

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

BEFORE SHRI WASEEM AHMED, ACCOUNTANT MEMBER
And

SHRI Ms. MADHUMITA ROY, JUDICIAL MEMBER

आयकर अपील सं./ITA No. 453/AHD/2015

अथावण वष/Asstt. Year: 2011-2012

M/s Patel D.J. Tobacco Products Pvt. Ltd., 203, Shilp-3, Sindhu Bhawan Road, Bodakdev, Ahmedabad-380054. PAN: AADCP8564G	Vs	The Assistant Commissioner of Income Tax, Circle-5, Ahmedabad
--	----	---

(Applicant)	(Respondent)
Assessee by :	Shri U.S Bhati & Abhimanyu Bhati, A.Rs
Revenue by :	Shri Santosh Karnani, Sr. D.R

सुनवाई का ताराख/Date of Hearing : 20/02/2019

घोषणा का ताराख /Date of Pronouncement: 26/04/2019

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)-9 dated 29/12/2014 (in short "Ld.CIT(A)" 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") dt.22/01/2014 relevant to the Assessment Year 2011-12.

2. The interconnected issue raised by the assessee is that the Ld. CIT (A) erred in confirming the order of the AO by sustaining the disallowance of interest for Rs. 10,57,492/- on account of diversion of funds.

3. The facts of the case are that the assessee is a Private Limited Company and engaged in the business of manufacturing of Bidis. The assessee in its books of account has shown an investment of Rs. 88,12,436/- in a partnership firm namely M/s. Avpram LLC, located in the USA as a capital contribution.

3.1 The assessee claimed that it had not received any interest from the firm M/s. Avpram LLC, the USA during the current year as the firm has incurred the loss.

3.2 The assessee further submits that it has sufficient balance in reserve and surplus on which interest has not been paid. Therefore the question of disallowance of interest expense u/s 36(1)(iii) does not arise.

4. However, the AO observed that the assessee had not reported any income during the financial year from the said firm in its financial statements/computation of income. As such the said firm is non-resident and share of profit from the said firm is not exempt u/s 10(2A) of the Act if it is not assessed in India.

4.1 The AO further found that the assessee has paid interest @ 12% on the borrowing of Rs. 6.04 crores during the year.

4.2 In view of the above, the AO presumed that the funds of the company had been diverted to non-business activities. The AO accordingly disallowed

the interest expenses of Rs. 10,57,492.00 being 12% on the amount of Rs. 88,12,436/- and added to the total income of the assessee company.

5. The aggrieved assessee preferred an appeal before the Ld. CIT (A). The assessee before the Ld. CIT (A) reiterated the same submissions as made before the AO.

6. However the Ld. CIT (A) disregarded the contention of the assessee by observing that the assessee failed to establish the business/commercial expediency as well as to prove that the funds are invested out of interest-free funds.

6.1 The Ld. CIT (A) accordingly confirmed the addition made by the AO of Rs. 10,57,492/- u/s 36(1)(iii) of the Act.

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

8. The Ld. AR before us filed a paper book running from pages 1 to 89 and submitted that the own fund of the assessee exceeds the amount of investment made as capital contribution in the firm. Therefore there cannot be any disallowance of interest expenses as it is presumed that the investment was made out of the own fund of the assessee. The learned AR in support of his claim drew our attention on the balance sheet which is placed on pages 18 to 42 of the paper book.

8.1 The Id. AR also submitted that there was no disallowance made by the AO in the earlier and succeeding assessment years, i.e. AY 2010-11, 2013-14,

and 2014-15 though the scrutiny assessments were carried out under section 143(3) of the Act. The copies of the assessment order are placed on pages 82 to 89 of the paper book.

8.2 The learned AR also drew our attention on the income tax return filed by the firm in the US which is placed on pages 43 to 62 of the paper book to demonstrate that the amount given by the assessee to the firm was as a capital contribution.

8.3 The learned AR further submitted that the assessee had made a capital contribution to the firm as a matter of commercial expediency to achieve the business objects of the company. In this regard, the learned AR drew our attention to the objects of the company which are placed on pages 4 to 17 of the paper book.

9. On the other hand, the Ld. DR submitted that the assessments were carried out under section 143(3) of the Act under CASS module which is limited scrutiny. As such the fact of capital contribution in the partnership firm was not verified by the AO. Therefore the principle of consistency cannot be applied in the given facts and circumstances.

9.1 The learned DR further submitted that the main objects of the assessee company are different with the main object of the partnership firm as discussed above. Therefore the concept of the principle of commercial expediency cannot be applied in the instant case. The Ld. DR vehemently supported the order of authorities below.

9.2 The learned AR in his rejoinder submitted that the assessment for the assessment A.Y. 2010-11 was not carried out under CASS module. Therefore the principle of consistency needs to be applied.

10. We have heard the rival contentions and perused the materials available on record. In the instant case, the assessee has made a capital contribution amounting to Rs. 88,12,436/- to a partnership firm based in the USA. The assessee in its income tax return has not disclosed any income from such a partnership firm. Therefore the AO was of the view that the interest expenses incurred by the assessee corresponding to such investment in the partnership firm need to be disallowed. Accordingly, such interest expenses were disallowed by the AO which was subsequently upheld by the learned CIT (A).

10.1 It is an undisputed fact that owned fund of the assessee exceeds the amount of capital contribution given to the partnership firm. Indeed the assessee is not charging the interest from the firm whereas the assessee was paying interest on the money borrowed by it. But the own fund of the assessee exceeds the amount of the capital contribution made by it, therefore in our considered view there cannot be any disallowance of the interest expenses on account of the interest not charged on such capital contribution. 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”.

10.2 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.”

10.3 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”.

10.4 In view of the above proposition, we hold that no disallowance of interest expense claimed by the assessee can be made on account of fund involved in the capital contribution as discussed above.

10.5 We further note that whatever income will arise to the assessee through this partnership firm will be subject to tax in India. The AO has also acknowledged this fact in his assessment order which has been discussed in the preceding paragraph. Therefore it cannot be said that the assessee has diverted its interest-bearing fund to non-commercial purposes. It is a fact on record that there was no income received by the assessee from such firm in the year under consideration. But in our considered view non-receipt of income cannot be the basis of the disallowance of the interest expenses.

10.6 It is a fact on record that the assessee has been filing its income tax return consistently year after year without declaring any interest income from

the firm. This fact was duly admitted by the Revenue in the assessment framed under section 143(3) of the Act. As such there was no addition made by the AO in the assessment on account of the diversion of income. Thus the question arises whether the principle of consistency can be applied in the given facts and circumstances. There was no change in the facts & circumstances; therefore we apply the principles of consistency. Thus in our considered view, there cannot be any disallowance on account of interest expenses due to the diversion of the fund. Hence, we direct the AO to delete the addition made by him. Thus the ground of appeal of the Assessee is allowed.

11. In the result, the appeal of the Assessee is allowed.

Order pronounced in the Court on 26/04/2019 at Ahmedabad.

-Sd-

**(Ms. MADHUMITA ROY)
JUDICIAL MEMBER**

(True Copy)

Ahmedabad; Dated 26/04/2019

Manish

-Sd-

**(WASEEM AHMED)
ACCOUNTANT MEMBER**