

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

**BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER
AND SHRI S. RIFAUR RAHMAN, ACCOUNTANT MEMBER**

**ITA Nos. 753/Hyd/2016 and 90/Hyd/2017
Assessment Years: 2009-10 & 2012-13**

M/s Kishore Muralidhar
Agarwal, Secunderabad.

vs. Income-tax Officer,
Ward – 10(4), Hyderabad.

PAN – ALDPC 9493R

(Appellant)

(Respondent)

Assessee by : Shri Sunil Kumar Jain
Revenue by : Smt. Neeju Gupta

Date of hearing : 13/06/2019
Date of pronouncement : 10/07/2019

ORDER

PER S. RIFAUR RAHMAN, A.M.:

Both these appeals filed by the assessee are directed against the order of CIT(A) – 6, Hyderabad for AYs 2009-10 and 2012-13. As identical issues are involved in both these appeals, the same were clubbed and heard together and therefore, a common order is passed for the sake of convenience.

2. On perusal of record, we find that the appeal in ITA No. 753/Hyd/16 was filed belatedly with a delay of 190 days. In this connection, assessee filed an affidavit affirming therein that at the relevant point time he was ill and doctor advised him to take complete bed rest for 4 months, due to which, the delay occurred and hence, the delay may be condoned as there is no deliberate intention to file the appeal belatedly. As the assessee was prevented by sufficient reason, we condone the delay and admit the appeal for hearing and adjudication.

3. Brief facts as taken from the appeal for AY 2009-10 are, assessee filed his return of income for the AY 2009-10 on 27/09/2009 admitting income of Rs. 6,55,950/-. Subsequently, the case was selected for scrutiny and notices u/s 143(2) and 142(1) were issued. In response, AR of the assessee submitted all the information called for.

3.1 Assessee's income consists of income from house property, income from salary, income from business being share income from partnership firm M/s Sri Durga Traders and income from other sources being dividend received from various persons/concerns. The share income from partnership firm and the dividend received were claimed as exempt. In the computation of income, assessee claimed loss on account of interest paid to the tune of Rs. 12,93,947/-.

3.2 During the assessment proceedings, the AO verified the interest paid details along with return of income, it was noticed that total interest paid by the assessee amounted to Rs. 15,35,470/-, out of which, interest received of Rs. 2,41,523/- was reduced and the net amount of interest paid of Rs. 12,93,947/- was claimed as loss. Further, AO verified the balance sheet submitted along with the return of income and noticed that the assessee borrowed the amounts to the extent of Rs. 2,37,38,450/- from various persons/concerns, and the above borrowed funds along with the own capital of Rs. 66,19,504/- was invested in share application money in various companies to the extent of Rs. 2,42,53,505/-. The AO noticed that major portion of the amounts borrowed as loans was utilized as investments on share application money in various companies. When asked to justify as to how it is eligible for claiming deduction of interest paid on loans taken when the said loans were invested in shares of different companies from which only dividend income was earned or expected to earn which is exempt from tax, the assessee filed the following reply:

"This is to inform you that I am partner in M/s. Sunil Ispot Udyog and Sri Durgo Steel Traders. I am also Director of M/s. Poncharatna Metal Processing Ltd. and Sir Narsing Laxmi Steels Pvt. Ltd. I am getting income from interest and also as Remuneration from companies to run, manage, conduct the business of Firms and Companies, I have to invest money. I have tak0'n loan [rom parties and this amount is invested either in the firm or in the companies. Without investing my shore I could not have become partner of partnership firms and Director in the company because without investment it is not possible to enter into partnership as a partner.

Whatever amount of interest I claimed as expenses in my individual I.T. Return and whatever amount I have received as interest income is offered for Income Tax. The income is not from share Dividend (income is exclusive of income from share Dividend. Therefore, Section 14A of Income Tax Act is not applicable because income is out Of preview of Dividend i.e., Section 14A."

After considering the reply of the assessee, AO invoked the provisions of section 14A and applied rule 8D, and disallowed Rs. 12,32,966/- u/s 14A of the Act.

4. Aggrieved with the above order of AO, the assessee preferred an appeal before the CIT(A).

5. Before the CIT(A), assessee submitted that the provisions of section 14A were not attracted to his case as no evidence was brought on record to relate that interest expenditure was incurred for earning tax free dividend income. The dividend income of Rs. 29,558/- received during the year was out of the total investment of Rs. 2 lakhs made in different companies over a period of time is out of his own funds and there was no nexus between the borrowed money and investment made in the shares of the companies. By relying on various case laws, he submitted that no addition was called for u/s 14A of the Act.

6. After considering the submissions of the assessee, the CIT(A) reduced the disallowance made by the AO u/s 14A by observing as under:

"06.0 The submission of the appellant and the assessment order have been carefully considered. The appellant has shown a total investment in shares of Rs.2,42,53,505/-. Out of this, Rs.2,40,20,500/- was invested in equity shares of M/s Pancharatna Metal Processing Ltd. and the balance was invested in the companies from which a dividend income of Rs.29,599/- has been received during the previous year under consideration. The assessee has also shown interest income of Rs.2,41,523/- on loans/advances given and interest from bank etc. According to the appellant, his own capital was utilised for making investments, the income from which were exempt and therefore, Sec 14A were not applicable to his case.

06.1 It is to be seen that partners' share of profit from investments in firms and income arising from investments in shares of companies, is not liable :0 tax. The assessee's investment may have enabled him to become a Director/Partner in the company/firm. But that is not the issue. The issue is that the income earned by him by virtue of such investment, i.e. dividend / share of profit would constitute exempt income, and as per Sec 14A of the LT. Act, any expenditure incurred in relation to such income would not be allowable as deduction. Therefore, whether borrowed funds were used for making such investments is to be seen. The balance sheet of the appellant shows that he had interest bearing funds amounting to Rs.2,37,38,450/- and non-interest bearing funds of Rs.66,19,504/- and as the funds were mixed up, it cannot be categorically stated that interest-free funds were only utilised towards investment, income from which was exempt. There is no strict formula or basis of segregation done either by the appellant or by the Assessing Officer. So, it can be reasonably be concluded that the appellant had interest bearing as well as interest free funds at his disposal which were utilised to earn both taxable and exempt income. In view of it, in principle, the action of the Assessing Officer in applying the provisions of Sec 14A is held to be in accordance with law.

06.2 But, as the funds are mixed, it cannot be said that the entire interest expenditure relates to the investments, the income from which would be exempt. An analysis of the appellant's balance sheet shows that the ratio of interest free funds (capital) to interest bearing funds (loans) is 22:78 (petty amounts having been ignored). It would be reasonable to hold that same mix of interest bearing and interest free funds was utilised for making investment, income from which would be

exempt from taxation. Seen from this angle, the amount of interest bearing funds used for such investment would amount to (Rs.2,37,38,450/x 78%). Correspondingly, 78% of the interest expenditure would also relate to such investment and would be hit by the mischief of provision of Sec. 14A of the LT. Act. The disallowance is reduced accordingly. The Assessing Officer is accordingly directed to recompute the disallowance u/s 14A of the Act.”

7. Aggrieved by the order of CIT(A), the assessee is in appeal before us raising the following grounds of appeal:

1. The learned Assessing Officer erred in making a disallowance for a sum of Rs. 12,32,966/- in terms of section 14A and the learned CIT(Appeals), Hyderabad has erred in upholding the same.

2. The appellant craves leave to add to, amend or modify the above grounds of appeal either before or at the time of hearing of the appeal, if it is considered necessary.”

8. Before us, Id. AR filed written submissions, which are as under:

“ With reference to the above we would like to inform you that the dividend income of Rs.29,558/- was received by the assessee from various companies (including listed companies) in which the assessee has made an investment. The detail of investments made has been enclosed as Annexure 1 for your ready reference). This is to inform you that out of Rs.29,558/-, no dividend was received from Pancharatna Metal Processing Limited.

1. The interest income received on the investment made out of the borrowed funds is Rs. 2,41,523/-.

Particulars	Amount in Rs.
Interest income received	Rs. 2,41,523/-
Less: Interest paid	Rs. 15,35,470/-
Net Interest paid	Rs. 12,93,947/-

From the above table, it can be drawn that the net Interest paid by the assessee individual is Rs. 12,93,947/-. We would further like to mention that the assessing officer has considered Interest Income as income earned for application of monies

received on borrowings but has disallowed expenditure paid on the same.

2. Further we would like to mention that in the scrutiny proceedings of the assessee for the AY 2013-14, the Ld. AO has allowed the interest expense claimed by the assessee against the interest income. The AO has raised the questions and called for details in this regard and the contentions of the assessee were duly accepted by the AO. We are also enclosing the copy of letter submitted to the AO in this regard along with Computation and the Assessment Order passed for the A Y 2013-14 (Annexure - 2). The interest paid breakup for AY 2009-10 is also enclosed as Annexure - 3. The AO cannot take one opinion in one year and a different opinion in another year with respect to the same issue. Thus, we request Your Honor to kindly consider the above and delete the said addition.

3. Further we would like to draw your honours kind attention to the case of *Joint Investments (P.) Ltd. v. Commissioner of Income-tax [2015] 372 ITR 694 (Delhi)* where in it was held that the disallowance under section 14A cannot exceed the amount of exempt income earned. "Assessee-company was engaged in diverse investment activities and in course of its business derived income from rent, sale of investments, dividend and interest -It declared tax exempt income inform of dividend to tune of Rs. 48.90 lakhs and voluntarily disallowed certain expenditure under section 14A - Assessing Officer recomputed disallowance and disallowed sum of Rs. 52.56 lakhs under section 14A, read with rule 8D - Assessee's grievance was that entire tax exempt income was lower than disallowance - Whether since Assessing Officer had not disclosed why assessee's claim for disallowance under section 14A had to be rejected, order of Assessing Officer was to be set aside - Held, yes ." The same decision was also held in the case of *Neeraj Consultants Ltd., Kolkata vs Department Of Income Tax on 19 October, 2016 [ITA No.316/Kol/2014]*.

4. Also, It was stated by the High Court in *Principal CIT v. India Gelatine and Chemicals Ltd. [2015] 376 ITR 553 (Guj)* that investment giving tax-free income had no nexus with borrowed fund, because the assessee had sufficient proprietary funds for investment, there could be no resort to section 14A so as to disallow any part of the interest on borrowed funds.

Following the above case law, even if the assessing officer calculates the expenditure which does not form part of total income, he must do it by taking the proprietary funds on a proportionate basis. As on 31.03.2009, the assessee has an amount of Rs. 66,19,504/- in his capital account. As such,

interest received on such investments must be reduced from the same.

9. On the other hand, Id. DR relied on the orders of revenue authorities.

10. Considered the rival submissions and perused the material on record. We notice that assessee is earning income from house property, income from salary, income from business being share income from partnership firm M/s Sri Durga Traders and income from other sources being interest/dividend received from various persons/concerns. During this year, as per the balance sheet submitted before us, it is noticed that assessee having his own capital to the extent of Rs. 66.19 lakhs and borrowed loans to the extent of Rs. 2.37 crores and assessee has utilized the funds to invest in shares to the extent of Rs. 2.43 crores and made investment in all other sundry assets along with cash balance to the extent of Rs. 60.5 lakhs. From the above, it is clear that assessee has his own capital to the extent of Rs. 66.19 lakhs, which was applied in acquiring other sundry assets including cash to the extent of Rs. 60.5 lakhs, whereas, majority of the borrowed funds were utilized to acquire the shares in other companies. During this year, assessee has earned dividend income of Rs. 29,558/- from the above investment and majority of the investments has not earned any dividend income during this year. Before us, assessee claims that AO has accepted the contention of the assessee in earlier assessment years i.e. assessee has borrowed money from various persons and in turn gave unsecured loan to Pancharatna Metal Processing Ltd., where the assessee is a director and required funds for business. The amounts were borrowed with the intention to give money on interest to Pancharatna Metal Processing Ltd., and earned income. Therefore, assessee has earned interest income, which was adjusted against the interest paid and the difference was declared as income from other sources. The same policy was adopted during this AY also. However, in this AY,

expenditure claimed is more than the income declared. Therefore, it should be allowed as expenditure during this year also. We noticed that the above submissions were put-forth by the assessee before the AO, which is placed on record. However, we notice that assessee has submitted balance sheet before us as on 31/03/2009, which clearly shows that assessee has disclosed share amount to the extent of Rs. 2.45 crores. We cannot accept the contention of the assessee that assessee has lent money to Pancharatna Metal Processing Ltd. During this year, rather assessee has treated this amount as investment in shares. In our considered view, assessee may not have earned any dividend income. However, majority of the investments were made out of borrowed funds and utilized for the investment purposes.

10.1 During this year, assessee has also declared only small amount of Rs. 29,558/- as dividend income, which earned from other investments, but, majority of the investments made by the assessee are in M/s Pancharatna Metal Processing Ltd. Considering the investment pattern adopted by the assessee during this year, it is clear that assessee has borrowed majority of the funds from lenders and made investment in M/s Pancharatna Metal Processing Ltd. It is clearly an investment activity, which is not earned any income during this year. Rule 8D can be applied only when there is mixed funds available with the assessee, which cannot be segregated, but, considering the financial pattern of the assessee, it is clear that interest expenditure incurred by the assessee is towards investment activities. Therefore, this expenditure can be set off against income from investments. Therefore, assessee cannot claim any expenditure, which is exempt from tax i.e. dividend income as well as share income from partnership firm. Therefore, in our considered view, assessee is not eligible to claim portion of interest expenditure incurred towards investment activities, which has not earned any income. We notice that CIT(A) has allowed the interest expenditure

proportionate to the borrowed funds and own funds. Therefore, we are inclined to accept the findings of the Id. CIT(A) and accordingly, interest expenditure is allowed proportionately to the own funds available with the assessee i.e. 22% and 78% of the interest expenditure is sustained. Accordingly, grounds raised by the assessee are dismissed. With regard to quantum of interest expenditure, the net expenditure to be considered not the total interest expenditure.

11. As the facts and grounds raised in ITA No. 90/Hyd/2017 are identical to that of ITA No. 753/Hyd/2016, following the decision therein, we uphold the order of CIT(A) and dismiss the grounds raised by the assessee.

12. In the result, both the appeals of the assessee are dismissed.
Pronounced in the open Court on 10th July, 2019.

Sd/-
(P. MADHAVI DEVI)
JUDICIAL MEMBER

Sd/-
(S. RIFAUR RAHMAN)
ACCOUNTANT MEMBER

Hyderabad, Dated: 10th July, 2019

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Copy to:-

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