

आयकर अपीलीय अधिकरण, जयपुर न्यायपीठ, जयपुर
IN THE INCOME TAX APPELLATE TRIBUNAL, JAIPUR BENCH 'B', JAIPUR

श्री रमेश सी. शर्मा, लेखा सदस्य एवं श्री विजय पाल रॉव, न्यायिक सदस्य के समक्ष
BEFORE: SHRI RAMESH C. SHARMA, AM & SHRI VIJAY PAL RAO, JM

आयकर अपील सं./ITA No. 711/JP/2018
निर्धारण वर्ष/Assessment Year : 2014-15.

Asstt. Commissioner of Income Tax, Circle-3, Jaipur.	बनाम Vs.	Shri Kapil Taneja, 58, Cosmo Colony, Vaishali Nagar, Jaipur.
स्थायी लेखा सं./जीआईआर सं./PAN No. ACRPT 2364 B		
अपीलार्थी / Appellant		प्रत्यर्थी / Respondent

निर्धारिती की ओर से / Assessee by : Shri Karni Dan Singh (Jt. CIT)
राजस्व की ओर से / Revenue by: Shri PC Parwal (CA)

सुनवाई की तारीख / Date of Hearing : 30.05.2019.
घोषणा की तारीख / Date of Pronouncement : 02/07/2019.

आदेश / ORDER

PER VIJAY PAL RAO, JM :

This appeal by the revenue is directed against the order dated 8th February, 2018 of Id. CIT (A), Kota for the assessment year 2014-15. The revenue has raised the following grounds :-

1. Whether on the facts and circumstances of the case and in law the Id. CIT (A) was justified in deleting disallowance of Rs. 42,46,087/- being relatable interest expenses under section 14A r.w.r. 8D without appreciating the fact that so called strategic investments made in closely held companies or firms are fruitified in the form of dividend, STCG/LTCG on sale of investment, Salary, remuneration etc. from any firm or company are received for the services rendered in personal capacity and not for mere investments ?
2. Whether on the facts and circumstances of the case and in law the Id. CIT (A) was justified in deleting disallowance of Rs. 65,28,895/- being interest incurred on investment in non-

business personal assets and loans and advances on which no interest has been charged without appreciating position of law that if the assessee sells assets the income from which is chargeable to capital gain tax, the assessee gets benefit of the all the moneys paid for acquiring such assets including ancillary expenses whatsoever, in computation of capital gain which is taxed at special rates also, say 20% in the case of long term capital gains and thus, strategic investment in acquiring assets as above cannot be said for the business purposes and relatable interest cannot be allowed treating the same as business expenses ?

Ground No. 1 is regarding disallowance of Rs. 42,46,087/- made by the AO under section 14A read with Rule 8D was restricted by the Id. CIT (A) to Rs. 2,76,768/-.

2. The assessee is an individual and derives income from salary, house property, trading in shares and commodity, capital gain and interest. The assessee filed his return of income on 28th November, 2014 declaring total income of Rs. 22,00,000/- after claiming the exempt income by way of capital gain and dividend from shares total amounting to Rs. 19,09,954/-. The AO noted that the assessee has claimed interest expenditure of Rs. 1,32,95,215/- and also having exempt income of Rs. 19,09,954/- against which attributable investment is Rs. 82,65,002/-. The AO invoked the provisions of section 14A read with Rule 8D(ii) & (iii) and made the disallowance of Rs. 42,46,082/-. Thus the AO has disallowed the interest expenditure in proportion to the total asset and investment in shares and securities as well as indirect administrative expenses being 0.5% of the average investment. The assessee challenged the action of the AO before the Id. CIT (A) and pointed out that the AO has committed mistake in calculating the disallowance as per Rule 8D(iii) being 0.5%. The said mistake was subsequently rectified by the AO while giving

effect to the order of the Id. CIT (A). Further it was pointed out that even after making the rectification in calculation, the disallowance would get reduced to Rs. 25,82,190/- which is still more than the exempt income earned by the assessee. The Id. CIT (A) allowed relief to the assessee by modifying the computation of disallowance under Rule 8D(ii) and 8D(iii) of the IT Rules. Thus the Id. CIT (A) has restricted the total disallowance under section 14A at Rs. 2,76,768/-.

3. Before us, the Id. D/R has submitted that the AO has computed the disallowance strictly as per Rule 8D of IT Rules. Therefore, excluding the investment made by the assessee, the disallowance restricted by the Id. CIT (A) is not as per the provisions of section 14A read with Rule 8D. The Id. D/R has further contended that the assessee has also given the interest free funds to the group concerns and further used the funds for purchase of fixed assets but no business was done during the year under consideration. Therefore, the AO has rightly disallowed the interest expenditure to the extent of Rs. 23,97,313/-. Similarly, the AO has computed the disallowance under Rule 8D(2)(iii) being 0.5% of the average investment which was reduced by the Id. CIT (A). He has relied on the order of the AO.

4. On the other hand, the Id. A/R has submitted that there is apparent mistake in calculating the disallowance under Rule 8D(2)(iii) while the AO has taken the amount at Rs. 18,48,774/- as against Rs. 1,84,877/-. Further, as regards the disallowance on account of interest expenditure, the AO has not considered the interest received by the assessee of Rs. 65,87,152/- and the disallowance should have been made only against the net interest payment instead of gross interest. Thus the AO has again committed a mistake by taking the gross interest expenditure instead of the net interest expenditure. The Id. A/R has further pointed out that the

attributable investment yielding the interest income is only Rs. 57,81,500/-. Therefore, the proportionate disallowance of interest needs to be computed with reference to only that investment from which the exempt income is earned. He has supported the order of the Id. CIT (A).

5. We have considered the rival submissions as well as the relevant material on record. As regards the computation of disallowance under Rule 8D(2)(iii), we find that there is a calculation mistake while arriving at the amount of disallowance by the AO of Rs. 18,48,774/- whereas the correct amount is Rs. 1,84,877/-. We further note that the Id. CIT (A) has further reduced this disallowance by taking the average investment which has yielded the exempt income. Thus to that extent we do not find any error in restricting the disallowance under Rule 8D(2)(iii) to Rs. 36,694/-. As regards the disallowance under Rule 8D(2)(ii), the Id. CIT (A) has computed the disallowance by taking the percentage of the investment yielding investment income to the total asset which comes to 3.58%. Accordingly, the Id. CIT (A) after taking the net interest payment and the ratio of 3.58% of the same has made the disallowance as attributable to the earning of exempt income. The relevant finding of the Id. CIT (A) on this issue is as under :-

"The A.O. has not worked out a nexus between the interest bearing & own funds or the investments which did not have any exempted incomes linked to them. The A.O has also not analysed the own funds available to the assessee for making such investments. If he was sure that the working of the appellant was wrong, he should have recorded his satisfaction before resorting to the disallowance as per rule 8D, however, these elements are missing from the assessment order.

The Delhi High Court in the case of Joint Investments (P.) Ltd. vs. CIT [2015]372 ITR 694/233 Taxman 117/59 taxmann.com 295 held that-

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.

It is also noticed that while calculating the disallowance as per rule 8D (iii) being 0.5% of Rs. 3,69,75,480/- in his order, the A.O has wrongly calculated the figure at Rs. 18,48,774/- (@5% instead of 0.5%). This amount comes to Rs. 1, 84,877/-. This reduces the addition by Rs.16, 63,897/- which the A.O should rectify while giving effect to this order. If this amount is reduced, the disallowance would get reduced to Rs. 25, 82,190/-(Rs.42, 46,087-16, 63,897) which is more than the exempt income earned. Thus the working itself gives unreal results based on the above calculations. Thus subject to the calculation done below based on the documents available, the disallowance is reworked as under-

Particulars	Amount
Interest paid	1,32,95,215
Less: interest received	65,87,152
Net interest paid	67,08,063
Investment attributable to exempt income	73,38,933
Total assets	20,50,61,628
Proportion of ratio of investment to the total assets	3.58%
Disallowance under Rule 8D(ii)	2,40,074
Disallowance under Rule 8D(iii) (.5% of 73,38,933)	36,694
Total disallowance	276768

Thus disallowance of Rs. 2,76,768/- is upheld. The balance disallowance of Rs. 39,69,319/- (inclusive of the calculation mistake amounting to Rs. 16,63,897/- discussed above) is to be deleted.

This ground is partly allowed.”

From the facts and details as considered by the Id. CIT (A), we find that the revenue has not pointed out any error as regards the correctness of the details considered by the Id. CIT (A). Accordingly, when the correct amount of investment and interest paid during the year under consideration was considered by the Id. CIT (A) for the purpose of disallowance under section 14A, then there is no reason to interfere with the said findings of the Id. CIT (A) qua this issue. Hence the order of the Id. CIT (A) is upheld.

Ground No. 2 is regarding disallowance of interest being incurred on the investment in non-business asset and loan and advances without interest.

6. The AO noted that the assessee has incurred interest expenditure of Rs. 1.65 crore on the borrowed fund of Rs. 17.22 crores and arrived to the rate of interest expenditure at 9.6%. The AO further noted that the assessee has made certain loans and advances to relatives on which no interest was charged and also made investment in the properties which are non-business assets. Accordingly, the AO has applied the said average rate of 9.6% on these investments and loan & advances and worked out the proportionate interest of Rs. 65,28,895/-. The AO, however, allowed the interest income received by the assessee during the year while computing the disallowance on this account. The Id. CIT (A) deleted the disallowance made by the AO by considering the fact that the assessee's own capital

is Rs. 2,25,84,374/- which is more than the investment and loan & advances given by the assessee to the relatives.

7. Before us, the Id. D/R has submitted that there is no direct nexus that the assessee's own fund is used by the assessee for giving loans and advances to the relatives and making investment in the non-business assets/personal assets. The AO has considered the net interest expenditure while making this disallowance and, therefore, the disallowance made by the AO is reasonable and proper. He has relied on the order of the AO.

8. On the other hand, the Id. A/R has submitted that the AO has ignored assessee's current liability of Rs. 3.56 crores on which no interest is paid and further the assessee has own capital of Rs. 2,25,84,374/-. When the assessee's own fund and interest free fund is more than the net investment in non-business asset, then no disallowance is called for on this account. He has supported the order of Id. CIT (A). The Id. A/R has further submitted that apart from the interest income of Rs. 65,87,152/-, the assessee has also received rental income of Rs. 29,38,242/- which is more than the interest worked out by the AO on such non-business assets. Hence, the Id. A/R has submitted that by considering all these facts no disallowance is called for.

9. We have considered the rival submissions as well as the relevant record. The AO has made the disallowance on account of interest by considering the non-business assets of the assessee at Rs. 13.66 crores and then applying the average rate of interest expenditure at 9.6% has worked out the disallowance at Rs. 75,25,859/-. The Id. CIT (A) has considered this issue as under :-

As regards Ground of appeal no 2, it is seen that the assessee has his own capital of Rs. 2,25,84,374/-. An assessee is required to run business looking to the commercial expediency and several other factors.

Apex Court, in the case of *S.A. Builders Ltd. v. CIT (Appeals)* [2007] 288 ITR 1/158 Taxman 74 , after considering what is commercial/business expediency, has observed as under :

"The expression 'commercial expediency' is an expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. The expenditure may not have been incurred under any legal obligation, but yet it is allowable as business expenditure if it was incurred on grounds of commercial expediency."

HIGH COURT OF RAJASTHAN in the case of Commissioner of Income-Tax v. Vijay Solvex Ltd. 59 taxmann.com 294 (Rajasthan) held-

Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital (Interest-free advances to sister concerns) - Assessment year 1992-93 - During course of assessment proceedings, Assessing Officer noticed that on one hand, assessee-company was making payment of interest to banks etc. but on other hand, it had advanced money to sister concerns on which no interest was charged - Assessing Officer was of view that interest bearing loans had been diverted to non-business purposes and, accordingly, he disallowed interest on interest-free advances given to sister concerns - It was observed that assessee-company had its own sufficient funds and revenue was unable to prove nexus between borrowed funds and advances given - Whether, on facts, notional interest disallowed by Assessing Officer was to be deleted - Held, yes

HIGH COURT OF BOMBAY in Commissioner of Income-tax v. Reliance Utilities & Power Ltd. 178 Taxman 135 (Bombay) held-

Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital - Whether 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 interest-free funds generated or available with company, provided said funds are sufficient to meet investments - Held, yes - Whether since, in instant case, said presumption was clearly established in view of findings recorded by Commissioner (Appeals) and Tribunal, impugned order passed by said authorities was to be affirmed - Held, yes

Secondly on the basis of the investments made, he has earned taxable income in the form of interest (considered by the A.O), Rent, Remuneration and Capital gains not exempted from tax. Thus the borrowing comes out as a logical decision and it has also helped the appellant earn strategic stake in certain entities with long term business prospects in mind. In that context, the interest spend on borrowings can be held to be a valid business expense.

SUPREME COURT OF INDIA in the case of Hero Cycles (P.) Ltd. v. Commissioner of Income-tax (Central), Ludhiana⁶³ taxmann.com 308 (SC) held-

Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital (Interest free loans) - Assessment year 1988-89 - Whether once it is established that there is nexus between expenditure and purpose of business (which need not necessarily be business of assessee itself), revenue cannot justifiably claim to put itself in arm-chair of businessman or in position of Board of Directors and assume role to decide how much is reasonable expenditure having regard to circumstances of case - Held, yes - Assessee filed its return claiming deduction of interest paid on borrowed sums from Bank under section 36(1)(iii) - Assessing Officer finding that assessee had used borrowed funds for giving interest free loans to its subsidiary company and directors, rejected assessee's claim - High Court upheld order of Assessing Officer - It was noted that advance to subsidiary company became imperative as a business expediency in view of undertaking given to financial institutions by assessee to effect that it would provide additional margin to subsidiary company to meet working capital for meeting any cash losses - Insofar as loans to directors were concerned, said loans were granted out of assessee's own surplus funds - Whether in view of aforesaid, impugned order passed by High Court was to be set aside - Held, yes

..12. Insofar as loans to the sister concern/subsidiary company are concerned, law in this behalf is recapitulated by this Court in the case of S.A. Builders Ltd. v. CIT (Appeals) [2007 (288) ITR 1/158 Taxman 74]. After taking note of and discussing on the scope of commercial expediency, the Court summed up the legal position in the following manner:—

26. The expression "commercial expediency" is an expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. The expenditure may not have been incurred under any legal obligation, but yet it is allowable as a business expenditure if it was incurred on grounds of commercial expediency.

27. No doubt, as held in *Madhav Prasad Jatia v. CIT* [1979 (118) ITR 200 (SC)], if the borrowed amount was donated for some sentimental or personal reasons and not on the ground of commercial expediency, the interest thereon could not have been allowed under section 36(1)(iii) of the Act. In *Madhav Prasad's case* [1979 (118) ITR 200 (SC)], the borrowed amount was donated to a college with a view to commemorate the memory of the assessee's deceased husband after whom the college was to be named, it was held by this court that the interest on the borrowed fund in such a case could not be allowed, as it could not be said that it was for commercial expediency.

28. Thus, the ratio of *Madhav Prasad Jatia's case* [1979 (118) ITR 200 (SC)] is that the borrowed fund advanced to a third party should be for commercial expediency if it is sought to be allowed under section 36(1)(iii) of the Act.

29. In the present case, neither the High Court nor the Tribunal nor other authorities have examined whether the amount advanced to the sister concern was by way of commercial expediency.

30. It has been repeatedly held by this court that the expression "for the purpose of business" is wider in scope than the expression "for the purpose of earning profits" vide *CIT v. Malayalam Plantations Ltd.* [1964 53 ITR 140 (SC), *CIT v. Birla Cotton Spinning and Weaving Mills Ltd.* [1971 82 ITR 166 (SC)], etc.'

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.

Allahabad High Court in the case of *CIT v. Radico Khaitan Ltd.* [2005] 274 ITR 354/142 Taxman 681 has held that where *the assessee company had sufficient fund other than the borrowed money for giving the amount in question as loan to its sister concern, which finding had not been specifically challenged in the present appeal. The conditions of s. 36(1)(iii) of the Act had been complied with and, therefore, the assessee company was entitled to full allowance of the 'amount of interest paid by it on borrowed capital.*

Thus, where both the aspect of own funds as well as creation of strategic interest as well as the earnings on the investments were concerned, and the A.O could not bring out the nexus between the borrowed funds for non commercially expedient purposes, the interest could not have been disallowed for it is not necessary that all investments give immediate returns to match the interest costs. Even investments in Capital assets not yielding income but interest being involved has been considered as allowable by the apex court as in the following orders-

SUPREME COURT OF INDIA In The Case Of Vardhman Polytex Ltd. v. Commissioner of Income-tax 25 taxmann.com 281 (SC) held-

Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital - Whether interest paid in respect of borrowings for acquisition of capital assets not put to use in concerned financial year can be allowed as deduction under section 36(1)(iii) - Held, yes

SUPREME COURT OF INDIA in Deputy Commissioner of Income-tax v. Core Health Care Ltd. 167 Taxman 206 (SC) held-

Section 36(1)(iii) ,read with Explanation 8 to section 43(1), of the Income-tax Act, 1961 - Interest on borrowed capital - Assessment year 1992-93 - Whether proviso inserted in section 36(1)(iii) with effect from 1-4-2004 has to be read as prospectively - Held, yes - Whether what section 36(1)(iii) emphasizes on is user of capital and not user of asset which comes into existence as a result of borrowed capital, unlike section 37(1) which expressly excludes an expense of a capital nature - Held, yes - Whether Legislature has, therefore, made no distinction in section 36(1)(iii) between 'capital borrowed for a revenue purpose' and 'capital borrowed for a capital purpose' and an assessee is entitled to claim interest paid on borrowed capital provided that capital is used for business purpose irrespective of what may be result of using such borrowed capital - Held, yes

So the proportionate disallowance made by the A.O cannot be upheld both on the facts as well as the legal precedents available in this regard.

The disallowance of Rs. 65, 28,895/- is accordingly directed to be deleted.

We find that the Id. CIT (A) has rightly considered the assessee's own capital at Rs. 2.25 crores. Further, the revenue has not disputed the current liability of the assessee at Rs. 3.56 crores on which no interest is payable. Thus considering the interest free fund as well as the rental income and interest income of the assessee which alone is more than the amount of interest disallowed by the AO, the Id. CIT (A) deleted the disallowance. Accordingly once the rental income and interest income of the assessee is Rs.95,25,394/- earned on the alleged non-business assets then the disallowance worked out by the AO on account of interest of Rs. 75,25,859/- is less than the said income, hence we do not find any error or illegality in the impugned order of the Id. CIT (A).

10. In the result, appeal of the revenue is dismissed.

Order is pronounced in the open court on 02/07/2019.

Sd/-
(रमेश सी. शर्मा)
(RAMESH C. SHARMA)
लेखा सदस्य / Accountant Member

Sd/-
(विजय पाल रॉव)
(VIJAY PAL RAO)
न्यायिक सदस्य / Judicial Member

Jaipur

Dated:- 02/07/2019.

Das/

आदेश की प्रतिलिपि अग्रेषित / Copy of the order forwarded to:

1. The Appellant- The ACIT, Circle-3, Jaipur.
2. The Respondent – Shri Kapil Taneja, Jaipur.
3. The CIT(A).
4. The CIT,
5. The DR, ITAT, Jaipur
6. Guard File (ITA No. 711/JP/2018)

आदेशानुसार / By order,

सहायक पंजीकार / Assistant. Registrar

