

आयकर अपील अाधिकरण, अहमदाबाद ँयायपीठ
**IN THE INCOME TAX APPELLATE TRIBUNAL,
" D " BENCH, AHMEDABAD**

BEFORE SHRI RAJPAL YADAV JUDICIAL MEMBER

And

SHRI WASEEM AHMED, ACCOUNTANT MEMBER

आयकर अपील सं./ITA No. 3285/AHD/2014

अाधरण वष/Asstt. Year: 2010-2011

M/s Rushil Industries Ltd., D-202, Sarthik Complex, Atabhai Chowk, Bhavnagar. PAN: AABCR0170N	Vs.	The A.C.I.T, Circle-1, Bhavnagar.
---	-----	---

(Applicant)	(Respondent)
Assessee by :	Shri S.N. Soparkar and Shri Parin Shah
Revenue by :	Shri Rajesh Meena, Sr. DR

सुनवाई का तारख/Date of Hearing : 22/01/2019

घोषणा का तारख /Date of Pronouncement: 05/03/2019

आदेश/O R D E R

PER WASEEM AHMED, ACCOUNTANT MEMBER:

The captioned appeal has been filed at the instance of the Assessee against the order of the Commissioner of Income Tax (Appeals)-XX, Ahmedabad, vide appeal no.CIT(A)-XX/19/13-14 dated 25/09/2014 arising in the matter of assessment order passed under s. 143(3) of the Income Tax Act, 1961 (here-in-after referred to as "the Act") dated 29/02/2013 relevant to Assessment Year 2010-11.

2. The Assessee has raised the following grounds of appeal:

1. *In law and in the facts and circumstances of the appellant's case, the Ld.CIT(A) has erred in holding that there was excessive payment made by the appellant to the specified persons to extent of 3% and on that ground confirming the disallowance of interest to the extent of Rs.1,67,463/- out of disallowance of Rs.3,34,926/- made in the assessment order.*
2. *In law and in the facts and circumstances of the appellant's case, the "Ld.CIT(A) has erred in upholding the disallowing of interest expenditure of Rs.16,83,923/- made by the Assessing Officer being the interest on C.C. A/c on the ground that the assessee would have deferred interest-bearing funds toward interest-free advances/loans/investment.*
3. *In law and in the facts and circumstances of the appellant's case, the "Ld.CIT(A) has erred in upholding the addition of Rs.39,15,600/- made by the "Ld.Assessing Officer for the alleged difference in the value of stock of ship as per the bank statement and the stock of ship as per the audited Annual Accounts.*
4. *In law and in the facts and circumstances of the appellant's case the "Ld.CIT(A) has erred in upholding the addition of Rs.5,55,720/- made by the Assessing Officer on account of difference in the figure of book debts as on the close of year given in the statement to the bank, and the amount of book debts as reflected in the Balance Sheet.*
5. *The appellant craves leave to add, alter, amend and/or withdraw any of the ground or grounds either before or at the time of hearing of appeal.*

3. The issue raised by the assessee in the ground no. 1 is that the Ld. Ld.CIT (A) erred in confirming the disallowance made by AO to the extent of 3% interest rate paid to related party u/s 40(A)(2)(b) of the Act, amounting to Rs. 1,67,463/-

4. Briefly stated facts are that the assessee is a private limited company and engaged in the business of Shipbreaking, Business of lending, Trading of scrap materials and Trading in commodities/currency.

5. The AO during the assessment proceedings observed that the assessee had paid the interest on the borrowed fund from the persons specified u/s 40A(2)(b) of the act @18% as against 12% paid to other outsiders.

5.1 On a question, by the AO, the assessee submitted that interest paid to these parties @18% p.a. is very much at the prevailing market rate.

5.2 However AO rejected the contention of the assessee and worked out the proportionate interest amounting to Rs.3,34,926/- which is more than 12% per annum. The amount disallowed was added back to the total income of the assessee.

6. Aggrieved assessee preferred an appeal before the Ld.CIT(A). The assessee before the Ld.CIT (A) submitted that assessee paid interest @ 12% to 18% on the amount borrowed during the year. If the loan was available @12%, then it was taken at that rate, and if it was not available at that lower rate, then it was taken at the rate at which it was available considering the exigency of such loan in the business. Further interest @18% was paid to most of the parties whether they are relative or not.

6.1 In the case of payment made to the person specified u/s 40A(2)(b), it was the duty of AO to enquire whether such expenses are excessive and unreasonable. Thus the onus is on the AO to bring material on record to prove that the payment of interest paid by the assessee was excessive or unreasonable.

7. However, the CIT-A has given partial relief to the assessee by observing from the interest ledger account that some of the parties have paid interest @15% and 18% per annum. The details of such parties stand as under:

1.	Shri J.N. Patel, HUF	15%
2.	Deviben I. Sanghvi	18%
3.	Vijay Ishwarbhai Sanghvi HUF	18%
4.	Bhartiben J. Doshi	18%
5.	Hiten K. Shah HUF	18%
6.	Aarti Ship Breaking	15%
7.	J.N. Patel HUF	12%
8.	Pars Steel Corporation	18%
9.	Vijaykumar & Co.	18%
10.	Dharmik J. Vanani	15%

7.1 There were many more parties to whom interest @15%/18% and 12% have been paid. Therefore it is reasonable to conclude that the prevailing market interest rate must be 15% per annum. Accordingly the Id. CIT-A restricted the disallowance to 3% in place of 6% amounting to Rs. 1,67,463/- only.

8. Being aggrieved by the order of the Ld.CIT (A) assessee is in appeal before us. The Id. AR before us filed a paper book running from pages 1 to 98 and reiterated the submissions as made before the learned CIT (A). On the contrary, the Id. DR before us vehemently supported the order of authorities below.

9. We have heard the rival contentions and perused the materials available on record. The issue in the instant case relates to the payment of interest on the borrowed fund by the assessee at the rate of 18% per annum. As per the

AO prevailing market rate of interest is at the rate of 12% per annum on the borrowed fund which was paid to the non-related parties whereas the related parties were paid interest @ 18% Per Annum on the borrowed fund. Since the assessee has made the payment of interest to the related parties at a higher rate of interest, therefore the AO was of the view that the assessee has paid excessive interest to the related parties in excess of the prevailing market rate as per the provisions of section 40A(2)(b) of the Act. Accordingly the amount of excess interest amounting to Rs. 3,34,926/-being the difference in the rate of interest @ 6% which was disallowed by the AO.

10. However the Ld.CIT (A) found that the assessee has also paid interest to the non-related parties within the range of 15 to 18% per annum on the borrowed fund. Therefore the Ld.CIT (A) concluded the reasonable prevailing rate of interest at the rate of 15% per annum on the borrowed fund. Thus the Ld.CIT (A) allowed the ground of appeal of the assessee in part.

11. The AO in the case on hand has assumed the prevailing market rate of interest at the rate of 12% per annum on the borrowed fund without bringing any tangible material on record. Therefore in the absence of any material by which the AO treated the interest paid by the assessee as unreasonable/excessive, we are not impressed with the finding of the AO.

12. There is no dispute about the use of fund borrowed by the assessee at the rate of 18% per annum. Thus it is transpired that the assessee has used the borrowed fund for its business. Regarding this, we are of the view that it is the assessee who knows its business affairs the best than any other person. Accordingly, the assessee can only decide the need for the borrowing from the related parties including the rate of interest. As such the AO is not

expected to direct/advice to the assessee to borrow the money for the business at a particular rate of interest. In this regard, we find support and guidance from the judgment of Honøble Delhi High Court in case Oracle India (P.) Ltd. reported in 11 taxmann.com 139 wherein it was held as under:

“It is well-settled that it is not open to the department to adopt a subjective standard of reasonableness and disallow a part of business expenditure as being unreasonably large, or decide what type of expenditure the assessee should incur and in what circumstances. Thus, the jurisdiction of the Assessing Officer is only confined to decide "Profits and gains of business or profession", i.e., whether the expenditure claimed was actually and factually expended or not and whether it was wholly and exclusive for the purposes of business. Reasonableness of the expenditure can be considered only from this limited angle for the purpose of determining whether in fact amount was spent or not.”

12.1 We also find support and guidance from the order of this tribunal in case of Omkarmal Gaurishanker reported in 39 TTJ 223 wherein it was held as under:

“Considering the ever-increasing inflation, the interest rate of 24% allowed by the assessee on the unsecured deposits received from various relatives by no stretch of imagination could be treated as unreasonable or excessive. The ITO was directed to allow deduction in respect of the entire amount of interest expenditure incurred by the assessee”.

13. We also note that there were certain non-related parties to whom the assessee has paid interest on the borrowed fund at the rate of 18% per annum. Therefore it is incorrect to hold that the assessee has paid an excessive rate of interest to the related parties. Thus it is transpired from the order of lower authorities that the assessee in most of the cases has paid interest at a higher rate to the related parties. But it is also an undisputed fact that there were very few unrelated parties to whom the interest has been paid at the rate of 18% per annum. Thus it is incorrect to hold that the assessee has paid interest @18% per annum to its related parties only.

In view of the above, we do not find any reason to uphold the finding of the Ld. CIT (A). Hence the ground of appeal of the assessee is allowed.

14. The second issue raised by the assessee in the ground no 2 is that the Ld. CIT(A) erred in confirming the disallowance made by AO for Rs. 16,83,923/- on account of diversion of interest-bearing funds towards interest-free advances/loans/investments.

15. During the assessment proceeding The AO noticed that the assessee had shown stock in the books of account for Rs. 8,01,37,200/- (in 5200 MT) out of total cost of the ship of Rs. 20,69,07,238/- (in MT 13426). This indicates that assessee has sold 61% ship. It was further noticed that customs duty, other port charges, etc. are of Rs. 1,51,39,081/- whereas outstanding balance in C/C account is of Rs. 1,24,05,546/- and Rs. 1,76,11,813/- aggregating the amount of Rs. 30017359/- which prove that the fund of the assessee has been diverted.

16. On a question by the AO, the assessee submitted that the company imported all the vessels on credit by establishing usance LC from the bank. As such the credit from the bank in the international market is available virtually at cost-free. Thus the assessee deploys the same for earning a higher rate of returns. The LC generally has a tenure of 180 days.

17. The assessee further submitted that the Company purchased vessel winner-4 weight 13426 MT in January 2010 for which it has made an advance payment of US\$ 3,50,000/- by availing credit facility of Rs. 1,22,64,000/- after payment of necessary margin at the rate of 25%. Another cash credit

limit of Rs. 2,26,67,882/- availed for payment of customs duty, etc. Aggregate credit availed by the company for the ship is Rs. 3,49,31,882/-

18. However, the AO disagree with the submission of the assessee by observing the following

- 1) Assessee failed to furnished the cash flow statement for the particular period from the date of application of CC for the vessel to 31-03-2010.
- 2) The aggregate borrowed fund for the purchase of ship is of Rs. 3,49,31,882/- in January 2010 out of which outstanding at the end of the year 3,00,17,359/- in CC account whereas sale proceeds is of Rs. 13 cores which indicate diversion of the fund.
- 3) The assessee failed to furnish the evidence regarding advance payment of US\$ 3,50,000/-

In view of the above, the interest for January 2010 to March 2010 is of Rs. 16,83,923/- (i.e., 683393 + 1045530/-) which was disallowed and added back to the total income of the assessee.

19. Aggrieved assessee preferred an appeal before the Ld.CIT (A). The assessee before the Ld.CIT(A) submitted that there was no diversion of fund as presumed by the AO. As such it is apparent from annual accounts for the year under consideration that there a meager increase in the investment and loans & advances, i.e. Investment increased by 60000/-, loans and advances increased by 7,51,420 only, other advance in the form of deposit viz telephone security TDS etc.

20. During the year debtors increased by Rs. 4,91,16,862/- which shows ship sold but cash of the appellant was blocked with the debtors, net fixed assets also increased by Rs. 53,24,118/- and an increased amount of Rs. 4,22,93,734/- was also lying in the bank account to be used in the following AY as compared to PY, and current liability also decreased by Rs. 3,78,30,679/- as compared to PY. Thus in this way, the whole amount of sale proceeds utilized for business.

21. The assessee further submitted that if the assessee complies with the condition of section 36(1)(iii), thus the claim of interest payment cannot be simply rejected.

22. However the Ld.CIT (A) disregard the contention of the assessee by observing the following

- 1) that the appellant has failed to provide the daily cash flow statements starting from the period for the CC limit taken and till the end of the year.
- 2) In the absence of the utilization of sale proceeds for business, the assessee explanation remained unsubstantiated. Therefore the addition made by AO is correct, and thus disallowance is confirmed.

23. Being aggrieved by the order of the Ld.CIT (A) assessee is in appeal before us.

24. The Id. AR before us submitted that the own fund of the assessee axes the amount of cash credit account as shown outstanding in the balance sheet. Thus it can safely be presumed that there was no diversion of fund and accordingly no disallowance of interest is warranted.

On the contrary, the Id. DR before us vehemently supported the order of the authorities below.

25. We have heard the rival contentions and perused the materials available on record. On perusal of the balance sheet of the assessee as on 31st March 2010, it was noticed that owned fund and Reserve & surplus of the assessee stands 6.51 crores whereas the outstanding credit balance of cash credit (both the accounts) in aggregate is 3 crores approximately. Thus a presumption can be drawn that the assessee has not diverted any borrowed fund for non-commercial activity. In this regard, we find support and guidance from the judgment of Honøble Bombay High Court in the case of *Reliance Utilities and Power Ltd.* reported in 313 ITR 340 wherein it was held as under:-

“The principle therefore would be that if there are funds available both interest-free and overdraft and/or loans taken, then a presumption would arise that investments would be out of the interest-free fund generated or available with the company, if the interest-free funds were sufficient to meet the investments. In this case this presumption is established considering the finding of fact both by the CIT(A) and Tribunal”.

25.1 Similarly, we also rely on the judgment of the Honøble Bombay High Court in the case of *CIT vs. HDFC Bank Ltd* reported in 366 ITR 505 (Bom).

The relevant extract of the order is reproduced below:-

“Where assessee's capital, profit reserves, surplus and current account deposits were higher than the investment in tax-free securities, it would have to be presumed that investment made by the Assessee would be out of the interest-free funds available with Assessee and no disallowance was warranted u/s 14A.”

25.2 Similarly, we also find support from the judgment of Honøble Gujarat High Court in the case of *UTI Bank Ltd.* reported in 32 Taxmann.com 370 where the headnote reads as under :

“If there are sufficient interest free funds to meet tax free investments, they are presumed to be made from interest free funds and not loaned funds and no disallowance can be made under section 14A”.

In view of the above proposition, we hold that no disallowance of interest expense claimed by the assessee can be made on account of investments as discussed above. Hence, we reverse the order of the authorities below. The AO is directed to delete the addition made by him. Hence the ground of appeal of the assessee is allowed.

26. The third issue raised by the assessee in ground no 3 is that the Ld.CIT (A) erred in confirming the addition made by the AO of Rs. 39,15,600/- on account of the difference in the value of the stock as per the bank statement and as per the audit annual accounts.

27. During the assessment proceeding, the AO noticed a difference in the value of stock shown in the bank stock statement and its final accounts.

28. On a question by the AO, the assessee replied that the difference in the value of the stock is arising due to two reasons. Firstly, on account of foreign exchange gain earned by the company while importing the ship on credit and secondly, on account of the element of central excise duty included in the bank statement stock which has not been considered in the valuation of stock in the books of accounts because assessee uses the exclusive method of accounting.

29. However, the AO rejected the contention of the assessee by observing as under:

- 1) No calculation of such Foreign Exchange gain furnished by Assessee, no ledger account showing the impact of gain from Foreign Exchange.
 - 2) Stock as per bank stock statement for bank Rs. 9,04,22,800/- and as per books of accounts 8,01,37,200/- difference is 1,02,85,600/- when the assessee is following the exclusive method without considering the excise duty element then the value of the stock should be of Rs. 8,40,52,800/- but still there is the difference of Rs. 39,15,600/- only.
30. Therefore the undervaluation of the stock has decreased the profit. Accordingly, the difference of Rs. 39,15,600/- was treated as income and added to the total income of the assessee.
31. Aggrieved assessee preferred an appeal before the Ld.CIT (A). The assessee before the Ld.CIT (A) filed the reconciliation statement for the difference in stock value. The assessee further submitted that the difference in exchange of Rs. 1,01,10,068 has already been offered to tax during the year under consideration by crediting the same to purchase account of ship winner-4 already.
32. However the Ld.CIT (A) reject the contention of the assessee by observing that the purchase of ship winner-4 ledger account was not filed before the AO. Moreover, no working of the FE gain in proportion of closing stock has been submitted to the AO.
33. As such these are additional evidence filed by the assessee without any request under rule 46A of Income Tax Rule. Thus in the absence of such application, these pieces of evidence are not admitted. Similarly the Foreign

Exchange fluctuation of Rs. 1,01,10,068 was taken by the assessee is to work out the proportionate effect in closing stock which is also not verifiable from any of the records as it was without any supporting evidence, no balance sheet, profit & loss account or FE gain account submitted by the assessee to verify the same. In view of the same addition made by AO is found correct and justified.

34. Being aggrieved by the order of the Ld.CIT (A) assessee is in appeal before us.

35. The Id. AR before us submitted that that there is no difference in the quantity of the stock. As such the difference was arising on account of valuation of closing stock. Thus there cannot be any addition to the total income of the assessee on account of valuation difference.

36. On the contrary, the Id. DR before us vehemently supported the order of authorities below.

37. We have heard the rival contentions and perused the materials available on record. The issue in the instant case relates to the difference in the amount of closing stock declared to the bank viz a viz recorded in the books of accounts. It was explained that the difference is arising on account of the higher value of stock declared to the bank to avail the higher amount of cash credit facility from the bank.

37.1 We also note that there was no difference in the quantity recorded by the assessee in its books of accounts in the stock statement as well as the stock statement furnished to the bank. Thus there is no dispute that the

difference in the valuation of closing stock for Rs. 39,15,600/- was arising due to the declaration of the higher value of the stock to the bank. In such situations, courts have held that there cannot be any addition in the total income of the assessee in the event assessee has declared the inflated value of the stock. We find support and guidance from the judgment of Honøble Gujarat High Court in the case of CIT Vs. Read the steel and tubes private Ltd reported in 40 taxman.com 177 wherein it was held as under:

“9.2 It is a settled law, as rightly held by the Tribunal, that only on account of inflated statements furnished to the banking authorities for the purpose of availing of larger credit facilities, no addition can be made if there appears to be a difference between the stock shown in the books of account and the statement furnished to the banking authorities. If, for the purpose of fulfilling the margin requirements of the bank purely on inflated estimate basis, when the stock statement had reflected inflated value of the stock, in wake of otherwise satisfactory explanation, both - for the purpose of value as well as quantity, we find no reason to interfere with the order of the Tribunal.”

37.2 There is no difference in the quantity of closing stock shown by the assessee in its books of accounts and furnished in the stock statement to the bank. Therefore we are not inclined to uphold the finding of the authorities below. Hence we direct the AO to delete the addition made by him. Thus the ground of appeal of the assessee is allowed.

38. The fourth issued raised by the assessee in the ground no. 4 is that the Ld.CIT (A) erred in confirming the addition made by the AO of Rs. 5,55,720/- on account of the difference in the value of debtors as per the bank statement given to bank and as per the audit annual accounts.

39. During the assessment proceedings, the AO noticed the assessee declared the value of debtors at Rs. 12,92,33,269/-in the statement given to

the bank. However, the debtors declare in the books of account of Rs. 12,86,77,549/-. Thus there is a difference of Rs. 5,55,720/- only.

40. On a question by AO, the assessee submitted that there is a minor difference in the value of debtors shown in the statement given to bank and books of accounts. Such a difference was noticed while conducting the audit after furnishing the debtor statement to the bankers. As such there was some change effected in the grouping and some balance of certain parties also underwent some changes. So the difference is appearing as observed by the AO. However, the AO rejected the contention of the assessee by observing that no reconciliation statement was filed by assessee together with the individual ledger account of the parties whose group head in the books of account has been changed as well as no substantial evidence established by the assessee to substantiate its claim. In view of the above, the difference was disallowed and added to the total income of the assessee

41. Aggrieved assessee preferred an appeal before the Ld.CIT (A). The assessee before the L.d CIT (A) submitted that there was an outstanding amount of Rs. 5,55,720/- from the party named quality casting industries which has been written off during the year and resulting difference of Rs. 5,55,720/-. The assessee in support of its claimed filed the copy of the account of the party, detail of bad debts expenses.

42. However, the ld. CIT(A) observed from the list of debtors that the party named quality casting industries had been shown in the list of debtors for the amount of Rs. 12,92,33,269/-.

43. Moreover, this plea was not taken by before the AO. As such the plea was taken 1st time during the appellate proceeding and a copy of the ledger account was filed as additional evidence without any request under rule 46A, and hence the plea of the assessee was not accepted.

44. Being aggrieved by the order of the Ld.CIT (A) assessee is in appeal before us.

45. The ld. AR before us reiterated the submissions as made before the learned CIT (A). On the contrary, the ld. DR before us vehemently supported the order of authorities below.

46. We have heard the rival contentions and perused the materials available on record. The issue in the instant case relates to the difference observed by the AO between the value of the debtors shown by the assessee in its books of accounts viz a viz list of debtors with valuation furnished to the bank.

46.1 The assessee before the Ld.CIT (A) filed certain additional evidence to demonstrate that the difference is arising in respect of one-party namely Quality casting industries amounting to Rs. 5,55,720/-which has been written off in the books of accounts of the assessee. However, the appeal of the assessee was rejected by the Ld. CIT (A) on the ground that there was no application under rule 46A was filed by the assessee.

46.2 There is no dispute in the contention of the assessee that it has written off the bad debts amounting to Rs. 5,55,720/- shown in the name of Quality casting industries which was not verified by any of the authorities below.

46.3 In our considered view if the assessee failed to move an application for the admission of additional evidence then the Ld.CIT (A) should have granted opportunity to the assessee to rectify the defect. But on perusal of the order of the Ld.CIT (A) we note that no such opportunity to rectify the mistake was given to the assessee.

46.4 Therefore after considering the facts in totality and in the interest of justice and fair play we are inclined to restore this issue to the file of AO for fresh adjudication as per the provisions of law and in the light of above-stated discussion. Hence the ground of appeal of the assessee is allowed for statistical purposes.

47. In the result, the appeal of the assessee is partly allowed for the statistical purposes.

Order pronounced in the Court on 05/03/2019 at Ahmedabad.

**-Sd-
(RAJPAL YADAV)
JUDICIAL MEMBER**

**-Sd-
(WASEEM AHMED)
ACCOUNTANT MEMBER**

(True Copy)
Ahmedabad; Dated 05/03/2019

Manish

आदेश क प्रत/Copy of the Order forwarded to :

1. अपीलार्थ / The Appellant
2. प्रत्यर्थ / The Respondent.
3. संबंधित आयकर आयुक्त / Concerned CIT
4. आयकर आयुक्त(अपील) / The CIT
5. प्रभागीय प्रत, आयकर अपील आधिकरण / DR, ITAT,
6. गार्डफाइल / Guard file.

आदेशानुसार/BY ORDER,
उप/सहायक पंजीकार (Dy./Asstt.Registrar)
आयकर अपील आधिकरण, अहमदाबाद / ITAT, Ahmedabad