, interest is to be disallowed on money borrowed for acquiring capital asset till the date on which the asset is brought to use, even if it is for expansion of the existing business. In the present case, the assessee claimed interest on borrowings. The contention of the assessee is that the interest payable was liable for deduction. Any interest paid on borrowings used for the purpose of expansion of existing business cannot be allowed. There is no dispute that the assessee had borrowed funds used for setting up of a new

capital asset. Being so, such interest cannot be allowed in view of the said proviso to section 36(1)(iii) of the Act. In the present case, the issue is whether interest payable on borrowed capital for setting up of capital asset till such time it comes into commercial production is allowable as revenue expenditure u/s. 36(1)(iii) of the Act while computing the income of the assessee or to be treated as capital expenditure to be added to the cost of asset. Section 43 of the Act defines certain terms relevant to determination of income from profits and gains of business or profession. Sub-section 1 of section 43 provides for fixing of actual cost of asset. Explanation 8 to section 43 was added by Finance Act, 1986 w.e.f. 1/4/1974. The object of the said amendment as contained in the Finance Bill, 1986 as it appears in 158 ITR (St.) 88 reads as under:

> *"Under the existing provisions of clause (1) of that section, 'actual cost' means the actual cost of the asset to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any person or authority. The proposed amendment seeks to clarify that any amount paid or payable as interest in connection with acquisition of an asset and relatable to a period after the asset is first put to use shall not form part and shall deemed never to have been formed part of the actual cost of the asset."*

9.3 A perusal of Explanation 8 of section 43(1) of the Act and the object for which the same was inserted with retrospective effect shows that no interest paid or payable by the assessee in connection with the acquisition of the asset for any period after the asset is first put to use shall not form part of the actual cost of the asset. The proposition in the present case is just reverse. The natural consequences of Explanation 8 would be that in case of any expansion,

interest paid or payable on loans raised in connection with the acquisition of an asset before the same is first put to use shall form part of the actual cost of the asset. Meaning thereby that it will be capitalized to be added to the cost of the asset. Explanation 8 to section 43(1) of the Act was added with retrospective effect from 1/4/1974. We find that Supreme Court in the case of Challapalli Sugars Ltd. vs. CIT reported in 98 ITR 167 observed that the expression actual cost under the Income-tax Act, 1922 was under consideration, which had not been defined therein. An identical issue therein was as to whether interest paid before commencement of production on the amount borrowed for the acquisition and installation of plant and machinery has to be considered as part of the actual cost of the assets. While referring to and relying on various principles and Rules on accountancy prevailing in commerce and industries, the Supreme Court held that correct method for determination of the cost of capital asset is to include all expenditure necessary to bring such asset into existence and to put them in working condition. In case money was borrowed by a newly started company in the process of construction and erecting its plant, the interest incurred before the commencement of production on such borrowed money can be capitalized and added to the total cost of fixed assets which have been created as a result of such expenditure and such rule of accountancy should be adopted for determining the actual cost of the assets in the absence of any statutory definition or other indication to the contrary. A perusal of Explanation 8 to section 43(1) of the Act, referred to above, clearly shows that the same is

nothing but reiteration of the principles laid down in M/s. Challapalli Sugars Ltd. (supra). The expression does not make any distinction whether the asset is acquired for setting up of an entirely new business or in the process of expansion of its existing business. It merely provides for determination of actual cost of asset on a date when the asset first is put to use. Unless an asset, which is being acquired, starts generating income, it cannot be said that the same is being used for the purpose of business. Once it is established that interest paid after asset is put to use is not to be included in the actual cost of an asset. There would be no alternate but to hold that the interest paid before the asset was first put to use would be included in the actual cost thereof and is to be treated as capital expenditure and not revenue in nature.

9.4 In view of the above discussion, we hold that the interest paid by the assessee used for the purpose of expansion of existing business cannot be allowed so as to claim deduction u/s. 36(1)(iii) of the I.T. Act. We do not find any infirmity in the direction of the CIT given u/. 263 of the Act. Hence, this ground of appeal of the assessee is rejected.

10. As regards disallowance u/s 14A, it was submitted that there was no fresh investments in mutual funds during the year and there was a reduction in the investments as at 31.3.2012. It was also submitted that the investments were made out own funds in the form of Capital and Reserves and the tax free

investments were only 7% of the own funds. Thus the investments were out of own funds in the form of capital and reserves. When the investment is made out of own funds, disallowance u/s 14A is not attracted. The Ld. AR relied on the following judgments:

1. Godrej & Boyce Manufacturing Co. Ltd (394 ITR 449) (SC)

2. Principal CIT vs Sintex Industries Ltd 82 taxman.com 171 Guj - Department SLP against this decision was dismissed by Supreme Court in 93 taxman.com 24.

10.1 Hence, according to the Ld. AR, there was no error in the assessment order warranting revision under section 263 of the Act. It was submitted that on the above both issues the assessing authority has taken one of the possible views and the CIT has no power to interfere.

11. The Ld. DR relied on the order of the CIT.

12. We have heard the rival submissions. According to the assessee, there is sufficient own funds to make investment in exempted income yielding investment. In our opinion, it is the duty of the assessee to show the availability of interest free funds to make investment. There should be sufficient interest free funds available with the assessee. Since the assessee had not show availability of interest free funds at the time of making investment and there was no examination of the issue by the Assessing Officer, the CIT was right in exercising jurisdiction u/s. 263 of the Act and directing the Assessing Officer to

re-examine the issue. Since the issue involved u/s.14A is having tax effect and there is loss of revenue, it cannot be said that CIT has committed error in directing the Assessing Officer to re-examine the issue. Accordingly, this ground of appeal of the assessee is rejected.

13. The next ground is with regard to taxability of income on account of lapsed liability.

14. The Ld. AR submitted that the AO had in fact examined in detail this point and gave reasons in paragraph 3.1 to 3.7 of the assessment order and made an addition of Rs.29,72,034/-. Thus, it was submitted that the conclusion of the CIT that the issue had not been examined was not correct. It was only in the order u/s 263 that the CIT pointed out that the AO had failed to examine the applicability of explanation 10 to section 43(1). It was submitted that the said explanation was relating to considering the reimbursement received towards acquisition of fixed assets and its impact on the cost/WDV of the assets and this had nothing to do with the issue of lapsed liability for which notice u/s. 263 was issued. According to the Ld. AR, in the revision proceedings u/s 263, CIT can consider only those items for which notice was issued. The Ld. AR relied on the following judgment:

CIT vs Ashish Rajpal (320 ITR 674) (Delhi)

14.1 Further, it was submitted that explanation 10 to section 43(1) was attracted only when a portion of the cost of an asset acquired by the assesse had been met directly or indirectly by the Central Government or State Government or any authority established under any law in the form of a subsidy or grant or reimbursement. According to the Ld. AR, the freezer deposit collected by the assessee from the dealers represent the liability of the assessee and the same cannot be considered as subsidy for the acquisition of freezers. The Ld. AR relied on the decision of the co-ordinate bench in the case of Acumen Capital Market Ltd vs DCIT (163 ITD 633) where it was held as follows:

> *"6.7 Section 263 is attracted only if order of assessing officer is erroneous in so far asit is prejudicial to the interest of the revenue. Thus, if one of the twin conditions namely; (i) the assessment order is erroneous and (ii) prejudicial to the interest of revenue, is not satisfied, the CIT does not have power to exercise his revisionary powers u/s 263 of the Act. In the instant case, as mentioned earlier, on examination of facts, we find there is no error in the assessment order for the CFT to invoke his powers u/s 263 of the Act, hence, we quash the same. It is ordered accordingly."*

In the light of the above arguments, it was prayed that the order of the CIT u/s 263 be quashed.

15. The Ld. DR relied on the order of the CIT.

16. We have heard the rival submissions and perused the record. We find that a similar issue came up for consideration before this Tribunal in assessee's own

case alongwith others in ITA Nos. 73-79/Coch/2014 and vide order dated 25/2014, it was held as under:

"4. We have considered the rival submissions on either side and relevant material on record. The issue arises is whether the deposits in respect of the freezer has to be considered as income of the assessee or not. As rightly submitted by the Ld. AR of the assessee that this issue was considered by the Tribunal in one of the assessees for the earlier assessment year and found that such deposits cannot be considered as income of the assessee. For the sake of convenience, we extract below the order dated 08.08.2012 passed by the Tribunal in the case of M/s. Kreem Foods (P) Ltd. In ITA No. 597/Coch/2010 relating to assessment year 2007-08:-

"3. At the time of hearing, the Ld. Counsel for the assessee submitted a copy of the order dated 25-05-2012 passed by this Bench in the case of Jojo Frozen Food (P) Ltd. and Cream Packs (P) Ltd. in I.T.A. Nos. 655 & 654/Coch/2010 wherein the Tribunal has considered an identical issue and decided the same in favour of the assessee. For the sake of convenience, we extract below the operative portion of the said order in respect of the above said issue.

"6. We have considered the rival submissions and carefully perused the record. We have also gone through the copy of the order passed by the co-ordinate bench of the Tribunal in the case of High Range Foods (P) Ltd, referred supra. In respect of the first issue, i.e., Whether the deposits received from the dealers can be considered as income of the assessee, the Tribunal has observed as under.

"*The assessee received Deposit for the supply of freezer from the concerned vendors. The freezers are required to safe keep the edible ice-creams. They are required for the purpose of business. The small vendors may not be inclined to purchase the freezers as they are not affordable to them considering their status. This made the assessee company to supply freezer on the receipt of fixed deposit and the compensation of the spread-over period. They are attached with a liability. The accrual comes only on termination of agreement. The business necessity requires cordial relationship with vendors. The assessee cannot treat these two amounts as receipts in the nature of income unless the so-called agreement terminated. In other words it is not a debt owned by the assessee. Hence, under the above facts and circumstances of the case, this*

issue to be decided in favour of the assessee by setting aside the orders of the authorities.

Besides the assessee never treated this as income in the books. The assessee consistently holding it so as the amount attached with a liability to refund. The assessee never admitted this amount as income in the books. Only accrued income arose to the assessee during the relevant previous year also can be brought to tax under the Income-tax provisions which is a settled law. In other words, there must be a debt owed to the assessee and until this is created in favour of the assessee as a debt due to the assessee, it cannot be said as income accrued. Hence, the decision relied by the Jr. D.R. in the case of CIT vs. T.V. Sundaram Iyengar and Sons cited supra, is clearly distinguishable on facts. In that case, assessee itself admitted this as income as per the book entries. Hence, it is distinguishable.

The decision relied by the ld. counsel for the assessee in the case of CIT vs. Realest Builders and Services Ltd. – 307 ITR 202 (SC) in addition to the following cases –

(a) Siddheswar Sahakari Sakhar Karkhana Ltd. vs. CIT & Others – 270 ITR 1 (SC);

(b) Bharat Petroleum Corporation Ltd. vs. CIT – 202 ITR 492 (Cal).

(c) Sugauli Sugar Works (Impugned) Ltd. – 236 ITR 518 (SC);

(d) Star India P. Ltd. vs. Addl. CIT – 311 ITR (ST) 235 (Mumbai).

(e) Govind Prasad Prabhu Nath – 171 ITR 417 (All.);

(f) Hindustan Housing and Land Development Trust Ltd. – 161 ITR 524 (SC);

(g) Ace Builders Pvt. Ltd. vs. CIT – 225 ITR 746 (SC);

(h) Mantra Tanta Yantra Vigyan vs. CIT – 300 ITR 140 (Raj.); and

(i) Guardian Industries Corpn. vs. Assistant Director of Income-tax – 7 DTR 594 (Del.).

are also supports the plea of the assessee. The accrual has been dealt with in the relied judgments. Hence, under the given set of facts and circumstances, we by relying on the above decisions set aside the orders of the authorities and allow this ground of the assessee as it cannot be treated as income for the year relevant under appeal."

7. Since the co-ordinate bench has already taken a view on identical issue, by following the said decision, we hold that the deposits collected from vendors cannot be considered as the income of the assessee so long as the agency agreement continues. Accordingly, we set aside the order of Ld CIT(A) on this issue in the hands of both the assessees and direct the AO to delete the addition made on this issue in the hands of both the assessees herein".

5. The only objection of the Ld. DR is that the appeal was filed against the order of the Tribunal and the same is pending before the High Court. But on a query from the Bench, the Ld. DR submitted that he does not have knowledge of any stay granted by the Hon'ble High Court on the operation of the earlier order of the Tribunal. Since the Ld. CIT(A) has followed the order of the Tribunal, we are of the considered opinion that mere pending of the appeal before the High Court against the order of the Tribunal cannot be a reason to take a different view. Therefore, by following the order of the Tribunal for the earlier assessment year, this Tribunal is of the considered opinion that the deposits collected by the assessee for freezer cannot be considered as income of the assessee.

6. In view of the above facts and circumstances of the case and in view of the order of the Tribunal, we do not find any infirmity in the order of the Ld. CIT(A) and accordingly, the same is confirmed.

7. In the result, all the appeals filed by the revenue stand dismissed."

16.1 In view of the above order of the Tribunal, to that extent, this issue is covered in favour of the assessee.

16.2 However, there was no issue before any of the authorities on earlier occasion with reference to applicability of Explanation 10 to section 43(1) of the I.T. Act. Being so, the CIT was right in exercising jurisdiction u/s. 263 and directing the Assessing Officer to consider the applicability of Explanation 10 to section 43(1) of the Act. Thus, this ground of appeal of the assessee is rejected.

17. In the result, the appeal of the assessee is dismissed.

Order pronounced in the open Court on this 27th December, 2018.

sd/-	sd/-
(GEORGE GEORGE K.)	(CHANDRA POOJARI)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Place: Kochi
Dated: 27th December, 2018
GJ
Copy to:
1. M/s. Combined Foods Private Limited, 28/3030, Elamkulam, Cheruparambath Road, Kadavanthara, Kochi-682 020.
2. The Pr. Commissioner of Income-tax, Kochi.
3. D.R., I.T.A.T., Cochin Bench, Cochin.
4. Guard File.

By Order

(ASSISTANT REGISTRAR)
I.T.A.T., Cochin