

**IN THE INCOME TAX APPELLATE TRIBUNAL  
CHANDIGARH BENCHES, 'SMC', CHANDIGARH**

**BEFORE SHRI N.K. SAINI, VICE PRESIDENT**

**ITA No.315/Chd/2017**  
Assessment Year: 2012-13

Shri Dharam Pal Aggarwal  
59-K, Sarabha Nagar  
Ludhiana

Vs. The ACIT  
Circle-6  
Ludhiana

PAN No. AAYPA9723E

(Appellant)

(Respondent)

Assessee By : Sh. Ashwani Kumar, CA  
Revenue By : Sh. A.P. Garg, Sr. DR

Date of hearing : 01/04/2019  
Date of Pronouncement : 22/04/2019

**ORDER**

This is an appeal by the Assessee against the order of the Ld. CIT(A)-4 dt. 23/11/2017.

2. In the present appeal Assessee has raised the following grounds:

*1. That order passed u/s 250(6) of the Income Tax Act, 1961 is against law and facts on the file in as much as the Ld. Commissioner of Income Tax (Appeals)-4, Ludhiana was not justified to arbitrarily uphold the action of the Ld. Assessing Officer in disallowing a sum of Rs. 13,77,730/- out of interest account by resort to provisions of Sec. 36(1)(iii).*

*2. That he was further not justified to arbitrarily uphold the action of the Ld. Assessing Officer in disallowing a sum of Rs. 2,26,635/- out of car expenses, depreciation, telephone and travelling expenses on account of estimated personal use thereof.*

3. Vide ground no. 1 the grievance of the assessee relates to the sustenance of disallowance of Rs. 13,77,730/- made by the Assessing Officer by invoking the provisions of Section 36(1)(iii) of the Income Tax Act, 1961 (hereinafter referred to as 'Act').

4. Facts of the case in brief are that the assessee filed the return of income on 22/09/2012 declaring income of Rs. 25,64,499/- which was processed under section 143(1) of the Act. Later on the case was selected for scrutiny.

5. During the course of assessment proceedings the Assessing Officer noticed that the assessee had given interest free advances to friends and family which were not for the business purposes and also claimed interest expenditure of Rs. 23,88,993.89 in the P&L Account. He also observed that the assessee had claimed deduction on interest expenditure under section 57 of the Act for Rs. 2,73,628/-. Thus the total interest expenditure claimed by the assessee was Rs. 26,62,621/- (Rs. 23,98,993.00 + Rs.

2,73,628.00). The Assessing Officer also pointed out that the loans to family and relatives outstanding in the balance sheet were as under:

Sr. No.	Particular	Amount
1	Vaishali Aggarwal	Rs. 4,05,000/-
2	Dev Bhoomi Angora Spng & Allied Ind.	Rs. 5,00,000/-
3	Fab Texre India P Ltd.	Rs. 44,60,000/-
4	Shakti Alpha Securities Pvt. Ltd.	Rs. 91,13,000/-
5	Amit Aggarwal	Rs. 77,402/-
6	Deepak Bakshi Loan	Rs. 1,00,000/-
7	Sushma Aggarwal	Rs. 1,000/-
8	S.P. Bansal	Rs. 60,00,000/-
9	Tirupati Balaji Exim P. Ltd.	Rs. 5,00,000/-
10	Sanjay Bansal	Rs. 65,00,000/-
11	Wansey Pastoral Company Aus.	Rs.2,45,196/-
Grand Total		Rs.2,79,01,598/-

5.1 The Assessing Officer asked the assessee to explain as to why the proportionate interest should not be disallowed on interest free advances under section 36(1)(iii) of the Act. In response, the assessee submitted as under:

*Regarding Your Honour's query relating to as to why a -proportionate interest be not made in view of the provisions of Section 36(1)(iii) as there are number of advances given by you on the other hand you are also paying interest on borrowed funds, in reply it is respectfully submitted that as mentioned earlier, the assessee has given all these advances prior to the amount of loan availed from M/s Bajaj Finance Ltd. However, the utilization of loan availed from M/s Bajaj Finance Ltd. was utilized to repay certain over draft facilities availed by the assessee from the bank in the past. However, some amounts/part of advances were given out of the over draft limits availed by the assessee in past. The detail of such amounts which are directly given by the assessee from over draft account in making advances to the parties whose amounts are outstanding as on 31.03.2012 and no interest has been earned thereon, has been drawn and is enclosed. The interest on such amounts has also been calculated. As such, only these amounts have been advanced out of the borrowed funds or otherwise have direct nexus between the amount borrowed and the interest free advances. During the course of assessment proceedings, books of accounts and relevant documents were produced in support of the nexus of borrowed funds invested in interest free advances even from the last year borrowings. Further it is also submitted that the parties namely Sh. Amit Aggarwal, Mrs. Vaishali Aggarwal and M/s Shakti Alfa Securities Private Limited are in relation to the assessee. All other parties are in no way in relation to the ASSESSEE".*

5.2 The Assessing Officer after considering the submissions of the assessee observed that the advances were out of the OD facility on which interest had been received were having the direct nexus, therefore interest expenditure of Rs. 7,17,875/- was allowable. On the remaining advances the Assessing Officer worked out the interest at Rs. 31,65,778/- and observed that the assessee had claimed the interest expenditure of Rs. 26,62,621/- out of which Rs. 7,17,875/- was allowable as the assessee had established direct nexus between the interest bearing borrowed funds and the interest income earned. He also observed that the interest amounting to Rs. 5,67,016/- was on the car loans which was allowable. He therefore restricted the disallowance to Rs. 13,77,730/- (Rs. 26,62,621.00 – Rs. 7,17,875.00 – Rs. 5,67,016/-).

6. Being aggrieved the assessee carried the matter to the Ld. CIT(A) and submitted as under:

During the relevant assessment year under consideration, the appellant had claimed an interest expenditure of Rs. 23,88,993.89 in its Profit and Loss Account. The appellant had also claimed in its return of income a deduction of interest expenditure of Rs. 2,73,628/- U/s 57 of the Income-Tax Act, 1961. Thus, the total interest expenditure claimed by the appellant was Rs. 26,62,621/- [Rs. 23,88,993/- + Rs. 2, 73,628/].

However, the Ld. Assessing Officer alleged that the advances made to family and friends amounting Rs. 2,79,01,598/- on which no interest was charged, were, made out of the appellant's borrowed funds, and, accordingly, effected a disallowance of Rs. 13,77,730/- out of interest expenditure claimed of Rs. 26,62,621/- by taking a recourse to the provisions of Section 36(I)(iii) of the Income-Tax Act, 1961.

In this connection, it is respectfully submitted that, no part of the borrowed funds was deployed in making the said advances of Rs. 2,79,01,598/- appearing in the books of M/s Shakti International [a proprietary concern of the appellant]. The appellant had already provided the details during the course of assessment proceedings for the year under assessment regarding the amount of those advances in the books of Sh. Dharam Pal Aggarwal advanced out of the HDFC Overdraft facility in the name of M/s Shakti International [a proprietary concern of the appellant], and on which interest had also been earned on such advances. Thus, an interest expenditure of Rs. 7,17,875/- was allowed as a deduction under Section 36(I)(iii) of the Income-Tax Act, 1961.

The appellant had availed loans from Loan Bajaj Finserv Lending II, Loan Bajaj Finserv Lending and Loan Car Mercedes Benz. This was implicit in grant of the bank facilities in respect of which interest shall be paid, that the said facilities were to be used for specific purposes, and, were also subject to stringent standards of credit monitoring by the banks. Moreover, the end use of the funds by the borrower was periodically, effectively and rigorously monitored by the banks through a combination of various means such as periodical reports, physical inspection of the borrower's unit and a regular review of the borrower's account etc.

Thus, from the above, it could be construed that, in the instant case, the funds raised by the appellant had only been used for the purposes for which they have been granted, and, the chances of diversion of funds are miniscule taking into account the stringent standards of monitoring and documentation prescribed.

#### 6.1 The reliance was placed on the following case laws:

- CIT Vs. Abhishek Industries Ltd. 286 ITR 1 (P&H)
- Judgment of Hon'ble Punjab & Haryana High Court in case of CIT Vs. Rakesh Gupta in ITA No. 37/2014 order dt. 02/07/2015

#### 6.2 It was further submitted as under :

From the perusal of the Balance Sheet of M/s Shakti International [a proprietary concern of the appellant], drawings/withdrawals were made amounting to Rs. 5,93,52,025.44 from the Capital A/c of Sh. Dharam Pal Aggarwal. Simultaneously, the same got transferred to the personal Capital A/c of Sh. Dharam Pal Aggarwal. The transfer of the funds to and from [or vice-versa] the Capital A/c of Sh. Dharam Pal Aggarwal appearing in the books of M/s Shakti International and the personal Capital A/c of Sh. Dharam Pal Aggarwal took place as and when the need for the same arose. The advances of Rs. 2,79,01,598/- had been made out of internal accruals and non-interest bearing funds being "Capital" and "Unsecured Loans" to the tune of Rs. 5.73 crores in the books of M/s Shakti International [a proprietary concern of the appellant] and Sh. Dharampal Aggarwal [the appellant]. The amount of Rs. 5.73 crores included an amount of the appellant's capital of Rs. 3.71 crores, which, was also much more than the amount of interest-free advances of Rs. 2,79,01,598/-. The Balance Sheets of Sh. Dharam Pal Aggarwal and M/s Shakti International as on 31.03.2012 are enclosed. Thus, no above interest-bearing borrowed funds were used for making the said advances of Rs. 2,79,01,598/.

#### 6.3 Reliance was placed on the following case laws:

- CIT(A), Bathinda Vs. Gurdas Garg [2015] 63 Taxmann.com 289 (P&H)
- CIT-2 Visakhapatnam Vs. Seven Hills Hospitals (P.) Ltd. [2015] 370 ITR 69 (A.P.)

- *Hero Cycles (P.) Ltd. Vs. CIT, Ludhiana [2015] 379 ITR 347 (S.C.)*
- *CIT Vs. Kapsons Associates (2016) 381 ITR 0204 (P&H)*

7. The Ld. CIT(A) after considering the submissions of the assessee sustained the disallowance made by the Assessing Officer by observing in para 5.2 & 5.3 of the impugned order as under:

*5.2 I have considered the observations of the Assessing Officer as made by him in the assessment order while making the impugned addition. I have also considered written submissions filed by the assessee through his learned AR vide letter dated 23.01.2017 on the issue under reference. I have further considered various judicial pronouncements relied upon by the learned AR of the assessee as well as other material placed by him on record. On careful consideration of the rival contentions, it has been noticed that the assessee has himself admitted that he has used overdraft facility to make interest free advances to related/unrelated parties. It has also been noticed that the assessee does not have sufficient interest free funds of his own to make interest free advances under reference. The nexus between the borrowed funds and that of the interest free advances given by the assessee is clearly established in the case of the assessee as he does not have any interest free funds of his own to make interest free advances. The judicial pronouncements relied upon by the assessee does not help him as sufficiency of interest free funds available with the assessee has not been proved. Under such circumstances, the action of the Assessing Officer in making an addition of Rs. 13,77,730/- in this case on account of disallowance out of interest expenses by invoking provisions of section 36(l)(iii) of the Act as the assessee has given interest free advance to related/unrelated parties allegedly out of borrowed funds which according to the Assessing Officer is for non business purposes cannot be said to be unjustified.*

*5.3 In view of the above stated facts and in the circumstances of the case, I am of the opinion that the Assessing Officer is fully justified in making an addition of Rs. 13,77,730/- in this case on account of disallowance out of interest expenses by invoking provisions of section 36(l)(iii) of the Act as the assessee has given interest free advance to related/unrelated parties allegedly out of borrowed funds which according to the Assessing Officer is for non business purposes. The addition of Rs. 13,77,730/- made by the Assessing Officer in this case on account of disallowance out of interest expenses by invoking provisions of section 36(l)(iii) of the Act is, therefore, upheld. In the result, the ground No. 1 of appeal taken by the assessee is dismissed.*

8. Now the assessee is in appeal.

9. The Ld. Counsel for the assessee reiterated the submissions made before the authorities below and further submitted that the assessee was having a capital of Rs. 3.48 Crores while the advances given as pointed out by the Assessing Officer were of Rs. 2.79 Crores therefore the capital of the assessee on which no interest was to be paid was more than the advances given to family and relatives, reference was made to page no. 16 of the assessee's compilation. It was further submitted that no such disallowance was made in the preceding years under similar circumstances therefore the disallowance made by the Assessing Officer and sustained by the Ld. CIT(A) was not justified. It was also submitted that the Assessing Officer himself allowed the interest on borrowed funds out of which advances were given to the relatives because the assessee had shown interest received from those loans and advances. It was accordingly submitted that wherever there was nexus between the borrowed funds and loans and advances given, the assessee had charged interest. As regards to the other interest free advances, the Ld. Counsel for the assessee submitted that since interest free funds in the form of capital of the assessee were more than the interest free

advances given, therefore, no disallowance was called for under section 36(1)(iii) of the Act.

10. In his rival submissions the Ld. Sr. DR strongly supported the orders of the authorities below and reiterated the observations made in their respective orders. It was further submitted that there was a direct nexus between the interest bearing borrowed funds and the interest free advances given by the assessee which had been admitted. It was contended that during the course of assessment proceedings before the Assessing Officer, the assessee stated that the advances were made by availing the OD limit, therefore, the source of interest free advances i.e. O.D. limit, was clearly established. Thus, the claim of the assessee that the funds had been given out, from the non interest bearing funds being "capital" and "unsecured loans" does not carry any force. It was further contended that no documentary evidence in the form of bank statement showing transfer of money for unsecured advances was furnished by the assessee, on the other hand there was enough material available with the Assessing Officer to establish that the interest free advances were made out of the interest bearing funds, therefore the disallowance made by the Assessing Officer and sustained by the Ld. CIT(A) was fully justified.

11. I have considered the submissions of both the parties and carefully gone through the material available on the record. In the present case it is noticed that the Assessing Officer himself admitted that on the loans and advances given by the assessee out of the borrowed funds by using the OD facility the interest was earned, he therefore allowed the interest expenditure to the extent of Rs. 7,17,875/-.

As regards to the other interest free advances, the bank statement of the assessee placed at page no. 16 of the assessee's compilation reveals that the capital of the assessee as on 31.3.2012 was at Rs. 3,48,04,747/- and the Assessing Officer pointed out in the assessment order that the assessee had given interest free advances to the family and relatives for a sum of Rs. 2,79,00,000/- which shows that the interest free funds in the form of capital were more than the interest free loans given to the family and relatives. In the present case, no nexus had been established by the Assessing Officer in between the interest free advances and the interest bearing borrowed funds, therefore, the disallowance of Rs. 13,77,730/- made by the Assessing officer out of the interest paid by the assessee and sustained by the Ld.CIT(A) was not justified. Accordingly the same is deleted.

12. Vide ground no. 2 the grievance of the assessee relates to the confirmation of disallowance of Rs. 2,26,635/- made by the Assessing Officer out of car expenses.

13. The facts related to this issue in brief are that the Assessing Officer during the course of assessment proceedings noticed that the expenses incurred by the assessee on telephone, travel and car were all mixed in nature wherein personal use cannot be

ruled out and that the assessee had not maintained any separate record for the details of personal expenses debited in the P&L Account. The Assessing Officer was of the view that 1/5<sup>th</sup> of the expenses were personal in nature. He worked out the disallowance at Rs. 4,18,865/- and since the assessee himself had disallowed a sum of Rs. 1,92,230/-, the Assessing Officer made the addition of Rs. 2,26,635/- (4,18,865.00 – 1,92,230.00).

14. Being aggrieved the assessee carried the matter to the Ld. CIT(A) and submitted as under:

*In this connection, it is submitted that, the appellant, being, an indenting agent has to talk to various overseas constituents regarding supply of material, availability of new products and payment matters etc.*

*Due to timing differences between India and other countries, the telephone calls were being made during odd times, and, that, too had to be made from residence only. As such, the substantial use of the telephone was for the business purposes of the appellant only, and, not for personal purposes. Moreover, the overseas constituents also visit India in order to negotiate about the terms and conditions for a product. In turn, the appellant has to ensure their proper visit to India. Thus, the expenses related to use of car and travelling expenses were incurred.*

**The Ld Assessing Officer had also failed to point out the exact amount of car, travelling and telephone expenses which were of non-business nature.**

*Taking note of the expenses claimed by the appellant during the year under consideration, the said expenses were claimed after effecting realistic disallowances, no further disallowances of the said expenses could be warranted. Further, the disallowances made by the Assessing Officer were based on mere suspicion and surmises, and, had not been supported by any material brought on record. Accordingly, the disallowances made by the Assessing Officer were purely on guesswork, and, are not sustainable in law. Thus, merely on estimate or on adhoc basis, a disallowance made was not justified, and, deserves to be deleted.*

14.1. The Ld. CIT(A) however did not find merit in the submissions of the assessee and sustained the addition by observing in para 6.2 and 6.3 as under:

*6.2 I have considered the observations of the Assessing Officer as made by her in the assessment order while making the impugned addition. I have also considered written submissions filed by the assessee through his learned AR vide letter dated 23.01.2017 on the issue under reference. On careful consideration of the rival contentions, I am of the opinion that the personal use of car and telephone cannot be ruled out in the case of the assessee in the absence of any day to day details with regard to use of telephone and car. Similarly, personal expenses of the assessee in traveling expenses cannot be ruled out. Moreover, the disallowance made by the Assessing Officer is very reasonable and cannot be said to be excessive under any circumstances. Under such circumstances, the action of the Assessing Officer in making an addition of Rs.2,26,635/- in this case on account of disallowance out of expense claimed by the assessee under the heads 'telephone expenses', 'car expenses', 'car insurance expenses', 'car depreciation' and travelling expenses' cannot be said to be unjustified.*

*6.3 In view of the above stated facts and in the circumstances of the case, I am of the opinion that the Assessing Officer is fully justified in making an addition of Rs.2,26,635/- in this case on account of disallowance out of expense claimed by the assessee under the heads 'telephone expenses', 'car expenses', 'car insurance expenses', 'car depreciation' and travelling expenses'. The addition of Rs.2,26,635/- made by the Assessing Officer in this case out of car, telephone and travelling expenses is, therefore, upheld. In the result, the ground No. 2 of appeal taken by the assessee is dismissed.*

15. Now the assessee is in appeal.

16. The Ld. Counsel for the assessee reiterated the submissions made before the authorities below and further submitted that all the expenses were used for the business purposes and no specific instance has been pointed out by the Assessing Officer wherein the expenses were not used for business purposes. Therefore, the disallowance made by the Assessing Officer and sustained by the Ld. CIT(A) was not justified. Alternatively it was submitted that the disallowance made by the Assessing Officer and sustained by the Ld. CIT(A) was highly excessive.

17. In his rival submissions the Ld. Sr. DR strongly supported the orders of the authorities below.

18. I have considered the submissions of both the parties and perused the material available on the record. In the present case, it is noticed that the Assessing Officer worked out the disallowance at Rs. 4,18,665/- as per following details:

<b>Sr. No.</b>	<b>Particulars</b>	<b>Amount</b>	<b>1/5<sup>th</sup> addition</b>
1	Telephone expenses	195465	39093
2	Travelling expenses	178288	35658
3	Car Depreciation	1399350	279870
4	Car Insurance	181208	36242
5	Car expenses	139008	27802
<b>Grand Total</b>		<b>2093319</b>	<b>418665</b>

18.1 From the above details it is noticed that the major disallowance was worked out on account of depreciation amounting to Rs. 2,79,870/- which is a statutory deduction. If such figure is reduced from the figure worked out by the Assessing Officer the remaining amount comes at Rs. 1,38,995/- while the assessee has already disallowed suo motu a sum of Rs. 1,92,230/-. Therefore the disallowance made by the Assessing Officer and sustained by the Ld. CIT(A) at Rs. 2,26,635/- (Rs. 4,18,665 – Rs. 1,92,230/-) appears to be excessive. I therefore, to meet the ends of justice restrict the addition made by the Assessing Officer and sustained by the Ld. CIT(A) at Rs. 50,000/- instead of Rs. 2,26,635/-.

21. In the result appeal of the Assessee is partly allowed.

(Order pronounced in the open Court on 22/04/2019)

**Sd/-**  
**(N.K. SAINI)**  
**VICE PRESIDENT**

Place: Chandigarh

Dated : 22/04/2019

AG/rkk

Copy to: The Appellant, The Respondent, The CIT, The CIT(A), The DR