

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "SMC", MUMBAI**

**BEFORE SHRI OM PRAKASH KANT, ACCOUNTANT MEMBER
AND
SHRI AMARJIT SINGH, JUDICIAL MEMBER**

**ITA No. 7032/MUM/2019
Assessment Year: 2014-15**

Deepak Nagindas Shah, 506-B, Walkeshwar Chandanwala CHS Ltd. 4, r. R. Thakkar Road, Walkeshwar, Mumbai - 400006 PAN: AAQPS1861H	Vs.	ACIT, Circle – 19(1), 2 nd Floor, Matru Mandir, Tardeo Road, Mumbai - 400007
(Appellant)		(Respondent)

Assessee by : Mr. Suchek Anchaliya (AR)

Revenue by : Ms. Rajni Roy (DR)

Date of Hearing : 02/12/2021

Date of Pronouncement: 22/12/2021

ORDER

PER OM PRAKASH KANT, AM

This appeal by the assessee is directed against order dated 30/09/2019 passed by the learned Commissioner of Income-tax (Appeals)-52, Mumbai [in short the Ld. CIT(A)] for assessment year 2014-15, raising following grounds:

1. *“On the facts and circumstances of the Appellant case and in law the Learned Commissioner of Income Tax (Appeals) erred in confirming the addition of Rs. 34,64,023/- on account of disallowance of interest paid.*
2. *On the facts and circumstances of the Appellant case and in law the Learned Commissioner of Income Tax (Appeals) failed to appreciate that business income is taxable income and not tax free income.*

3. *On the facts and circumstances of the Appellant case and in law the Learned Commissioner of Income Tax (Appeals) failed to appreciate that it is not mandatory to have positive business income to claim expenses.*
4. *On the facts and circumstances of the Appellant case and in law the Learned Commissioner of Income Tax (Appeals) failed to appreciate that all borrowed money is deployed in Partnership Firm to earn business income.*
5. *On the facts and circumstances of the Appellant case and in law the Learned Commissioner of Income Tax (Appeals) failed to appreciate that business income cannot be bifurcated that part of business income is taxable and part is tax free.*
6. *On the facts and circumstances of the Appellant case and in law the Learned Commissioner of Income Tax (Appeals) failed to appreciate that the appellant has earned Rs. 1,41,59,155/- as business income from M/s Ritesh Exports which is significantly higher than the interest expenses claimed.*
7. *On the facts and circumstances of the Appellant case and in law the Learned Commissioner of Income Tax (Appeals) failed to appreciate that entire share investment has been made out of appellant's own capital and as such disallowance made u/s 14A r.w.r. 8D to the tune of Rs. 32,33,963/- is bad in law.*
8. *The Appellant craves leaves to add, alter, amend, withdraw or modify any or all grounds of appeal, each of which are without prejudice to one another."*

2. Briefly stated facts of the case are that the assessee is a partner in firm M/s 'Ritesh Exports' along with partner in other 6 (six) firms. The assessee filed return of income for the year under consideration on 08/07/2015 declaring total income of rupees nil. The return of income filed by the assessee

was selected for scrutiny assessment and statutory notices were issued and complied with. In the assessment completed under section 143(3) of the Act on 06/12/2016, the Assessing Officer made disallowance of ₹ 34,64,023/- out of interest paid for money borrowed and disallowance of ₹ 7,21,341/- in terms of section 14A read with Rule 8D of Income -tax Rules,1962 (in short the 'Rules'). The Id. CIT(A) also upheld the disallowances. Aggrieved, the assessee is in appeal before the Income-tax Appellate Tribunal (in short 'the Tribunal'), raising the grounds as reproduced above.

3. Before us parties appeared through videoconferencing facility. The assessee filed a paper book containing pages 1 to 13.

4. In ground Nos. 1(one) to 6 (six) of appeal, the assessee has challenged disallowance of Rs. 34, 64, 023/- sustained by the Ld. CIT(A). The facts in brief qua the issue in dispute are that in the return of income the assessee has shown consolidated loss of ₹ 23, 29, 925/- under the head 'profit and gains of the business' from seven partnership firms. While computing profit from M/s 'Ritesh Exports', the assessee has considered share of profit of ₹ 1,41,59,155/- as exempted u/s 10(2A) of the Act, whereas against interest income of Rs.17, 60,000/- claimed deduction of interest expenditure of ₹ 52,24,023/-. The Assessing Officer observed that assessee has borrowed funds at the interest rate of 9% per annum, whereas very nominal interest of ₹ 17,60,000/- had been earned from loan to the partnership firm on opening capital of ₹ 927.28 lakhs which was reduced to ₹ 848.68 at the year end. In view of the observations, the Assessing Officer concluded that assessee has diverted interest-bearing funds at the rate of 9% per annum for the purpose of

giving loan to its related concern M/s 'Ritesh Exports' at very nominal rate and therefore, he disallowed the difference in interest paid (Rs, 52,24,023/-) and interest received (Rs. 17,60,000/-) which amounted to ₹ 34,64, 023/-.

5. Before the Ld. CIT(A), the assessee claimed that borrowed money was deployed for running business income, however the Ld. CIT(A) confirmed the disallowance observing as under:

“5.3 The contentions of the assessee have been duly considered. It is observed that the assessee has borrowed substantial funds @ 9% p.a. and the total interest expenditure claimed is of Rs.52,24,023/-. There is no dispute that the assessee has charged a very nominal rate of interest on the loan given to its related concern, M/s Ritesh Exports considering that the gross interest received is of only Rs.17 60,000/though the opening balance of the loan given is of Rs.927.28 lacs and the closing balance of loan is Rs.848.68 lacs. Thus, the AO has rightly held that the assessee _has diverted his interest bearing funds @ 9% for the purpose of giving loans to its related concern, M/s. Ritesh Exports at a very nominal rate. As regards t e contention of the assessee that he has also earned share of profit of Rs. 1,41,59,155/on his investment in M/s. Ritesh Exports and which should also be considered while computing the disallowance out of interest, it is held that the contention cannot be accepted since, share of profit is not taxable in the hands of the assessee. In view of such a factual position, no infirmity is found in the action of the AO of disallowing an “amount of Rs.34,64,023/being the difference between the interest paid of Rs.52,24,023/and interest received of Rs.17,60,000/-. Accordingly, Ground Nos.1 to 6 of the appeal are dismissed.”

6. We have heard rival submission of the parties and perused the relevant material on record. It is undisputed that assessee has invested borrowed

money in partnership firm as capital contribution. The issue in dispute before us is whether the assessee is allowed to claim deduction of interest paid in excess of interest earned from said investment as capital contribution. There is no doubt that assessee has borrowed the money at the rate of 9% per annum, whereas a nominal amount of ₹ 17,60,000/- has been earned on capital invested in the partnership having opening capital of ₹ 927.28 lakhs and closing balance of ₹ 848.68 lakhs. The disallowance made by the Assessing Officer falls under section 36(1)(iii) of the Act according to which amount of interest paid in respect of capital borrowed for the purpose of the business or profession shall be allowed while computing the income under the head 'profit and gains of the business' except where the capital is borrowed for acquisition of the asset. The Hon'ble Supreme Court in the case of **SA builders Ltd vs. CIT reported in 288 ITR 1 (SC)** has held that interest claimed on money borrowed against interest-free advances to related concern is allowable if same is advanced under business expediency. The relevant finding of Hon'ble Supreme Court is reproduced as under:

"It is true that the borrowed amount in question was not utilized by the assessee in its own business, but had been advanced as interest free loan to its sister concern. However, in our opinion, that fact is not really relevant. What is relevant is whether the assessee advanced such amount to its sister concern as a measure of commercial expediency. Learned counsel for the Revenue relied on a Bombay High Court decision in Phaltan Sugar Works Ltd. Vs. Commissioner of Wealth-Tax (1994) 208 ITR 989 in which it was held that deduction under Section 36(1)(iii) can only be allowed on the interest if the assessee borrows capital for its own business. Hence, it was held that interest on the borrowed amount could not be allowed if such amount had been advanced to a subsidiary company of the assessee. With respect, we

are of the opinion that the view taken by the Bombay High Court was not correct. The correct view in our opinion was whether the amount advanced to the subsidiary or associated company or any other party was advanced as a measure of commercial expediency. We are of the opinion that the view taken by the Tribunal in Phaltan Sugar Works Ltd (supra) that the interest was deductible as the amount was advanced to the subsidiary company as a measure of commercial expediency is the correct view, and the view taken by the Bombay High Court which set aside the aforesaid decision is not correct.

Similarly, the view taken by the Bombay High Court in Phaltan Sugar Works Ltd. vs. Commissioner of Wealth-Tax (1995) 215 ITR 582 also does not appear to be correct.

We agree with the view taken by the Delhi High Court in CIT vs. Dalmia Cement (Bhart) Ltd. (2002) 254 ITR 377 that once it is established that there was nexus between the expenditure and the purpose of the business (which need not necessarily be the business of the assessee itself), the Revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the board of directors and assume the role to decide how much is reasonable expenditure having regard to the circumstances of the case. No businessman can be compelled to maximize its profit. The income tax authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. The authorities must not look at the matter from their own view point but that of a prudent businessman. As already stated above, we have to see the transfer of the borrowed funds to a sister concern from the point of view of commercial expediency and not from the point of view whether the amount was advanced for earning profits.”

7. In the instant case, the assessee has invested funds bearing interest rate of 9% per annum into partnership firm as capital contribution and earned interest at the rate prescribed in partnership deed. In such circumstances, it cannot be disputed that money has been advanced for the purpose of the business expediency. Thus, respectfully following the ratio laid down in the case of **SA Builders Limited (supra)**, we are of the opinion that no

disallowance of interest could be made in the case of the assessee as money has been advanced for the purpose of the business expediency of the assessee. The respective grounds raised by the assessee are accordingly allowed.

8. In ground No. 8 of the appeal that the assessee has challenged effective disallowance of ₹ 7,21,341/- in terms of section 14A read with Rule 8D(2)(iii) of the Rules, which has been sustained by the Id. CIT(A).

9. Briefly stated facts qua the issue in dispute are that the Assessing Officer observed substantial investment of ₹ 1,66, 53,749/- by the assessee which resulted into exempted income and therefore invoking section 14A , the Assessing Officer computed disallowance under Rule 8D(2)(ii) of ₹ 25, 12, 622/-and under rule 8D(2)(iii) of ₹ 7, 21, 341/-. However, according to the Assessing Officer interest expenditure of ₹ 34,64,023/- had already been considered for disallowance out of interest expenditure, he restricted disallowance to only ₹ 7,21, 341/-. The Ld. CIT(A) upheld the disallowance observing as under:

“6.3 Contentions of the assessee have been duly considered. It is observed that the AO had computed the total disallowance u/s.14A to be of Rs.34,64,023/which comprised of disallowance under Rule 8D(2)(ii) of _ Rs.25,12,622/and disallowance under Rule 8D(2)(iii) of Rs.7,21,341/-. However, since the AO had already considered an amount of Rs.34,64,023/for disallowance out of interest expenditure on account of diversion of interest bearing funds @ 9% p.a. for the purpose of giving loans to M/s. Ritesh Exports at a very nominal rate, the AO did not make any further disallowance out of interest as per Rule 8D(2)(ii) and restricted the disallowance u/s.14A to Rs.7,21,341/as per Rule 8D(2)(iii). Since the AO has not made any

disallowance u/s.14A r.w.Rule 8D(2)(ii) out of the interest expenditure, the contention of the assessee that the no interest bearing funds have been used for the purpose of its exempt investments is not relevant at all. Moreover, it is observed that the assessee has earned dividend income of Rs.2 77 155/in the relevant year and therefore as per the decision of the Hon'ble ITAT Special Bench, Delhi in the case of Vireet Investments P. Ltd. (82 taxmann.com 415), disallowance is required to be made as per Rule 8D(2)(iii) in respect of the indirect expenses. Accordingly, no infirmity is found in the action of the AO of making the said disallowance u/s.14A of Rs.7,21,341/as per Rule 8D(2)(iii). Accordingly, Ground No.7 of the appeal is dismissed”.

10. We have heard rival submission of the parties on the issue in dispute and perused the relevant material on record. The disallowance has been made by the AO under section 14A read with Rule 8D of Rules. The section 14A(1) prescribe not allowing deduction of expenditure related to exempted income. The section 14A(2) prescribe how the said expenditure relatable to exempted income can be apportioned out of the expenditure claimed. The legislature has prescribed method of such apportionment under Rule 8D of Rules.

11. We find that assessee has claimed share of profit from partnership firm and dividend income of ₹ 2,77,155/- as exempted income, however while computing income under the head 'profit and gains of the business,' has not claimed any kind of expenditure against share of profit from firms except deduction against interest income from firms. The relevant part of computation filed in the return of income is reproduced as under:

“Income from Firms/AOP

1. M/s Ritesh Export

*(PAN: AAAFR1990E, Share (Profit: Loss: Remu.): 25:25:0**Capital Balance : 84868747)*

<i>Profit – Exempt u/s 10(2A)</i>	<i>14159155</i>		

<i>Interest</i>	<i>1760000</i>	<i>1760000</i>	

<i>Less: Int Paid On Loan</i>	<i>4557725</i>		
<i>Int On L.I.C. Loan</i>	<i>666298</i>	<i>5224023</i>	<i>-</i>
<i>3464023</i>	-----	-----	

2. *M/s S.S. Enterprises**Name : Deepak Nagindas Shah**AY: 2014-15**(PAN: AADFS4279G, Share (Profit : Loss: Remu): 8.5:8.5:0**Capital Balance : 5016014)*

<i>Profit-Exempt u/s 10 (2A)</i>	<i>-1762158</i>		

<i>Interest</i>	<i>536336</i>	<i>536336</i>	
<i>Less: Professional Tax</i>	<i>10000</i>	<i>10000</i>	<i>526336</i>
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3. *M/s Disha Associates**(PAN: AAGFD1491G, Share (Profit : Loss: Remu): 12.5:12.5:0**Capital Balance : -3439)*

<i>Profit-Exempt u/s 10 (2A)</i>	<i>-14</i>	<i>0</i>

4. *M/s Disha Realtors**PAN: FD0831L Share (Profit : Loss: Remu): 10:10:10**Capital Balance : 0)*5. *M/s Vidhi Enterprises**(PAN: AAGFV433C, Share (Profit : Loss: Remu): 10:10:10**Capital Balance : 13388119)*

<i>Profit-Exempt u/s 10 (2A)</i>	<i>3577154</i>

<i>Interest</i>	607762	607762

6. <i>M/s Smith Realtors</i>		
<i>(PAN: ABTFS0096A, Share (Profit : Loss: Remu): 16:10:0</i>		
<i>Capital Balance : -3404498)</i>		
<i>Profit-Exempt u/s 10 (2A)</i>	4525942	0

7. <i>M/s Dhanera developers</i>		
<i>(PAN: AAHFD6887B, Share (Profit : Loss: Remu): 6.5:6.5:0</i>		
<i>Capital Balance : 1202500)</i>	-----	
<i>Profit-Exempt u/s 10 (2A)</i>		0

		----- -2329925”

12. On perusal of the above computation of income under the head ‘profit and gains of the business’, we find that assessee has not claimed any kind of expenditure against the exempted income from share of profit of from the firms. The interest expenditure has already been held by us in preceding paras as incurred for business purpose. The assessee has also not claimed any expenditure against dividend income of ₹ 2,77,155/-. In such circumstances issue of disallowance of expenses does not arise. When the assessee has not claimed any expenses under the head profit and gains of the business, the disallowance made by the Assessing Officer invoking section 14A read with rule 8D is not warranted. Accordingly, we set aside the order of the lower authorities on the issue in dispute and allow the ground No. eight of the appeal.

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

Order pronounced in the open court on 22nd December, 2021.

Sd/-

(AMARJIT SINGH)
JUDICIAL MEMBER

Sd/-

(OM PRAKASH KANT)
ACCOUNTANT MEMBER

मुंबई Mumbai; दिनांक Dated: 22/12/2021

Alindra, PS

आदेश प्रतिलिपि अग्रेषित / Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त (अपील) / The CIT(A)-
4. आयकर आयुक्त / CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई /
DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार (Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai