

**IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH "A", HYDERABAD**

**BEFORE SHRI V. DURGA RAO, JUDICIAL MEMBER
AND SHRI D.S. SUNDER SINGH, ACCOUNTANT MEMBER**

ITA Nos.	A.Y	Appellant	Respondent
1372/Hyd/2017	2013-14	M/s. Pioneer Genco Limited, Hyderabad. PAN – AACCPQ218Q	ITO, Ward – 16(3) Hyderabad.
1373/Hyd/2017	2013-14	M/s. Pioneer Power Corporation, Hyderabad. PAN – AADCP2141F	

Assessee by : Shri A.V.Raghu Ram
Revenue by : Shri K.Gopala Krishna

Date of hearing : 12-03-2019
Date of pronouncement : 05-04-2019

ORDER

PER D.S. SUNDER SINGH, A.M:

This appeal is filed by the assessee against the order of the Commissioner of Income Tax (Appeals) – 4 (CIT(A)-4), Hyderabad dated 26.05.2017.

1372/Hyd/2017:

Grounds of appeal:

- 1. The orders of the learned CIT(A) not only is erroneous both on facts and in law in so or as it is prejudicial to the assessee but is perverse.*
- 2. The learned CIT(A) erred in confirming the disallowance of Rs.5,52,33,794 made u/s. HA though has referred to a decision of tribunal in the case of Prathista Industries that is in favour of the assessee and though there is nothing to controvert the submissions that the investments are from own funds.*
- 3. The learned CIT(A) erred in confirming the addition of Rs.71,01,080 made*

u/s 27(1) without appreciating the fact that this issue is squarely covered by the decision of the Supreme Court in the case of Hero Cycles 379 ITR 347 where in it is observed that it is not for the department to dictate as to how the finance should be managed only on the ground that the amount advanced exceeded the reserves and profits.

4. *Any other ground that may be urged at the time of hearing.*

2. Ground No.1 & 4 are general in nature which does not require any specific adjudication.

3. The common issue in both the appeals in ground No.2 is related to the disallowance of expenditure pertaining to income exempt u/s 14A of the IT Act. For the A.Y 2013-14, the A.O found that the assessee has made the investments of Rs.30.42 crores in equity shares which yields dividend income exempt u/s 14A of the Act. Therefore, the A.O disallowed a sum of Rs.5,42,33,794/- u/s 14A r.w.r.8D of IT Rules.

4. Aggrieved by the order of the A.O the assessee went on appeal before the CIT(A) and the Ld. CIT(A) confirmed the addition made by the AO. Against the order of the Ld.CIT(A) the assessee is in appeal before this Tribunal.

5. During the appeal hearing the Ld. AR made three fold arguments. Firstly the Ld. AR argued that for invoking the provision u/s 14A of the Act, the A.O has to record the satisfaction

which is absent in the present case. Secondly the Ld. AR submitted that the assessee is having sufficient interest free funds available in the business, which are used for making the investments, hence, argued that there is no case for disallowance of expenditure relatable to the earning of dividend income. Supporting the argument, the Ld.A.R referring to the page No. 48 of the paper book explained that for the year ending 31.03.2012 the assessee company had received the share capital of Rs.123.87 crores and during the year under consideration the assessee had generated cash of Rs.11.10 crores from operations and argued that the assessee had sufficient interest free funds for making the investments. The Ld.AR further argued that there is no direct expenditure for earning the dividend income, hence stated that there is no case for disallowing the expenditure for making the investment. Thirdly the Ld. AR argued that during the relevant assessment year the assessee had earned the dividend income of Rs. 5,12,310/- and the disallowance should be restricted to the exempt income earned during the impugned assessment year. The assessee also relied on the decision of Coordinate Bench of the ITAT, Visakhapatnam in ITA No. 330/Viz/2018 in the case of M/s RRR Investments Services (P) Ltd dated 28.11.2018.

6. On the other hand the Ld. DR supported the orders of the lower authorities and submitted that in the instant case the assessee had earned the dividend income and also made the investments in the equity shares which yields exempt income. Hence, argued that the expenditure relatable to earning the exempt income required to be disallowed invoking the provisions of Sec. 14A r.w.r. 8D of the Rules, since the assessee has earned the dividend income during the impugned assessment year. The Ld.DR argued that the A.O has rightly made the addition as per Rule 8D of Income Tax Rules. Hence, requested to uphold the order of the Ld. CIT(A) and dismiss the appeal of the assessee.

7. We have heard both the parties perused the material placed on record. The first limb of the argument of the Ld. AR is that the A.O has not recorded the satisfaction for invoking the provisions of Sec. 14A r.w.r 8D of IT Rules and consequent disallowance of expenditure, hence there is no case for the disallowance. We have gone through the grounds raised by the assessee before the Ld.CIT(A) as well as before the Tribunal and the assessee has not raised this ground before us. During the appeal hearing the assessee did not furnish any evidence to support his argument that the AO has not recorded the satisfaction. Therefore this argument of the assessee is untenable, accordingly rejected.

7.1. The second limb of argument of the Ld. AR is that assessee is having interest free funds which were used for the purpose of investments hence no disallowance of interest is called for. This argument of Ld.AR is not acceptable, since Sec. 14A permits the A.O to disallow the expenditure relating to the earning of exempt income and Rule 8D prescribes the manner and method for the disallowance to be made. Rule 8D has been introduced with an intention to address ambiguous issues for disallowance of interest in the event of availability of interest free funds and interest-bearing funds. If the funds are used from the common pool and the assessee paid the interest on borrowed funds, disallowance relating to investments made in equity capital attracts Section 14A of the Act. There is lot of difference in disallowance of interest u/s 36(1)(iii) and the disallowance of expenditure relating to exempt income. In case of the disallowance relating to Section 14A it is the assessee who has to establish that the non-interest bearing funds were used for investments. In the instant case the Ld.AR referring to Page No.48 submitted that the assessee had received the sum of Rs.123.87 crores for the year ending 31/03/2012 and stated to have been utilized for investments. Similarly argued that in addition to the share capital there is also balance available from the cash generated out of operations for investment. Hence

supported his argument stating that interest free funds were utilized for investments hence no disallowance is called for u/s 36(1)(iii)/14A. We have gone through the paper book and balance sheet available in paper at page No.46 and 47 and observe that the share capital received was completely utilized during the F.Y. ending 31/12/2012 leaving cash balance of Rs.13.57 crores. During the impugned A.Y. there was an increase of investments to the extent of Rs.30.42 crores and the assessee failed to establish that the interest free funds were used for investments. For a query from the bench Ld.A.R could not specifically clarify whether the investments were made out of cash credit account or the current account. In the instant case the assessee made investments which yield exempt income and the disallowance is permitted by section 14A of the I.T.Act. The assessee earned the dividend income and did not make any disallowance of expenditure. In the circumstances it is for the assessee to demonstrate that the non-interest bearing funds were used for investments and the Ld.AR failed to establish the same. In the circumstances the AO has rightly invoked the provisions of section 14A of the act and this view is supported by the decision of Hon'ble Karnataka High court in the case of Bharath Beedi Works (P.) Ltd. v. Additional Commissioner of Income-tax, Range-2, Mangalore, 2016] 74

taxmann.com 95 (Karnataka). Therefore we are unable accept the argument of the Ld.AR on utilization of interest free funds and the same is rejected.

7.2. The third limb of argument of Ld. AR is that the disallowance should not exceed the exempt income earned by the assessee. In the instant case, the A.O had disallowed the sum of Rs. 5,52,33,794/- u/s 14A r.w.r 8D of the IT Rules, against which assessee had earned the dividend income to the extent of Rs. 5,12,310/-. The Ld.AR relied on the decision of Coordinate Bench of ITAT, Visakhapatnam in ITA No. 330/Viz/2018 for the A.Y 2014-15 in the case of RKR Investments Services Pvt Ltd. VS ITO. Where in it was held that the disallowance of expenditure should not exceed the exempt income earned by the assessee in the relevant assessment year. For the sake of clarity and convenience we extract the relevant part of the order of the coordinate bench RKR Investments Services Pvt Ltd supra which reads as under:

“6. We have heard both the parties and perused the material placed on record. In this case, the assessee made the investments in the Listed Securities, but the exempt income earned was only Rs.500/-. The AO made the disallowance of Rs.87,51,655/- as per Rule 8D of income tax Rules. The Ld.AR relied on the decision of Hon’ble High Court of Delhi in the case of Joint Investments Pvt. Ltd. Vs. Commissioner of Income Tax (supra), wherein it was held that the disallowance should not exceed the income earned by the

assessee. For the sake of clarity and convenience, we extract relevant part of the order of Hon'ble High Court of Delhi which reads as under :

“9. In the present case, the AO has not firstly disclosed why the appellant/assessee's claim for attributing Rs.2,97,440/- as a disallowance under Section 14A had to be rejected. Taikisha says that the jurisdiction to proceed further and determine amounts is derived after examination of the accounts and rejection if any of the assessee's claim or explanation. The second aspect is there appears to have been no scrutiny of the accounts by the AO - an aspect which is completely unnoticed by the CIT (A) and the ITAT. The third, and in the opinion of this court, important anomaly which we cannot be unmindful is that whereas the entire tax exempt income is Rs.48,90,000/-, the disallowance ultimately directed works out to nearly 110% of that sum, i.e., Rs.52,56,197/-. By no stretch of imagination can Section 14A or Rule 8D be interpreted so as to mean that the entire tax exempt income is to be disallowed, The window for disallowance is indicated in Section 14A, and is only to the extent of disallowing expenditure 'incurred by the assessee in relation to the tax exempt income'. This proportion or portion of the tax exempt income surely cannot swallow the entire amount as has happened in this case.”

7. The Ld.AR also relied on the decision of K. Ratanchand & Co. of coordinate Bench Ahmedabad, wherein the coordinate Bench has examined various decisions of Hon'ble High Courts and the Coordinate Benches and restricted the disallowance to exempt income earned by the assessee u/s 14A. We extract the relevant part of the order of the coordinate bench in the case of K.Ratanchand &Co supra which reads as under:

7. Further in the case of Jivraj Tea Ltd. (supra) and others, the co-ordinate Bench held that disallowance under section 14A cannot be more than the exempt income. The relevant portion of the decision is reproduced below—

“2. have heard the rival submissions and perused the orders of the lower authorities and materials available on record. In the instant case, the assessee received exempt dividend income of Rs.900/-. The Assessing Officer was of the opinion that expenditure incurred for earning the exempt dividend income was not allowable to the assessee and the assessee has not disallowed any expenditure towards the earning of the exempted dividend income, he by invoking the provisions of Section 14A computed expenditure attributable to the earning of exempt dividend income under Rule 8D of the Income-tax Rules and made disallowance for interest expenditure of Rs.1,49,710/- and administrative expenses of Rs.12,750/-. The assessee unsuccessfully appealed before

the CIT (A). The contention of the assessee is that the interest free funds available with the assessee in the form of share capital and free reserves as on the date of balance- sheet was Rs.17,86,69,501/- and the investments at the end of the year was at Rs.1,26,00,538/- only. Therefore, in view of the decision of the Hon'ble Gujarat High Court in the case of Hitachi Home and Life Solutions (I) Ltd. (supra) and Torrent Power Ltd. (Supra), no disallowance towards interest expenditure incurred for earning exempt income can be made. Regarding the disallowance of administrative expenses of Rs.12,750/-, we find that the Chandigarh Bench of the Tribunal in the case of A.C.I.T. v. Punjab State Coop & Marketing Fed. Ltd. in ITA No. ITA No.548/Chd/2011 for AY 2007- 08 has held that disallowance u/s. 14A read with Rule 8D cannot exceed the exempt dividend income. Therefore, we restrict the disallowance of administrative expenses to Rs.900/- only, being the exempt dividend income earned by the assessee. Thus, this ground of appeal of the assessee is partly allowed."

8. The facts of the case of assessee are well covered by the above referred judicial pronouncements of the Co-ordinate Benches. So much so that it is undoubted that assessee is a dealer in shares, trading of shares has been shown as income from business, stock in trade in shares is at Rs.41,16,992 investment in shares not held for business are only Rs.51,000, and dividend income earned during the year is Rs.58,963. However, assessee has maintained same books of accounts for his business of trading in cloth, trading in shares, commission income, income from real estate and exempt income. There is no bifurcation available on record to segregate the entire expenses incurred on the type of business activities carried on and some element of cost for earning exempt income cannot be ignored in these circumstances. The assessee has demonstrated that it has carried out the business activity of sale and purchase of shares. The Revenue on the other hand could not place any contrary material on record. Therefore, in the light of decision of the co-ordinate Benches we are of the considered view that the AO was not justified in invoking the provisions of section 14A of the Act. The dividend so earned is incidental to normal business activities of the assessee. Moreover, the AO has made disallowance of Rs.4,04,204/- whereas the assessee has earned exempt income in the form of dividend of Rs.58,963/-. Even assuming that some expenditure is required to be disallowed but such disallowance should not exceed the quantum of exempt income. Therefore, in view of the decision of the Co-ordinate Benches we hereby hold that the addition under section 14A cannot be more than the exempt income and should therefore be restricted to Rs.58,963/-. This ground of the assessee is partly allowed."

During the appeal hearing, the Ld.DR did not bring any other case law of Higher Court/ jurisdictional High court to controvert the decisions relied upon

by the assessee. Therefore, respectfully following the decision of the Hon'ble High Court and the Coordinate Bench, we hold that disallowance u/s 14A required to be restricted to the extent of dividend income earned by the assessee, under section 14A read with Rule 8D of I.T.Rules. Accordingly, we set aside the orders of the lower authorities and allow the appeal of the assessee."

7.3. Similar view was expressed by the coordinate Bench of ITAT, Hyderabad in the case of M/s Jasper industries in ITA No.283/Hyd/2017 dated 15/06/2018.

7.4. Respectfully following the view taken by the Coordinate Bench in the case of M/s RKR Investments Services Pvt Ltd., and M/s Jasper Industries (cited supra) we hold that the disallowance u/s 14A should be restricted to the extent of dividend income earned by the assessee. Accordingly we set aside the order of the Ld. CIT(A) and allow the appeal of the assessee partly.

8. The second ground in this appeal is related to the disallowance u/s 37(1) of the Act for an amount of Rs. 71,01,080/- representing interest for diversion of interest bearing funds to associate/subsidiary companies. During the assessment proceedings the A.O found that there was increase in loans and advances given to related parties to the extent of Rs.591.75 lakhs and the assessee is paying the interest on borrowings. The assessee submitted before the AO that the advances were given to

subsidiaries/associate companies for purchase of equity shares due to commercial expediency and the funds were used for business purpose. The assessee argued before the AO that no disallowance is called for diversion of funds u/s 36(1)(iii) of the Act. Not being impressed with the explanation of the assessee the A.O held that the advances given to associate/subsidiary companies as diversion of interest bearing funds for non business purposes and accordingly disallowed the interest of Rs.71,01,080/- proportionately u/s 37(1) of the Act.

9. Aggrieved by the order of the A.O the assessee went on appeal before the CIT(A) and the Ld.CIT(A) confirmed the addition made by the A.O. Against the order of the Ld.CIT(A), the assessee is in appeal before this Tribunal.

10. During the appeal hearing the Ld. AR submitted that the assessee has given the advances to the extent of Rs. 984.30 lakhs to its 100% subsidiaries/ associates for business purpose and from own funds. The Ld. AR drawing our attention to page No. 58 of the paper book submitted that the assessee has made the investment in the assessee's associate, carrying on the same business. The assessee further submitted that the assessee is in the activity of power generation and it is the obligation of the

assessee to give uninterrupted power supply to the grid as per the agreements. In case of shortage it is incumbent up on the assessee to draw the power from the associated concerns and honour the commitment. Therefore argued that the assessee require mutual help from the associates to honour the commitments and carry on the business uninterruptedly. The assessee further argued that it is the assessee who has established the associated and it is also the responsibility of the assessee to take care of them without facing financial problems. The assessee did not charge any interest on the advance given to associate concerns and in the turn the associates also did not claim any interest thus there is no loss of revenue. Since the funds are advanced for business purpose the and the same were utilized for the intent purpose, the Ld.AR contended that there is no case for disallowing the interest and accordingly requested to set aside the order of the Ld.CIT(A) and delete the addition.

10.1. The second limb of argument made by the Ld.AR is that the outstanding short term loans and advances as at the end of the year was Rs.984.30 lacs as against the outstanding of Rs.386.31 lacs in the immediately preceding year. Thus short term loans given by the assessee to it's associates in the year under consideration was Rs. 591.75 lakhs and the assessee is having

sufficient interest free funds from the internal accruals and hence no disallowance is called for. Referring to the page No. 48 of the paper book the Ld. AR submitted that the cash generated from the operations during the year under consideration was 11.10 crores and the opening cash balance was 13.57 cores as per the cash flow statement and the share capital and Reserves and Surplus are available to the extent of Rs.308.56 crores, hence submitted that no interest bearing funds are utilized by the assessee for giving short term loans to it's associated hence, no case of disallowance u/s 37(1) of the Act. Accordingly, requested to set aside the order of the CIT(A) and delete the addition.

10.2. On the other hand the Ld. DR argued that the assessee has debited the sum of Rs. 7.72 crores interest on borrowing and argued that had the assessee did not give interest free loans, the assessee would not have incurred the said interest expenditure. Hence argued that the Ld.AO has rightly disallowed the interest and no interference is called for in the Ld.CIT(A) order.

10.3. We have heard both the parties perused the material available on record. From the assessment order it is observed that the assessee made the advances to the associate concerns for purchase of equity shares. The A.O disallowed the interest relating

to the advances given to the associates concerns with an observation that the advances made during the year crossed the amount of reserves and surpluses and the profits added during the year. The Ld.AR has drawn our attention to page No. 48 of the paper book, wherein it is established that the cash generated during the year from the operations was 11.10 crores and the opening cash balance was 13.57 crores which is more than the amounts advanced by the assessee to its sister concerns. Apart from the above the assessee is having accumulated reserves of Rs.269.33 crores which is non interest bearing and the assessee is free to invest the interest free funds available as per the business requirement. In the instant case though profits added during the year are lesser than the amounts advanced by the assessee to its associate firms, the fact remains that the share capital and the accumulated reserves and surpluses stood at 308.56 crores which does not bear any interest. The revenue has not controverted this fact. For making the disallowance of interest for diversion of funds it is the burden of the department to prove the case that the assessee had diverted the interest bearing business funds for non business purposes. In this case the department could not establish that the assessee had diverted the funds. Apart from the above the assessee also submitted that the advances are given to the

associate concern in view of the business expediency and the same was not controverted by the revenue. The assessee referring to page No. 58 of the paper book submitted that the amounts were advances to the associate concerns carrying on the same business and all the associate concerns are interdependent for power generation and to supply or to draw the power from the power grid. Thus the business expediency also has been established by the assessee. The business expediency is the decision of the assessee but not the department. Department did not demonstrate that there was is no commercial expediency for giving the interest free loans to the associate concerns. The Ld. AR relied on the decision of Hon'ble Supreme Court in the case of Hero Cycles (P.) Ltd.v. Commissioner of Income-tax (Central), Ludhiana, [2015] 63 taxmann.com 308 (SC) where in Hon'ble Apex court held as under:

"13. In the process, the Court also agreed that the view taken by the Delhi High Court in CIT v. Dalmia Cement (P.) Ltd. [\[2002\] 254 ITR 377/ 121 Taxman 706](#) wherein the High Court had held that once it is established that there is nexus between the expenditure and the purpose of business (which need not necessarily be the business of the assessee itself), the Revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the Board of Directors and assume the role to decide how much is reasonable expenditure having regard to the circumstances of the case. It further held that no businessman can be compelled to maximize his profit and that the income tax authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. The authorities must not look at the matter from their own view point but that of a prudent businessman.

14. Applying the aforesaid ratio to the facts of this case as already noted above, it is manifest that the advance to M/s. Hero Fibres Limited became

imperative as a business expediency in view of the undertaking given to the financial institutions by the assessee to the effect that it would provide additional margin to M/s. Hero Fibres Limited to meet the working capital for meeting any cash loses.

15. It would also be significant to mention at this stage that, subsequently, the assessee company had off-loaded its share holding in the said M/s. Hero Fibres Limited to various companies of Oswal Group and at that time, the assessee company not only refunded back the entire loan given to M/s. Hero Fibres Limited by the assessee but this was refunded with interest. In the year in which the aforesaid interest was received, same was shown as income and offered for tax.

16. Insofar as the loans to Directors are concerned, it could not be disputed by the Revenue that the assessee had a credit balance in the Bank account when the said advance of Rs. 34 lakhs was given. Remarkably, as observed by the CIT (Appeal) in his order, the company had reserve/surplus to the tune of almost 15 crores and, therefore, the assessee company could in any case, utilise those funds for giving advance to its Directors.”

10.4. In the instant case the assessee has demonstrated the business expediency and the revenue did not controvert the submissions made by the assessee with tangible material. Similarly the assessee also has established that there are interest free available funds for making giving the advances. This fact was also not controverted by the department, therefore we hold that there is no case for disallowance of interest for giving advances to its associate concerns. Accordingly, we set aside the order of the CIT(A) and delete the addition made by the A.O. The appeal of the assessee is allowed on this ground.

1373/Hyd/2017:

11. In the instant case the A.O made the disallowance u/s 14A of the IT Act, r.w.Rule 8D of Income Tax Rules. amounting to Rs. 2,69,78,503/- against the dividend income of Rs. 2,11,775/-.

12. The facts and circumstances of the case are identical to M/s. Pioneer Genco Limited, in ITA No. 1372/Hyd/2017 decided in this order. Since the facts are identical, following the view taken by us in the case of M/s. Pioneer Genco Limited, Hyderabad, we direct the A.O to restrict the disallowance u/s 14A r.w.r 8D of the IT Rules to the extent of Rs.2,11,775/-, the dividend income earned by the assessee against the disallowance of Rs.2,69,78,503/-. Accordingly, the appeal of the assessee is partly allowed.

9. In the result both the appeals filed by the assessee are partly allowed.

Order pronounced in the open court on 05th April, 2019.

Sd/-
(V. DURGA RAO)
JUDICIAL MEMBER

Sd/-
(D.S. SUNDER SINGH)
ACCOUNTANT MEMBER

Hyderabad, Dated: 05/04/2019.

KRK

- 1 Shri K. Vasant Kumar, AV Raghu Ram, P. Vinod & M. Neelima Devi, ADVs, 610, Babukhan Estate, Basheerbagh, Hyderabad.
- 2 ITO, Ward – 16(3), Hyderabad.
- 3 The CIT(A)-4, Hyderabad.
- 4 The Pr. CIT-4, Hyderabad
- 5 The DR, ITAT Hyderabad
- 6 Guard File