

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

**BEFORE SHRI MAHAVIR SINGH (VICE PRESIDENT) AND
SHRI S. RIFAUR RAHMAN (ACCOUNTANT MEMBER)**

**ITA No. 5132/MUM/2018
Assessment Year: 2013-14**

Mr. Ravi Goenka,
15, Shirin Chambers, 348/50,
Samuel Street, Vadgadi,
Mumbai-400 003.

Vs. Asst. Commissioner of Income Tax,
Circle 17(3),
Room No. 137, 1st floor,
Aayakar Bhavan, M.K. Road,
Mumbai-400020.

**PAN No. AACPG 9107 E
Appellant**

Respondent

Assessee by : Mr. Shekhar Gupta, AR
Revenue by : Mr. Bharat Andhale, DR

Date of Hearing : 12/07/2021
Date of pronouncement : 05/10/2021

ORDER

PER S. RIFAUR RAHMAN, A.M.

The present appeal filed by the assessee is against the order of Commissioner of Income Tax (Appeals)-28, Mumbai [in short 'CIT(A)'] for the assessment year 2013-14 dated 20.07.2018 and arises out of assessment completed u/s 143(3) of the Income Tax Act, 1961 (in short the Act).

2. Brief facts of the case are the assessee filed return of income declaring total income of Rs.2,05,68,430/- on 16.09.2013. The return was processed u/s 143(1) of the Income Tax Act, 1961 (in short 'the Act'). Subsequently, the case was selected for scrutiny under CASS and notices u/s 143(2) and 142(1) of the

Act were issued and served on the assessee. In response the AR of the assessee filed the relevant information as called for.

During the assessment proceedings, the Assessing Officer observed the computation of income under the head Income from business as under :

Sr. No.	Particulars		
1.	Profit Before tax as per Profit and Loss Account	51,235	
	Less : Any other exempt Income	(98,433)	(47,198)
2.	Profit from Firm : M/s Ramanand Kidarnath International		
	Remuneration	1,29,32,962	
	Interest	87,87,718	
	Profit	50,55,951	
	Less : Interest		
	Interest on SVC T/C 242	6,94,387	
	Interest Paid to Aqua Steel	1,80,000	
	Interest Paid to Park Tools Ltd.	1,20,000	
	Reha Goenka	1,47,892	
	Shreya	1,69,758	13,12,037
	Less: Profit Exempt u/s 10(2A)	50,55,951	2,04,08,643
	Profit and Gains from Business and profession		2,03,61,445

3. From the above computation, he observed as below:

“4.1 It can be observed from the above computation that the assessee has adjusted the interest paid on Loan to his income from firm. It is a clear proposition in Income tax Act. 1961 that only those expenditures can be allowed as deductions, which are used for business purposes. Here, the assessee has two types of business income- one is his income from trading in shares and another is his share of profit firm, interest on capital and remuneration from firm. The assessee in his various submissions has admitted that he has advanced the borrowed money to the firm which means he has not used this money in his business activity of trading in shares. Therefore, the interest paid on these borrowed funds cannot be adjusted against the income from trading in shares. The questions which remain now are firstly can the assessee adjust such interest paid against the income from firm and secondly, if at all, can the differential amount between interest paid to bank and interest received from firm can be treated his income.

4.1.1 To seek clarification on the first question, a show cause notice vide e-mail dtd. 14.12.2015 was issued to assessee. The assessee replied vide letter dtd. 25th Jan, 2016, the relevant portion of which is reproduced hereunder "As regards interest, we have already submitted our explanation that the borrowing by the assessee was for and on behalf of the firm and as such no part of the interest paid to be disallowed".

From the submissions filed by the assessee on record, it is observed that -

A) Though, the assessee has borrowed funds but the funds have been enjoyed by the firm. For the purpose of income tax act, partner and firm, both are separate legal entities. Therefore, at best, if a deduction is to be taken, should be taken by the firm and that too if the firm has paid interest on the "same" funds to partner. Here, the assessee has received interest from firm to the tune of Rs.87,87,718/- on partner's capital. However, he could not prove beyond doubt that the interest received from firm and treated as business income is on the "same" fund which was borrowed by assessee and used by firm.

B) The nature of the funds given to firm is also of high significance. If the assessee introduces the borrowed fund as capital and receives interest on it from the firm as his business income, then the interest paid on it makes it a case for taking deduction from the interest received. However, From the submissions made by the assessee, it is observed that the capital of the assessee was Rs.8,14,44,624/- as on 31/03/2013 and the interest received by the partner from the firm was Rs.87,87,718/-. The partnership deed submitted by the assessee in the case of firm mentions that the interest on capital shall be provided at the rate of 12% which comes to Rs.97,73,354/-. This means that the interest paid by firm on capital is itself less than what it should have been, so there is no question of the amount of Rs.87,87,718/- having included the amount of interest on funds extended by the partner to the firm. Also, the assessee during the course of hearing could not prove that he has received any amount of interest on funds extended to the firm whereas he is claiming the interest as deduction on the same amount in his computation of income. Further, the P&L account submitted by the firm has separate head for interest paid on partners' capital and interest paid on other loans. There also, it is not mentioned that any amount of interest other than the interest on capital has been paid by the firm to the partner. Therefore, it is clear that the firm has not paid any

interest on funds taken from partner other than capital, which means the partner has not received any business income against the borrowed funds on which the deduction is claimed.

In view of the above discussion, it is clear that the assessee has not shown the borrowed funds as his capital rather these are interest free loans given to firm and hence claim of such deduction of the interest on such borrowed funds, from business income is repudiated and an amount of Rs.13,12,037/- is added to the Total income of the assessee.

4.1.2 To seek clarification on the second question, assessee was shown caused vide letter dated 14/12/2015 as to "Interest paid on loan taken from SVC bank is at 14% wherein interest received is at 12%. Why the difference should not be disallowed" In reply, the assessee made submissions dated 21st December, 2015, the relevant part of which is reproduced here -

"With reference to the disallowance of difference in interest of 2% on loan taken from SVC Bank at 14% and given to the firm M/s. Ramanand Kidernath International at 12%, we have to state that the assessee has borrowed funds from the bank and given to M/s Ramanand Kidernath International because the bank limits for the firm has been exhausted and firm could not take loan and hence the assessee had taken loan and given to the firm which has been proved by furnishing the bank statement. Now as per section 40(b) of the Income Tax Act, a firm cannot pay interest to its partner more than 12% but since the funds have been used by the firm, the actual amount of interest paid to the bank should be allowed. We have to further submit that the firm is not an independent entity but only a compendious name given to partnership for convenience. Partners are real owners of the assets of the firm. (Hon'ble Supreme Court in the case of N. Khandervali Saheb and Another vs. Guddu Sahib (Decd.) and Others 261 ITR 1) (Copy enclosed) Borrowing by the assessee has been made on behalf of the firm and the borrowed funds were transferred to the firm.

Assessee's reply has been carefully considered. Without prejudice to the discussion in para 4.1.1, even if we assume that the assessee has earned interest @12%, he has invested the interest bearing fund @14% in the firm. Therefore, without prejudice

to addition made under para 4.1.1 supra, an addition of Rs.99,198/- is made to the total income of the assessee.”

4.2 Without prejudice to the above discussion, even if assessee's contention is accepted that since the borrowed funds have been used by the firm and the deduction of interest on them should be allowed, it is also to be noted that the assessee has earned Rs.50,55,951/- as profit from firm which is claimed as exempt and the interest on borrowed funds is being claimed by him as expenditure. Therefore, the firm and partner being two separate legal entities for the purpose of Income Tax Act, it amounts to claiming an expenditure against exempt income which would attract provisions of section 14A in the light of Goderj Soaps & Boyce Ltd. In this regard, the assessee was show caused by letter dated 14/12/2015 as to "Interest expenditure has been claimed in computation against the income from partnership firm which is exempt. In such a case why disallowance u/s 14A should not be made." In reply the assessee submitted his response vide letter dated the relevant portion of which is reproduced here "With reference to the query raised by your goodself regarding disallowance us 14A on interest expenses, we have to state that the amount of loan borrowed by the assessee has been lent to Ms. Ramandnd Kidernath International on which interest has been earned. The assessee has capital of Rs. 9.52 Crores and the investment in the firm is Rs. 8.14 Crores as on 31.03.2013. No part of the borrowed funds from others has been used for the purpose of investment in shares. The details of interest paid are as under:

Sr. No.	Interest to	Amount (₹)
1.	Shamrao Vithal Co-Op. Bank Ltd	6,94,387
2.	Aqustel Water Purification Systems P. Ltd	1,80,000
3.	Park Tools Ltd	1,20,000
4.	Reha Goenka	1,47,892
5.	Shreya	1,69,758

With reference to interest to Shamrao Vithal Co-op. Bank Ltd and Aqustel Water Purification Systems P. Ltd. and Park tools Ltd. we are enclosing herewith the bank statement wherein it is proved that the money borrowed has been given to M/s. Ramanand Kidernath International immediately. The assessee has taken loan of Rs. 15 lakhs from Aqustel Water Purification Systems P. Ltd. on 20-05-2008 and lent to M/s.

Ramanand Kidernath International on 21-05-2008, from park tools Ltd Rs.6 lakhs on 30-06-2008 and Rs. 4 lakhs on 01-07-2008 and lent to Ms. Ramanand Kidernath International on 01-07-2008 and 02-07-2008 respectively and borrowed Rs. 75 lakhs from Shamrao Vithal Co-op Bank Ltd on 28-06-2012 and lent to Ms. Ramanand Kidernath International on 29-06-2012. Hence, the money which has been borrowed on which interest has been paid have been lent to Ms. Ramanand Kidernath International on which interest has been earned.

Further, with reference to interest paid to Rhea Goenka and Shreya Goenka, the same is added wis 64 being minors. Here also the funds taken are given to M/s. Ramanand Kidernath Internation on which interest is earned and hence since no borrowed funds have been used to purchase the shares, section 14A does not apply.

Further, we would like to draw your attention to the decision of Hon'ble ITAT Mumbai I Bench in the case of DCIT vs. Ms. India Advantage Securities Ltd. ITA No. 671/Mum/2011 (copy enclosed) held that "in case of trading in shares, no disallowance u/s 14A can be made." The same has been upheld by the Hon"ble Bombay High Court."

The assessee's contentions have been dispassionately considered. However, going by his own submission, it is observed that the funds borrowed by the assessee have been actually used by the firm, the profit from firm is claimed as exempt. The contention that the exempt amount has already been taxed in the hands of firm and is actually not exempt, is not acceptable on two grounds-

A) The firm and partners are two separate legal entities for the purpose of Income Tax Act and therefore taxability of any income and tax liability thereupon is to be decided independent of the each other depending upon the facts and circumstances of the case. In this regard, the position has also been clarified by THE ITAT AHMEDABAD BENCH (SPECIAL BENCH) in the case of Vishnu Anant Mahajan vs. Assistant Commissioner of Income-tax, Circle 5, Baroda, wherein the Hon'ble tribunal held that share income of a partner from firm has to be excluded from his total income liable to tax and in such a situation, provision contained in

section 14A will come into operation and any expenditure incurred in earning said share income has to be disallowed.

B) If the assessee's contention that "the exempt amount has already been taxed in the hands of firm and is actually not exempt", is accepted then by this logic even the dividend income claimed as exempt by the share/fund holders should not attract the provisions of section 14A because the companies/funds have already paid Dividend Distribution Tax on that income and thus the section itself should become redundant and ultra vires, but the validity of the section has been upheld by Bombay High Court in the case of Godrej and Boyce.

Also, there have been number of judicial pronouncements upholding the applicability of section 14A in respect of dividend income. Few of them are quoted below-

- Smt. Leena Ramachandran [(2011) 339 ITR 296 (Ker)]
- Technopack Advisors P Ltd [(2012) 50 SOT 31 (Delhi)(URO)]
- Relaxo Footwear Ltd [(2012) 50 SOT 102 (Delhi)]
- Cheminvest Ltd {121 ITD 318 2009 (DEL)}
- Yogesh J Shah [(2010)(46 SOT 183) (Mum) (URO)]

Therefore, in the light of the above discussion the undersigned is satisfied as per section 14A (3) that the expenditure in relation to the exempt income has not been correctly disallowed by the assessee and it is to be disallowed as per Rule 8D.

For the calculation purpose, it is to be considered that the assessee himself has admitted that the borrowed funds have been used by firm and as the profit from the firm has been claimed as exempt by the assessee, the interest expenditure claimed by the assessee is a direct expenditure claimed in relation to the business income within the ambit of Rule 8D (i). In the light of this fact, the calculation of expenditure disallowed as per section 14A, is as follows –

Section	Details		Rupees
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8D(2) (i)	Expenditure directly related to exempt income		13,12,037/-
8D(2)(ii)	A X B/C A = Interest B = Opening + closing investment/2 C= Opening total assets + closing total asset/2		Nil
8D(2)(iii)	½ % of average investment		Nil
		Total	13,12,037/-

4. Aggrieved with the above order, the assessee preferred an appeal before the Ld. CIT(A) and filed detailed submission, the Ld. CIT(A) after considering the submissions of the assessee sustained the addition made by the Assessing Officer as per Rule 8D(2)(i) of the Income Tax Rules, 1962 (in short 'the Rules').

5. Aggrieved with the above order, the assessee in appeal before us raising following grounds of appeal :

1. *The Ld. CIT(A) has erred in law on the facts of the case in sustaining the disallowance of interest Rs.13,12,037/- u/s 14A of the Income Tax Act paid by the assessee.*
2. *The Ld. CIT(A) has erred in law and on the facts of the case in sustaining the disallowance of interest paid to the assessee's minor children whose income is already clubbed with the income of the assessee u/s 64 of the Act.*
3. *The Ld. CIT(A) has sustained the disallowance of interest without considering the decision of the Special Bench in the case of Vishnu Mahajan wherein the Special Bench held that expenditure proportionate to the exempted income should be disallowed.*

6. Before us, the Ld. AR brought to our notice the observation of the Assessing Officer at page 2 of the order and he submitted that the capital of the assessee is Rs.9.32 crores whereas investment in the firm is Rs.8.14 crores as on 31.03.2013. He submitted, it clearly indicates that the assessee has not utilized the borrowed funds for the purpose of investment in shares. He relied on the

decision of *CIT v. HDFC Bank Ltd.* [2014] 366 ITR 505 (Bom). Further, he submitted that the Assessing Officer relied on the case of *Vishnu Anant Mahajan v. ACIT* (2012) 147 TTJ (Ahd)/(SB) 142 which is distinguishable to the facts of the present case.

7. On the other hand, the Ld. DR relied on the orders of lower authorities.

8. Considered the rival submissions and material on record. We noticed from the records submitted before us that the assessee has computed the income from business as under :

Sr. No.	Particulars		
1.	Profit Before tax as per Profit and Loss Account	51,235	
	Less : Any other exempt Income	(98,433)	(47,198)
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	Interest Paid to Park Tools Ltd.	1,20,000	
	Reha Goenka	1,47,892	
	Shreya	1,69,758	13,12,037
	Less: Profit Exempt u/s 10(2A)	50,55,951	2,04,08,643
	Profit and Gains from Business and profession		2,03,61,445

8.1 From the above, we noticed that the assessee is a partner of the firm M/s Ramanand Kidarnath International and earned interest income from the firm and also received share of profit to the extent of Rs.50,55,951/-. The same was claimed by the assessee as exempt. However, the assessee also claimed interest expenditure against the remuneration and interest income earned by the assessee from the firm to the extent of Rs.13,12,037/-. The Assessing Officer treated the above interest expenditure as disallowable u/s 14A r.w.s. 8D(2)(i).

After careful consideration of the case we noticed that the assessee has borrowed certain funds for the purpose of business and transferred the same to the firm. There is no doubt that this is an expenditure to the assessee. There are only two source of income i.e. first income from the firm and second is trading in shares. From the records submitted before us and even the Assessing Officer observed that the assessee has not utilized the borrowed funds in share business. It is fact on record that the assessee has earned remuneration and interest income from the firm and these are chargeable to tax. As per the submissions of the assessee, the assessee has utilized the loan taken for the purpose of firm. Even in case the AO rejected the contention of the assessee still the interest paid by the assessee is an expenditure for the assessee and assessee can claim this expenditure independently. From the assessment order, we noticed that the Assessing Officer disallowed the interest just because the assessee has utilized the borrowed fund in the firm.

8.2 From the balance sheet submitted before us, we noticed that the assessee has own funds by way of capital is Rs.9.52 crores and borrowed funds from other to the extent of Rs.2.4 crores. Whereas, the assessee has invested Rs.8.4 crores in M/s. Ramanand Kidernath International and balance funds were invested in various land and building properties and in some stock of shares. From the above balance sheet it is not individually identifiable how the own funds were utilized by the assessee. It is not possible to identify whether the assessee has fully introduced the capital in the firm or utilized certain own funds in the properties. It is fact that the assessee has borrowed certain funds and utilized the same in the firm. In our considered view, the assessee has duly earned the interest income from the firm and also incurred interest expenditure on the

funds utilized for the purpose of the business. Therefore, the assessee is eligible to claim the above expenditure independently against the income earned by the assessee. It is important to note that the earning of interest income is restricted by the provision of section 40(b) whereas assessee has to incur interest expenditure as per agreement with the lenders. The source of interest income from the firm is not exempt. Therefore, it is not proper on the part of Assessing Officer to add the difference of interest over and above paid by assessee as expenditure directly related to exempt income. The AO cannot penalize the assessee simply for the reason that assessee cannot claim more than the restricted interest as per section 40(b) of the Act. Otherwise, assessee would have claimed the same interest paid by him to the lenders. Therefore, the interest paid to the firm is not exempt and chargeable to tax. The interest expenses incurred by the assessee is adjustable against the interest income as a separate source of income. It is not proper on the part of AO to treat the interest expenditure with the exempt income from the firm. Therefore, the ground No. 1 raised by the assessee is allowed.

8.3 Ground Nos. 2 & 3 are consequential in nature. Accordingly, the ground Nos. 2 & 3 are not adjudicated.

9. In the result, the appeal filed by the assessee is partly allowed.

Order pronounced in the open Court on 05/10/2021

Sd/-
(MAHAVIR SINGH)
VICE PRESIDENT

Sd/-
(S. RIFAUR RAHMAN)
ACCOUNTANT MEMBER

Mumbai;
Dated: 05/10/2021

Rahul Sharma, Sr. P.S.

Copy of the Order forwarded to :

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

//True Copy//

BY ORDER,

(Dy./Assistant Registrar)
ITAT, Mumbai