

IN THE INCOME TAX APPELLATE TRIBUNAL  
“SMC - B” BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT

ITA No.1770/Bang/2019
Assessment year: 2016-17

Venkataram Nanjundaiah Sridhar, No.3027, 15 <sup>th</sup> Cross, 6 <sup>th</sup> Main, BSK 2 <sup>nd</sup> Stage, Bengaluru – 560 070. <b>PAN: ACKPS 1002L</b>	Vs.	The Income Tax Officer, Ward 7(2)(1), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Smt. Suman Lunkar, CA
Respondent by	:	Shri Ganesh R. Ghale, Standing Counsel for Dept.

Date of hearing	:	11.12.2019
Date of Pronouncement	:	20.12.2019

**ORDER**

This appeal by the assessee is against the order dated 26.6.2019 of the CIT(Appeals)-7, Bengaluru relating to assessment year 2016-17.

2. The assessee is an individual. His source of income is income from house property, income from business of a partnership firm of which he was a partner, interest income on loans & advances and deposits. In the return of income under the head ‘income from other sources’, the assessee declared a loss of Rs.16,76,696. The computation of income under the head ‘income from other sources’ was as follows:-

“Income from other sources

Saving Bank Interest received	76,081	
Interest received from Muktha Sridhar	25,66,000	
Interest on IT Refund		
Interest on FD	<u>42,722</u>	
	26,84,803	
Less: Interest paid on loan	<u>43,61,499</u>	(16,76,696)

3. It can be seen from the aforesaid computation that the assessee received interest from Muktha Sridhar (his wife) of a sum of Rs.25,66,000 against which the assessee claimed deduction of Rs.43,61,499 being interest paid. The factual details which are undisputed are that assessee borrowed a sum of Rs.5 crores from National Co-operative Bank. The assessee invested a part of this amount in the partnership firm, Prakash Tea Agency as capital. A part of interest paid on the borrowings from the National Co-operative Bank was claimed as a deduction under the head ‘income from business’ (to the extent of Rs.20,42,890) and allowed by the AO. The assessee lent a sum of Rs.2,55,00,000 out of a sum of Rs.5 crores borrowed from National Co-operative Bank to his wife, Mrs. Muktha Sridhar. She paid a sum of Rs.25,66,000 as interest to the assessee and this was declared as income under the head ‘income from other sources’. The total interest paid to National Co-operative Bank was a sum of RS.64,04,389, out of which a sum of Rs.20,42,890 was claimed as deduction under the head ‘income from business’. The remaining sum of Rs.43,61,499 was claimed as deduction against interest income received from Mrs. Muktha Sridhar. The loan from National Co-operative Bank of Rs.5 crores was availed on 26.10.2014 relevant to AY 2015-16 and opening balance in the aforesaid loan account as on 1.4.2016 was Rs.1,65,721.

4. On the above facts, the AO examined the claim of assessee for a deduction of sum of Rs.43,61,499 under the head 'income from business'. The aforesaid claim of deduction had to be examined under the parameters of section 57(iii) of the Income Tax Act, 1961 [the Act] which lays down that income from other sources shall be computed after making deduction of any other expenditure (not being in the nature of capital expenses) laid out or expended wholly and exclusively for the purpose of making or earning such income.

5. In the order of assessment, the AO has noticed the fact that deduction u/s. 57(iii) of the Act can be allowed only to the extent of interest income earned from Mrs. Muktha Sridhar and accordingly restricted the deduction of a sum of Rs.25,66,000. Consequently, the loss declared under the head 'income from other sources' stood reduced accordingly. Aggrieved by the action of the AO, the assessee preferred an appeal before the CIT(Appeals).

6. Before the CIT(Appeals), the assessee submitted that irrespective of the interest earned by the assessee, deduction u/s. 57(iii) of the Act cannot be restricted so long as the expenditure was incurred for the purpose of earning income under the head 'income from other sources' and in this regard placed reliance on the decision of Hon'ble Supreme Court in the case of *CIT v. Rajendra Prasad Moody, 115 ITR 519 (SC)* wherein it was held as follows:-

“What section 57(iii) requires is that the expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning income. It is the purpose of the expenditure that is relevant in determining the applicability of section 57(iii) and that purpose must be making or earning of income. Section 57(iii) does not require that this purpose must be fulfilled in order to qualify the expenditure for deduction. It does not say that the expenditure shall be deductible only if any income is made or

earned. There is in fact nothing in the language of section 57(iii) to suggest that the purpose for which the expenditure is made should fructify into any benefit by way of return in the shape of income. The plain natural construction of the language of section 57(iii) irresistibly leads to the conclusion that to bring a case within the section, it is not necessary that any income should in fact have been earned as a result of the expenditure.

Moreover when a profit and loss account is cast in respect of any source of income, what is allowed by the statute as proper expenditure would be debited as an outgoing and income would be credited as a receipt and the resulting income or loss would be determined. It would make no difference to this process whether the expenditure is X or Y or nil, whatever is the proper expenditure allowed by the statute would be debited. Equally, it would make no difference whether there is any income and if so, what, since whatever it be, X or Y or nil, would be credited. And the ultimate income or loss would be found. The expenditure which is otherwise a proper expenditure can cease to be such merely because there is no receipt of income. Whatever is a proper outgoing by way of expenditure must be debited irrespective of whether there is receipt of income or not. That is the plain requirement of proper accounting and the interpretation of section. 57(iii) cannot be different. The deduction of the expenditure cannot, in the circumstances, be held to be conditional upon the making or earning of the income.

It is true that the language of section 37(1) is a little wider than that of section 57(iii), but that can make any difference in the true interpretation of section 57(iii). The language of section 57(iii) is clear and unambiguous and it has to be construed according to its plain natural meaning and merely because a slightly wider phraseology is employed in another section which may take in something more, it does not mean that section 57(iii) should be given a narrow and constricted meaning not warranted by the language of the section and, in fact, contrary to such language.

Therefore, the interest on money borrowed for investment in shares, which had not yielded any dividend was admissible under section 57(iii).”

7. The CIT(Appeals), however, upheld the order of AO on the ground that the addition can be justified on the parameters laid down in section 40A(2)(b) of the Act as excessive and unreasonable payment made to a relative. The following were the relevant observations of the CIT(A):-

“5.3 The appellant has argued that for claiming deduction u/s 57 (iii), it is not necessary that income should have actually resulted and has cited various judicial decisions including *Rejendra Prasad Modi 115 ITR 519 (SC)*. In this case the Hon'ble HC has held that section 57(iii) requires that the expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning income. In the case of the appellant, an amount of Rs 2.55 crore was advanced to Mrs Mukta Sridhar out of total loan amount of Rs 5 crore from the Bank. Therefore, the interest expenditure attributable to advance amount of Rs 2.55 crore can only be said to have been laid out or expended wholly and exclusively for the purpose of making or earning income on the said advance amount. The assessee cannot claim deduction of entire interest payment to the Bank as deduction against the interest received on part of the loan amount advanced to Mrs Mukta Sridhar. Therefore, the proportionate interest amount attributable to the loan advanced to Mrs Mukta Sridhar being Rs 32,66,238/-, the appellant could not have claimed Rs 43,61,499/- as deduction u/s 57 of the Act. Further, since the loan from the Bank bearing higher rate of interest has been diverted by the appellant as advance to his wife at a lower rate of interest, the transaction with wife will come under the purview of section 40A(2)(b) of the Act. The appellant has paid interest to the bank at a higher rate than that charged from the wife. Therefore, onus lies with the appellant to show that the rate of interest charged from wife is not low or unreasonable. There is nothing on the record to explain or support the approach of the assessee to advance amount at lower rate to his wife when he borrowed the money from the Bank at a higher rate. Consequently, the claim of deduction of interest amount by the appellant has to be restricted to the amount of interest received from his wife Mrs Mukta Sridhar.

5.4 In the case of *Shatrunjay Diamonds 261 ITR 258* the Hon'ble Bombay HC has held that in case of transactions u/s

40A(2)(b) the onus of proving the reasonableness of the price is on the assessee. Reliance is also placed on following judicial decisions:

- i. *Prakash Engineering Works [2015] 54 taxmann.com (Calcutta HC)*
- ii. *S. M. Haq [2014] 46 taxmann.com 171 (Allahabad HC)*
- iii. *M.L.B.D. Books International [2009] 184 Taxman 276 (Delhi)*

5.5 In view of above. the disallowance of Rs 16,76,696/- made by the AO out of claim of interest expenses is to be upheld. This disallowance will be in addition to Rs 1,18,803/- by the AO on account of interest received from Savings Account and from FD with the Bank.”

8. Aggrieved by the order of CIT(Appeals), the assessee has preferred the present appeal before the Tribunal. I have heard the submissions of the Id. counsel for the assessee and the Id. DR.

9. The Id. counsel for the assessee besides reiterating the submissions made before the AO also placed reliance on the decision of the Hon'ble Karnataka High Court in the case of *CIT v. Sridev Enterprises, 192 ITR 165 (Kar)*. In the aforesaid case, the issue was with regard to disallowance of interest u/s. 36(1)(iii) of the Act. The case pertained to AY 1978-79. As on the first day of the relevant assessment year, there was an opening balance of loan and on the aforesaid opening balance in the earlier assessment year, deduction on account of interest was allowed u/s. 36(1)(iii) of the Act. For AY 1978-79, disallowance of interest u/s. 36(1)(iii) was made on borrowings during the previous year relevant to AY 1978-79 as also the opening balance. The Hon'ble Karnataka High Court held that since the opening balance was already accepted as a loan borrowed for the purpose of business and allowed in the earlier assessment year, no disallowance of the opening balance can be made in the AY 1978-79. When this decision was cited, a specific query was put to the assessee as

to whether in the year in which the loan was given, deduction was allowed in the hands of assessee in assessments concluded u/s. 143(3) of the Act. The Id. counsel for the assessee expressed her inability to furnish the required details. In such circumstances, I am of the view that the assessee cannot take the benefit of the decision of the Hon'ble Karnataka High Court cited by her.

10. The Id. DR placed reliance on the decision of Bangalore Bench in the case of *M.J. Aravind v. JCIT, ITA No.1991/Bang/2016 for AY 2012-13, order dated 20.4.2018*. We have examined the aforesaid decision and find that the decision rendered in the case of *Rajendra Prasad Moody (supra)* was considered, but the finding of fact is that the assessee did not show with evidence that the expenditure claimed by her as deduction was incurred for the purpose of earning income which was charge able to tax under the head 'income from other sources' (vide para 9 & 10 of the aforesaid order). In view of the above, the decision cited by the Id. DR is not of any relevance to the facts of the present case.

11. In the present case, there has been no dispute with regard to the borrowing of funds by the assessee from National Co-operative Bank of Rs.5 crores and using the said amount to give loan to Mrs. Muktha Sridhar to his wife to the extent of Rs.2.55 crores. I am therefore of the view that to the extent interest is paid to National Co-operative Bank of Rs.2.55 crores of amount borrowed, deduction has to be allowed while computing income of the assessee under the head 'income from other sources'. The proportionate interest has been quantified by the CIT(Appeals) in his order at Rs.32,66,238 and to this extent, I am of the view that deduction should be allowed, even though the said deduction is over and above the income that the assessee earned by lending money borrowed to his wife, Mrs. Muktha Sridhar. I am also of the view that the action of the CIT(Appeals) in sustaining the disallowance u/s. 40A(2)(b) of the Act is not correct because

there is no provision similar to section 40A(2)(b) of the Act in the computation of income under the head 'income from other sources'.

12. In view of the above, I am of the view that deduction u/s. 57(iii) of the Act claimed by the assessee at Rs.43,61,499 should be allowed to the extent of Rs.32,66,238. I hold and direct accordingly and accordingly allow the appeal of assessee in part.

13. In the result, the appeal of the assessee is partly allowed.

Pronounced in the open court on this 20<sup>th</sup> day of December, 2019.

Sd/-  
( N V VASUDEVAN )  
VICE PRESIDENT

Bangalore,  
Dated, the 20<sup>th</sup> December, 2019.

*/Desai S Murthy /*

Copy to:

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

By order

Assistant Registrar  
ITAT, Bangalore.