

**IN THE INCOME TAX APPELLATE TRIBUNAL "D", BENCH
MUMBAI**

**BEFORE SHRI M.BALAGANESH, AM
&
SHRI RAM LAL NEGI, JM**

**ITA No.1013/Mum/2016
(Assessment Year :2010-11)**

M/s. Mecords India Limited 216, Swastik Chambers, Sion Trombay Road Chembur, Mumbai – 400 071	Vs.	Income Tax Officer – 10(2)(4), Aayakar Bhavan M.K.Road, Mumbai – 400 020
PAN/GIR No. AAACM3324N		
(Appellant)	..	(Respondent)

Assessee by	Shri Vijay Mehta
Revenue by	Shri J. Saravanan
Date of Hearing	28/08/2019
Date of Pronouncement	04/10/2019

आदेश / O R D E R

PER M. BALAGANESH (A.M):

This appeal in ITA No.1013/Mum/2016 for A.Y.2010-11 arises out of the order by the Id. Commissioner of Income Tax (Appeals)-22, Mumbai in appeal No.CIT(A)22/IT/345/2014-15 dated 11/01/2016 (Id. CIT(A) in short) against the order of assessment passed u/s.143(3) of the Income Tax Act, 1961 (hereinafter referred to as Act) dated 07/03/2014 by the Id. Income Tax Officer-10(2)4, Mumbai (hereinafter referred to as Id. AO).

2. The only issue to be decided in this appeal is as to whether the Id CITA was justified in confirming the disallowance of interest u/s 36(1)(iii) of the Act on a proportionate basis in the facts and circumstances of the case.

3. The brief facts of this issue are that the assessee company is engaged in the business of manufacturing and trading of industrial fabrics, dipped nylons chafer fabrics and other fabrics. The Id AO observed that assessee had shown secured loan of Rs 13,43,00,000/- , working capital loan from banks at Rs 16,82,59,808/- and unsecured loans at Rs 5,28,28,541/- as on 31.3.2010 as against the opening balances of Rs 13,38,70,416/- , Rs 15,84,22,076/- and Rs 5,20,46,296/- as on 1.4.2009 respectively. The assessee had debited total finance cost in its profit and loss account amounting to Rs 4,91,91,557/- which includes interest paid to banks at Rs 3,66,24,468/- and interest paid to others at Rs 1,25,67,089/-. The Id AO on verification of schedule of loans and advances given by the assessee , observed that the assessee had shown other advances at rS 5,79,37,770/- as on 31.3.2010 as against Rs 8,19,38,063/- as on 1.4.2009. Accordingly, he came to the prima facie conclusion that the interest bearing funds were diverted by the assessee for non business purposes by giving interest free loans / advances to the following parties and resorted to make proportionate disallowance of interest :-

Name of party	Balance as on 31/03/2009	Balance as on 31/03/2010	Amt. Received/ given during the year	Disallowance proportionate interest @ 12%
Ajit G Mehta	9,87,589	9,87,589	-	1,18,511
Jitendra G Mehta	2,53,398	2,53,398	-	30,408
Mamta A Mehta	69,34,659	9,79,985	59,54,674	8,32,159

Mecords Leasing Finance Co. Ltd	1,96,737	1,96,737	-	23,608
Mehta Growell Holding	6,41,41,470	4,22,55,887	2,18,85,583	76,96,976
Neeta M Mehta	51,87,622 '	67,39,895	15,52,273	8,08,787
Total				95,10,449

3.1. The Id AO worked out the disallowance of interest by adopting a notional rate of 12% per annum on the higher of either the opening balance or the closing balance in respect of the aforesaid parties and arrived at the interest disallowance figure of Rs 95,10,449/-.

3.2. The assessee in response to show cause notice replied as under:-

a. Mehta Growell Holdings Ltd.

This is an advance towards purchase of property at Maval Taluka, Dist, Pune having survey no. 124/B. Copy of Memorandum of Understanding between Mehta Growell Holdings Ltd. & Mecords India Ltd. is enclosed for your reference.

b. Neeta Nitin Mehta

This is an advance payment towards purchase of flat. During the year Company has paid Additional Advance of Rs. 15,52,273/-

c. Mamta Ajit Mehta

This is an advance towards purchase of Shares. However she expired and accordingly the process of purchase was delayed and hence referred to as

advance.

d. Atul Desai - Rs,3,78.300/-

It is an advance against salary.

e. Mecords Leasing & Finance - Rs. 1,96,737/-

This is a Business advance.

Kindly appreciate that all the advances are for business purposes and as such question of disallowance of interest does not arise at all.

Further, we state that during the F.Y. 2009-10 and 2010-11 the Company has received interest - free funds particulars of which are of which are as follows:

1) AjitMahta	Rs.	6,86,005/-
2) Gopalds Mehta	Rs.	6,78,300/-
3) Jitendra Mehta	Rs.	6,26,370/-
4) Zubin Mehta	Rs.	6,50,348/-
5) Iswaryam Machineries	Rs.	37,43,797/-
6) Share Capital Money	Rs.	17,36,59,757/-

Without prejudice, we state that in view of the above interest free funds available with the company, no disallowance can be made in hands of the company.

3.3. The assessee further replied that in connection with the advance given to M/s Mehta Growell Holding Ltd, the same was towards purchase of property at Maval Taluka District, Pune, having Survey No. 124/B, in support of which, a copy of Memorandum of Understanding between Mehta Growell Holding Ltd and assessee was furnished. It was submitted that the completion of the development was delayed abnormally by Mehta

Growell Holding Ltd. The Id AO extracted the relevant portions of the said MOU in page 4 of his order. The Id AO rejected the contentions of the assessee that during the year the assessee had sufficient interest free funds at its disposal for making these interest free advances. The Id AO specifically pointed out that the share application money stated to be received during the year by the assessee was actually received in the sum of Rs 17,40,76,032/- during the financial year 2010-11. Hence assessee could not have used the said sum for making interest free advances to the aforesaid parties. The Id AO also observed that the advances given to Mehta Growell Holding Ltd towards purchase of immovable assets are capital in nature and held that the proportionate interest paid on borrowed funds should have been capitalized by the assessee to the cost of investment in immovable asset and not to be claimed as deduction. He observed that further opening and closing balance of Mehta Growell Holding Ltd and Mamta Mehta reflects reduced balance which clearly shows running account for giving and taking of interest free loans. This fact also shows that the assessee had no intention to purchase the property / shares as the assessee has received advance from these parties. He also placed reliance on the amendment brought in section 36(1)(iii) of the Act with effect from 1.4.2004 wherein the interest paid in respect of capital borrowed for acquisition of an asset for extension of business will not be allowed as deduction till the asset is first put to use. With these observations, the Id AO made proportionate disallowance of interest in the sum of Rs 95,10,449/- by holding that borrowed funds were diverted for non-business purposes.

4. The Id CITA upheld the action of the Id AO by observing as under:-

"5.5 I have considered the facts and circumstances of the case. The party wise merits in respect of the proportionate interest disallowances are being adjudicated as under:

i) Regarding interest free loans/advances given to Ajit G Mehta and Jitendra G Mehta ,no explanation was provided as to the purpose of these loans/advances at the time of assessment proceedings or during appellate proceedings. As the appellant has offered no explanation and no business connection being apparent, the proportionate disallowance of interest made by the Assessing Officer is confirmed.

ii) The amount given to Mamta A Mehta has been explained to be on account of advance for purchase of shares which process got delayed as she expired. Except for stating the aforesaid, no explanation has been offered as to how the advance for purchase of shares was necessitated by commercial expediency. There is nothing on record to indicate that the advance given for purchase of such shares was for strategic investment. The proportionate disallowance of interest made by the Assessing Officer in respect of this party is also confirmed.

iii) As regards the advances given to Mehta Growell Holdings Ltd. and Neeta Nitin Mehta, the same have been explained to be for the purpose of purchase of land and flat respectively. The appellant is in the business of manufacturing and trading of Industrial Fabrics, Dipped Nylons ,Chafar Fabrics and other Fabrics. It is not in the real estate business. Given this fact, the appellant's submission that the advances given for purchase of these immoveable properties were for business purposes is not acceptable. The only business connection would be if these immoveable properties were to be used for extension of existing business in which case also the proviso to section 36(1)(iii) would apply which specifically provides that" any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction." In the instant case also, the assets were yet to be put to use. Considering all these facts and provisions of law, the action of the Assessing Officer in making proportionate disallowance of interest in respect of the advances to these two parties is upheld.

iv) In respect of advance given to Mecords Leasing & Finance, it has simply been stated that it is a business advance. No details have been given as to how and in which manner it is a business advance. There is nothing on record to indicate that there are regular transactions with this party. The opening and closing balance of advance given to this party remain the same. No explanation has been given regarding future services expected

from this party. There is no apparent business connection and no explanation has been given as to how the advance given was necessitated by commercial expediency. Under the circumstances, the proportionate disallowance of interest made by the Assessing Officer in respect of this party is also confirmed.

5.6. The appellant had also submitted, alternatively, that as the appellant had at its disposal corresponding interest free advances received from various parties mainly comprising of share application money (amounting to Rs. 18.80 crores in aggregate) much exceeding above interest free advances made, no disallowance could be made in the hands of the appellant in this regard. I find that this contention of the appellant is at variance with the facts on record. Perusal of the appellant's Balance Sheet shows that as on 31/03/2009 (opening balance as on 01/04/2009) there was a balance of Rs. 8,19,38,063/- on account of advances as against share capital of Rs.5,99,00,000/- and negative balance of (-) Rs. 7,04,30,898/- in the Reserves and Surplus account. This shows that the appellant had nil interest free funds at its disposal at the time of making the advances of Rs. 8,19,38,063/-. The borrowed funds were, therefore, utilized for making advances which were not for the purpose of business as discussed in the foregoing para. The share application money was infused only in the F.Y. 2009-10 and that also in trickles starting from 01/10/2009 onwards only. The advances already stood given before the receipt of share application money when the appellant had no interest free funds at its disposal. In view of these facts, the appellant's alternative submission also fails and the ground of appeal on the issue of proportionate disallowance of interest is dismissed.”

5. Aggrieved, the assessee is in appeal before us.

6. We have heard the rival submissions and perused the materials available on record. We find that the preliminary argument made by the Id AR is that no disallowance of interest could be made on the funds borrowed in the earlier years and lying in opening balance as on 1.4.2009 when the said borrowings and utilization thereon were accepted as meant for business purposes in earlier years. Reliance in this regard has been rightly placed on the decision of Hon'ble Karnataka High Court in the case of CIT vs Sridev Enterprises reported in 192 ITR 165 (Kar) wherein it was held as under:-

“4. We are in agreement with the view expressed by the Tribunal. The status of the amount standing as outstanding due from Nalanda on the first day of the accounting year is the amount that stood outstanding on the last day of the previous accounting year; therefore, its nature and status cannot be different on the 1st day of the current accounting year, from its nature and status as on the last day of the previous accounting year. Regarding the past years, the assessee claims for deductions were allowed in respect of the sums advanced during those years; this could be, only on the assumption that those advances were not out of borrowed funds of the assessee. This finding during the previous years is the very basis of the deductions permitted during the past years, whether a specific finding was recorded or not. A departure from that finding in respect of the said amounts advanced during the previous year, would result in a contradictory finding; it will not be equitable to permit the revenue to take a different stand now, in respect of the amounts which were the subject-matter of previous years’ assessments; consistency and definiteness of approach by the revenue is necessary, in the matter of recognising the nature of an account maintained by the assessee so that the basis of a concluded assessment would not be ignored without actually reopening the assessment. The principle is similar to the cases where it has been held that a debt which had been treated by the revenue as a good debt in a particular year cannot subsequently be held by it to have become bad prior to that year.

6.1. It is not in dispute that the borrowings were made in earlier years and its utilization thereon in earlier years has been accepted as genuine and meant for business purposes in the earlier years. It is not in dispute that no disallowance of interest has been made in earlier years with regard to the said borrowings and utilization thereon. The Id AR stated that the assessments for the Asst Years 2007-08 to 2009-10 were completed u/s 143(1) of the Act and no proceedings were either initiated by the Id AO u/s 147 of the Act or by the Id CIT u/s 263 of the Act even after passing of the impugned assessment order for any of those years i.e Asst Years 2007-08 to 2009-10 to disturb the returns thereon. Hence the issue had become final for those asst years with regard to the allowability of interest paid on borrowed capital. In this regard, the Id DR vehemently argued that the Asst Year for which the decision of Hon’ble Karnataka High Court was rendered pertain to the periods where the Id AOs’ use to

apply their mind even while processing the return u/s 143(1) of the Act and a provision for making prima facie adjustments and consequential levy of additional tax u/s 143(1A) of the Act were also present in the statute. The Id DR argued that hence under those circumstances, once a return is accepted u/s 143(1) of the Act, it tantamounts to acceptance of the claim of the assessee by the Id AO after due application of mind. We are not inclined to accept to this argument of the Id DR in as much as the basis of selection of case for scrutiny was and is always vested with the wisdom of the revenue and it was and is never under the control of the assessee. In the instant case, even after framing the assessment for the Asst Year 2010-11 wherein the interest was disallowed in respect of borrowings made in earlier years, the revenue had not resorted to reopen the earlier years or revise the assessments for the earlier years in the manner known to law. We are equally afraid as to whether the Id DR would advance the same argument in the issue of reopening of assessments for those earlier years where return has been processed u/s 143(1) of the Act after due application of mind by the Id AOs' at that relevant point of time. If it be so, then the entire judicial decisions rendered by the Hon'ble Supreme Court and Hon'ble High Courts in the context of reopening would get completely defeated. Hence we are not inclined to accept the arguments of the Id DR in this regard. We find that the Id AR submitted that the amounts advanced to Neeta M Mehta alone had increased during the year. We find that with regard to amounts advanced to all other parties except Neeta M Mehta, the closing balance had only reduced when compared to the opening balance and hence there cannot be any disallowance of interest on the opening balance of loans advanced to parties as per the ratio laid down by the Hon'ble Karnataka High Court referred to supra.

6.2. We also find that similar decision was rendered by the Hon'ble Gujarat High Court in the case of Virendra R Gandhi vs ACIT in Tax Appeal No. 20 of 2004 with Tax Appeal No. 124 of 2005 dated 27.11.2014.

6.3. With regard to loan given to Neeta M Mehta during the year, we find that during the year , the assessee had advanced only a sum of Rs 15,52,273/- to the said party and we find that assessee is having sufficient own funds during the year in the form of current year profits before depreciation to the tune of Rs 4.24 crores. Hence it could be reasonably presumed that the amounts to Neeta M Mehta were advanced interest free out of own funds available with the assessee in the form of current year profits itself. Hence there cannot be any disallowance of interest u/s 36(1)(iii) of the Act on a proportionate basis even for the same.

6.4. In view of our aforesaid observations, we direct the Id AO to delete the disallowance of interest u/s 36(1)(iii) of the Act in the sum of Rs 95,10,449/- and allow the Ground No.1 raised by the assessee in this regard.

7. In the result, the appeal of the assessee is allowed.

Order pronounced in the open court on this 04/10/2019

Sd/-
(RAM LAL NEGI)
JUDICIAL MEMBER

Sd/-
(M.BALAGANESH)
ACCOUNTANT MEMBER

Mumbai; Dated 04/10/2019
KARUNA, sr.ps

Copy of the Order forwarded to :

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

//True Copy//

BY ORDER,

(Asstt. Registrar)
ITAT, Mumbai