

IN THE INCOME TAX APPELLATE TRIBUNAL
“A” BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI JASON P. BOAZ, ACCOUNTANT MEMBER

ITA No.37/Bang/2019
Assessment year : 2014-15

Shri Hastimal Phoolchand Jain, M/s. Hind Book Manufacturers, P H Chambers, Kanchanagar Galli, Hubli – 580 028. PAN: ABUPJ 4673R	Vs.	The Income Tax Officer, Ward 1(4), Hubli.
APPELLANT		RESPONDENT

Appellant by	:	Shri H.N. Khincha, CA
Respondent by	:	Shri Vikas Suryavamshi, Addl.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	23.07.2019
Date of Pronouncement	:	31.07.2019

ORDER

Per N V Vasudevan, Vice President

This appeal by the assessee is against the order dated 23.10.2018 of the CIT(Appeals), Hubballi, relating to assessment year 2014-15.

2. The issue that arises for consideration in this appeal is as to, whether revenue authorities were justified in disallowing a part of interest expenditure by invoking the provisions of section 40A(2)(b) of the Income-Tax Act, 1961 [“the Act”].

3. The assessee is an individual carrying on business of dealing in paper boards and related products under the name and style of M/s. Hind Book Manufacturers. In the course of assessment proceedings, the AO noticed that the assessee had claimed as deduction while computing income from business a sum of Rs.1,67,49,220 being interest paid on unsecured loans. Rate of interest paid on unsecured loans was around 18%. Unsecured loans have been obtained from relatives of assessee. In the aforesaid scenario, the AO was of the view that the interest expenses claimed in the P&L account, a part of it should be disallowed as excessive and unreasonable by invoking the provisions of section 40A(2)(a) which provides as follows:-

“Section 40A(2)(a):- Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause(b) of this sub-section, and the Assessing Officer is of opinion that such expenditure is excessive or unreasonable having regard to

- a. the fair market value of the goods, services or facilities for which the payment is made; or
- b. the legitimate needs of the business or profession of the assessee; or
- c. the benefit derived by or accruing to him there from, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction:

Section 40A(2) is applicable where **any** of the requirement mentioned in (a), (b) and (c) above is satisfied and **it is not necessary that all the three requirements should be cumulatively satisfied** [Coronation Flour Mills V Asst. CIT (2009) 314 ITR 1 (Guj)].

The persons referred to in clause (a) are the following, namely:-

- (i) Where the assessee is an individual -
 - a. any relative of the assessee (i.e, spouse, brother, sister, any lineal ascendant or descendant) of such individual;
 - b. any person in whose business or profession the assessee (i.e individual) himself or his relative has substantial interest.
- (ii) Where the assessee is a company,

In the instant case, the assessee being an individual and the person(s) referred to are any relative.

Under the Income Tax Act, 1961 there are various definitions of word "relative" for different sections and different purpose.”

4. The AO was of the view that the assessee had deliberately paid higher rate of interest to the relatives than the market rate. There was no plausible explanation received from the assessee and in the circumstances the AO considered 12% rate of interest as reasonable rate to be paid on such unsecured loans obtained from the relatives. Accordingly, a sum of Rs.55,82,720 was disallowed by the AO and added to the total income of assessee as computed by the AO in the order of assessment as follows:-

“In view of the preceding paragraphs, the submission of the assessee is not acceptable and the interest of Rs. 1,67,49,220/- being claimed as interest paid towards unsecured loans is restricted to Rs.1,11,66,500/- @ 12% of the fair market value considering it reasonable. Therefore, a sum of Rs. 55.82,720/- is added back to the income returned on account of the same and brought to tax accordingly; Penalty Proceedings u/s. 271(1)(c) is initiated since the assessee.”

5. On appeal by the assessee, the CIT(Appeals) was of the view that the action of the AO was correct, but he expressed the view that rate of interest to be adopted as reasonable was 15%. Still not being satisfied by

the relief given by the assessee, the assessee has preferred the present appeal before the Tribunal.

6. The assessee has filed additional ground of appeal in which he has sought to raise a plea that some of the loans on which interest paid by the assessee was disallowed were not given to the relatives as defined in section 2(41) of the Act and therefore the provisions of section 40A(2)(b) could not have been applied in respect of those loans. The additional ground sought to be raised in this regard is as follows:-

“1. In any case the learned Assessing officer had erred in invoking the provisions of section 40A(2b) of the Act on the ground that entire unsecured loans were from relatives only and the learned CIT(A) has erred in confirming the same. On proper appreciation of facts and the law applicable, only a few loan creditors are relatives of the appellant in terms of section 2(41) of the Income tax Act. The conclusions of authorities below being wholly erroneous both on facts and law are to be rejected.”

7. We shall first deal with the additional ground. The issue raised in the additional ground was raised before the AO as well as CIT(Appeals) and therefore the issue raised in the additional ground arises out of the order of CIT(Appeals) and is therefore admitted for adjudication.

8. As far as merits of additional ground is concerned, the definition of 'relative' is given in section 2(41) of the Act and it reads as follows:-

“ 'relative' in relation to an individual means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual.”

9. A perusal of the chart given as Annexure-I to this order would show that persons who are considered as non-relatives are collaterals. They cannot be regarded as relatives within the meaning of section 2(41) of the Act and consequently interest paid to non-relatives cannot be disallowed by

invoking the provisions of section 40A(2)(b) of the Act. To this extent, the addition made by the revenue authorities are liable to be deleted and is hereby deleted.

10. As far as the loan to relatives is concerned, the Id. counsel for the assessee has brought to our notice the decision of the Bangalore Bench of the Tribunal in the case of *Vogue Vestures P. Ltd. v. ACIT, ITA No.1284/Bang/2011, order dated 30.11.2012* in which on an identical issue, this Tribunal came to the conclusion that the interest paid @ 18% to relatives was fair and reasonable and deleted the addition made u/s. 40A(2)(b) of the Act. The Tribunal in coming to the aforesaid conclusion has given the reason that for availing loans from banks, there are several security norms and RBI guidelines to be satisfied. It was also suggested in the aforesaid order that the rate of interest would be bound to be more, when the loans are given without any security. The Tribunal made a reference to the decision of the Hon'ble Supreme Court in the case of *Upper India Publishing House P. Ltd. v. CIT, 156 ITR 585 (SC)* wherein the Hon'ble Apex Court held that section 40A(2)(b) cannot have any application unless it is first held that the expenditure was excessive and unreasonable. Taking all the above circumstances into consideration, the Tribunal held that 18% rate of interest was fair and reasonable.

11. The Id. DR submitted that the aforesaid decision was in relation to AY 2005-06 and that ratio cannot be applied in the present appeal which involves AY 2014-15. In our view, the reasons given by the Tribunal in the aforesaid decision is equally applicable to the present case and therefore following the aforesaid decision, we hold that the interest paid to the relatives in the present case cannot be considered to be as excessive and unreasonable. Accordingly, disallowance of interest made by the revenue authorities is hereby deleted.

12. In the result, the appeal by the assessee is allowed.

Pronounced in the open court on this 31st day of July, 2019.

Sd/-

(JASON P. BOAZ)
Accountant Member

Sd/-

(N.V. VASUDEVAN)
VICE PRESIDENT

Bangalore,
Dated, the 31st July, 2019.

/ Desai Smurthy /

Copy to:

1. The Appellant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar,
ITAT, Bangalore.

ANNEXURE - I

HASTIMAL PHOOLCHANDJI JAIN ITA 37/BANG/2019.					
Sl No.	Name	Relationship	Interest Paid	Relatives Covered U/s 40A(2)(b)	
				YES	NO
1	Phoolchandji H.Jain [HUF],Hubli	Father	614,671.00		614,671.00
2	Bhermalji P.Jain HUF Hubli	Brother	568,341.00		568,341.00
3	Hastimalji P.Jain HUF Hubli	Own	547,415.00		547,415.00
4	Gajrajji P.Shah HUF Hubli	Brother	472,268.00		472,268.00
5	Motilalji P.Shah HUF Hubli	Brother	564,576.00		564,576.00
6	Uttamchandji P.Shah HUF Hubli	Brother	386,356.00		386,356.00
7	Popatlalji P.Shah HUF Hubli	Brother	333,808.00		333,808.00
8	Gajrajji P.Shah Hubli	Brother	693,329.00	693,329.00	
9	Motilalji P.Shah Hubli	Brother	562,312.00	562,312.00	
10	Uttamchandji P.Shah Hubli	Brother	685,603.00	685,603.00	
11	Popatlalji P.Shah Hubli	Brother	669,362.00	669,362.00	
12	Vipulkumar B.Jain Hubli	Nephew	638,031.00		638,031.00
13	Predeepkumar B.Jain Hubli	Nephew	561,633.00		561,633.00
14	Subhash H.Jain Hubli	Son	671,122.00	671,122.00	
15	Anilkumar H.jain Hubli	Son	605,231.00	605,231.00	
16	Kumarpal G.Shah Hubli	Brother Sons	307,815.00		307,815.00
17	Mansukh G.Shah Hubli	Brother Sons	302,372.00		302,372.00
18	Tajpal M.Shah Hubli	Brother Sons	433,832.00		433,832.00
19	Sripal M.Shah Hubli	Brother Sons	261,516.00		261,516.00
20	Chirag P.Shah Hubli	Brother Sons	93,082.00		93,082.00
21	Smt Shakuntalabai B.Jain Hubli	Brother Wife	569,981.00		569,981.00
22	Smt Shakuntalabai H.Jain Hubli	Wife	734,803.00	734,803.00	
23	Smt. Surekhabai G.Shah Hubli	Brother Wife	651,789.00		651,789.00
24	Smt. Karunabai M.Shah,Hubli	Brother Wife	619,231.00		619,231.00
25	Smt Shobhabai U.Shah, Hubli	Brother Wife	518,279.00		518,279.00
26	Smt. Urmilabai P.Shah, Hubli	Brother Wife	424,220.00		424,220.00
27	Smt. Kalpana V. Jain, Hubli	Nephew Daughter in Law	353,931.00		353,931.00
28	Smt Deepika S.Jain, Hubli	Daughter in law	394,847.00		394,847.00
29	Smt Preethi A.Jain, Hubli	Daughter in law	499,616.00		499,616.00
30	Monal G.Shah, Hubli	Brother Daughter	374,033.00		374,033.00
31	Mikhail Anilkumar.Jain, Hubli	Grand Son	7,124.00	7,124.00	
32	Labdhi Subhash.Jain, Hubli	Grand Daughter	7,543.00	7,543.00	
33	Rishika Vipulkumar. Jain, Hubli	Nephew Daughter	7,124.00		7,124.00
34	Divit Subhahsh. Jain, Hubli	Grand Daughter	6,355.00	6,355.00	
35	Viram Vipulkuamr Jain, Hubli	Nephew Son	6,355.00		6,355.00
36	Sha Pukhraj Prakashkumar, Hubli	Friend	944,406.00		944,406.00
37	Subhash H.Jain HUF Hubli	Son	42,310.00		42,310.00
38	Anilkumar H.jain HUF Hubli	Son	42,310.00		42,310.00
39	Komal M.Shah, Hubli	Brother Daughter	196,550.00		196,550.00
40	Harshakumari U.Shah, Hubli	Brother Daughter	104,187.00		104,187.00
41	Kushalraj U.Shah, Hubli	Brother Sons	114,156.00		114,156.00
42	Harshkumar P.Shah, Hubli	Brother Sons	114,586.00		114,586.00
43	Vipulkumar B.Jain HUF Hubli	Nephew	42,805.00		42,805.00
			16,749,216.00	4,642,784.00	12,106,432.00

