



**IN THE INCOME TAX APPELLATE TRIBUNAL,
'D' CHENNAI BENCH, CHENNAI**

**BEFORE S/SHRI CHANDRA MOHAN GARG, JUDICIAL MEMBER
AND ARUN KHODPIA, ACCOUNTANT MEMBER**

ITA No.1971/Chny/2017

Assessment Year : 2011-12

B.V.Reddy Enterprises, 2-1285, B.V.Reddy Colony, Chittor-517 001	Vs.	ACIT, Corpn. Circle-1(2), Chennai
PAN/GIR No.AACCN 2252 L		
(Appellant)	..	(Respondent)

ITA No.3275 & 3276/Chny/2016

Assessment Years : 2012-13 & 2013-14

ACIT, Corpn. Circle-1(2), Chennai	Vs.	B.V.Reddy Enterprises, 2-1285, B.V.Reddy Colony, Chittor-517 001
PAN/GIR No.AACCN 2252 L		
(Appellant)	..	(Respondent)

Assessee by : Shri S.Sridhar , AR
Revenue by : Shri G.Johnson, Addl CIT (DR)

Date of Hearing : 23 /2/ 2022
Date of Pronouncement : 31 /3/2022

ORDER

Per C.M.Garg, JM

ITA No.1971/Chey/2017 for the assessment year 2011-12 is filed by
the assessee against the order of the CIT(A)-5, Chennai dated 29.6.2017.

2. ITA Nos.3275 & 3276/Chey/2016 are filed by the revenue against the separate orders both dated 28.9.2016 for the assessment years 2012-13 & 2013-14, respectively.

First we take up for adjudication the appeal of the revenue in ITA No.3275/Chen/2016 for A.Y. 2012-13.

3. The only solitary issue raised in the grounds of appeal is that the Id CIT(A) was not correct in deleting the addition made in respect of estimated interest on interest free advance of Rs.20 crores by holding that the advance related to advance for purchase of property.

4. Ld Sr DR drawing our attention towards relevant part of assessment order submitted that advance given to Arjunlal Sunderdas for the purpose of buying properties as interest free advance and hence, the amount of Rs.1,60,00,000/- is brought to taxation. Ld Sr DR submitted that the Assessing Officer has made addition after doing proper analysis of the facts and materials on record, which was deleted by the Id CIT(A) without giving any cogent and justified reasons, therefore, the addition made by the AO may kindly be upheld by setting aside the first appellate order. Ld Sr DR drew our attention to para 3 of assessment order and submitted tht the assessee has advanced Rs.20 crores to Arjunlal Sunderadas without charging any interest thereon, therefore, the AO was right in making disallowance in this regard. Ld Sr DR submitted that the observations and findings recorded by Id CIT(A) in paras 7 to 9 are not sustainable, therefore,

same may kindly be dismissed by restoring the assessment order on this issue.

5. Replying to above, Id AR drew our attention towards top page 3 of the CIT(A) order and submitted that as the assessee has filed confirmation letter clarifying that the advances were received from the assessee for identifying and for buying a suitable property and the said advance would not carry any interest. Id counsel vehemently pointed out that despite the said confirmation, the AO charged notional interest @ 8% of the said property advance by recording perverse findings, therefore, the addition made by the AO is not sustainable. He also submitted that it a clear fact that the recipient of the advance initiating the insolvency proceedings before the competent authority was also brought to the notice of the AO and the said fact was brushed aside without any reason. Id counsel also submitted that in the totality of facts and circumstances of the case, the contention of the assessee for deleting the notional charge of interest aggregating to Rs.1,60,00,000/- from the computation of taxable total income and thus rendered justice by the Id CIT(A) by considering the entire facts of the case. Therefore, the first appellate order may kindly be upheld.

6. On careful consideration of the rival submissions, we observe that the Id CIT(A) has granted relief to the assessee with the following observations:

"7. I have carefully considered the facts, order of the AO, submissions made by the appellant and material on record. The issue to be decided is very simple in as much that whether interest free advances made to one Arjunlal Sunderdas by the appellant could be loaded with notional interest. There is no dispute on the fact that the impugned advances aggregating Rs. 1.60,00,000 during the relevant period has been made by the appellant to Arjunlal Sunderdas ostensibly for the purpose of procuring land. The appellant is in the business of rendering financial services as in the preceding years. The impugned advances made between 20.12 2006 and 13.12 2006 were made to Arjunlal Sunderdas who is assessed to tax at PAN AABPA8094R. for purchase of land Such has been confirmed by the recipient vide his confirmation dated 20th of December, 2013 who has; also confirmed that this amount did not carry any interest. The address given on the letter-head is of Pantheon Apartments. 17. Pantheon Road, 17, Pantheon Road, 1st Lane, Chennai-600 008. The confirmation on the file of the AO has not been controverted by the AO. Similarly, the letter dated 27.4.2016 in R.No.37/2015-B IP No.25/2014 addressed to all creditors by the official assignee appointed by the High Court of Madras has confirmed certain Eissions made by the appellant and that Arjunlal Sunderdas subsequently has been adjudicated as insolvent on a creditor petition by an order of the High Court dated 21.04.2014. Further, the Madras High Court by' an order dated 22.2.2016 in application No 27 of 2016 in IP No.25 of 2014 permitted the official assignee to conduct, a special public examination after serving notice ,to the creditors. It. may not be put of place to mention that the advances made by the appellant to Arjunlal Sunderdas over the years is to the order of Rs.25,00,00,000.

8.. From the above what flows is that the assertion by the appellant that the impugned amount was advanced free of interest remains uncontroverted. The attendant developments also go into prove that the recipient of the advance moved a insolvency petition before the Madras High Court and was declared as such.- It also transpires that several other such persons have made advances to Arjunlal Sunderdas of whom many are pursuing the case for recovery in the High Court. The appointment of the official assignee bares evidence to the same. The fact remaining as they are, it was not open for the AO to charge interest on an advance for purchase of land made free of interest.

9. Taking a different view of the matter, it could be examined as to whether such advance was made by the appellant in the course of its

business of rendering financial services. However, this issue has-not been examined by the AO. In the event that it is found by the AO that the advance was made for purposes other than its business, it would be open for the AO to examine as to whether such loss in event it is written off would constitute a capital loss or a loss of capital or a business loss. For the limited purpose of this appeal it would suffice to hold that the AO's action in charging notional interest on the advance made is bereft of merit and cannot be upheld. The AO is directed to delete the addition made. This ground of appeal is allowed."

7. On perusal of the impugned order and the reasons recorded by the AO for making the notional addition of Rs.1,60,00,000/- @ 8% of impugned advance amount, we are of the considered view that the Id CIT(A) has considered that the impugned amount was advanced to Arjunlal Sunderdas out of interest free amount and this assertion of the assessee remains uncontroverted. Ld. CIT (A) also observed that it was not open for the AO to charge interest on an advance for purchase of land made free of interest. Ld CIT(A) also noted that the recipient moved insolvency petition before the Hon'ble Madras High Court and was declared as such. He also noted that several other such persons have made advances to Arjunlal Sunderdas of whom many are pursuing the case for recovery in the High Court. After considering the above factual matrix of the case, Id CIT(A) in para 9 held that the AO has not examined the issue in proper perspective and in the event that it was found by the AO that advances were made for the purposes other than its business, it would be open to examine as to whether such loss in the event it is written off would constitute a capital loss or a loss of capital or a business loss. We are in full agreement with

the findings recorded by the Id CIT(A) in deleting the addition made by the AO. Hence, we see no perversity, ambiguity and valid reason to interfere with the order of the Id CIT(A), which is hereby confirmed.

8. In the result, appeal of the revenue is dismissed.

ITA No.3276/Chen/2016: A.Y. 2013-14

9. The first issue is against restriction of disallowance made u/s.14A of the Act.

10. We have heard the rival submissions and perused the record of the case. In this case, the assessee has earned Rs.2,02,786/- as dividend income during the year under consideration and claimed as exempt. The Assessing Officer did not accept the plea of the assessee on the ground that the assessee has made investment in earning the income and made the addition. In first appeal, the Id CIT(A) in the impugned order referred to the decision of Hon'ble Delhi High Court in the case of Joint Investments Pvt Ltd vs CIT, 372 ITR 694 (Del) and also the decision of Chennai Tribunal in the case of M/s. Ambattor Clothing Ltd vs JCIT in ITA No.1436, 1643/Mds/2014 & 910/Mds./2015 dt.28.12.2015, wherein, it was held that disallowance u/s.14A r.w Rule 8D should not exceed the exempt income. The assessee has claimed of earning Rs.2,02,786/- as dividend and requested for restricting the disallowance of notional expenses to the extent of tax free income. Hence, the Id CIT(A) directed the AO to restrict the

disallowance to the extent of dividend income earned during the year under consideration. Therefore, we see no valid reason to interfere with the order of the Id CIT(A), hence, confirmed. This issue is allowed.

11. The next issue relates to deletion of addition made in respect of estimated interest on interest free advance of Rs.25 crores.

12. Similar issue had come up for consideration for the assessment year 2012-13 and vide our order of even date in paras 3 to 8 (above), we have upheld the findings of the Id CIT(A) in deleting the addition. Hence, following the precedent, we dismiss this ground of the revenue.

13. The last issue relates to deletion of proportionate disallowance made in respect of expenses incurred relating to interest free advances made to group concerns.

14. Facts relating to this issue are that during the course of assessment proceedings, the Assessing Officer noticed that the assessee had made advances to its various group concerns and individuals, however, no interest was charged against the advances made. The AO noticed that the assessee has not disallowed any expenses which are related to the interest free advance to group concerns. In response to AO's query, the assessee submitted that no expenditure was incurred in respect of interest free advance made to its group concerns. The AO did not accept the contention

of the assessee and disallowed 30% of total expenses of Rs.2,82,75,918/-, which comes to Rs.84,82,775/-.

15. On appeal, the Id CIT(A) deleted the disallowance made by the AO with the following observations:

"13. have carefully perused the facts in issue, order of the AO, submissions made by the appellant and material on record. The issue to be decided is with regard to the sustainability of- the disallowance of Rs.84,82,775 being proportionate expenses against non-levy of interest made by the AO being 30% of the total expenses of Rs.2,82,75,918. The AO's observation was that the appellant has not charged any interest against, advances made to group concerns and hence the disallowance. Assailing the disallowance the appellant pleaded that the AO had erred on facts in coming to the conclusion that .interest-bearing advances were made to sister concerns and related parties. It also assailed the blanket 30% disallowance of the total expenditure in the P & L a/c of Rs.2,82,75,918 which comprise various heads. The AO had further omitted to take note of the disallowance made suo moto in the statement of total income by the appellant in this regard. The appellant's plea rested on the plank that such advances were wrongly presumed as being diverted out of" borrowed funds for non-business purposes. It was also pointed out that the appellant had not borrowed any funds which carried interest and hence the taken was not tenable on facts.

14. The jurisdictional High Court in the cases of P.R.M.S. Ramanathan Chettiar CIT(72 ITR 534) (Mad) and M.P.S.Raja v.CIT (105 ITR 295) (Mad), has held t interest paid on borrowed capital will be allowed as deduction only if the capital was used for the purpose of business. Again, the Hon'ble High Court of Punjab & Haryana in the case of CIT v. Kudu Industries in ITA No.388 of 2014 order dated 31.7.2015 have held that where mixed funds are diverted towards interest free advances the disallowance should be made up to the level of the average cost of debt to the assessee. No such case has been made out by the AO and on the contrary the appellant's plea that there were no borrowed funds has not been controverted. In another case where it was found that the assessee has got adequate interest free funds by way of share capital and reserves and surplus to the extent of Rs. 43 crores and net current assets of Rs. 55 crores and hence, it was contended that borrowed funds are diverted to

subsidiary. In such circumstances, there cannot be any disallowance as was decided in CIT vs. Prem Heavy Engineering Works (P) Ltd (2008) 285 ITR (All) following a number of decisions on the subject by other High Courts. Therefore, I am of the considered view that no disallowance on account of interest on advances made to the related parties could have been made by the AO. Similarly, I am of the view that the blanket disallowance of 30% of the total expenditure is without any basis and hence is untenable on facts and in law. The AO is directed to delete the same. This ground of appeal is allowed.”

16. Ld Sr DR could not point out any specific reasons and facts that the assessee had given advance out of borrowed funds to its group concerns. If this is the fact, no disallowance on proportionate basis is called for. Hence, we uphold the findings of the Id CIT(A) in deleting the disallowance made by the AO. This ground of the revenue is rejected.

17. In the result, appeal of the revenue for A.Y. 2013-14 is dismissed.

ITA No.1971/Chen/2017 A.Y. 2011-12 –Assessee’s appeal.

18. Ground Nos.1 to 3 relate to confirmation of disallowance of Rs.3,20,000/- relating to transaction with Mr E.Ramanatha Naidu.

19. Ld counsel for the assessee submitted that the Id CIT(A) has erred in confirming the addition of Rs.3,20,000/- relating to transaction with Mr E.Ramanatha Naidu in para 6 to 6.4 of the assessment order in the computation of taxable income without assigning proper reasons and justification. Ld counsel vehemently pointed out that the Id CIT(A) has also failed to appreciate that the principles of notional disallowance as well as double taxation even though canvassed to fortify the stand of the assessee, the said legal factors read with the facts of the present case were

completely overlooked, thereby vitiating the decision rendered by them. He finally stated that the addition made by the AO and confirmed by the Id CIT(A) may kindly be deleted.

20. Replying to above, Id Sr. DR took us through paras 3.3 of the assessment order and submitted that since the assessee was following mercantile system of interest, the interest accrued for the year end should be offered for taxation. Ld Sr DR pointed out that the assessee claims that it is an interest free advance, subsequently, the assessee has come out with explanation that Rs.10,00,000/- was offered as interest income in A.Y. 2012-13 and Rs.28,00,000/- will be offered as interest income for A.Y. 2013-14 in respect of advance to Shri E.Ramanatha Naidu. Ld Sr DR strenuously pointed out that this contention of the assessee was not acceptable by the authorities below since the assessee was following mercantile system of accounting, interest accrued on the advance of Rs.50,00,000/- @ 8% amounting to Rs.3,20,000/- was rightly treated as interest accrued on this advance for A.Y. 2011-12 and was rightly added to the income of the assessee. He also drew our attention towards relevant part of first appellate order in paras 6 to 6.4 and submitted that the contention of the assessee has no legs to stand that the notional disallowance made for A.Y. 2011-12 results into double taxation of the said interest receipts as it was offered to tax in subsequent assessment year 2012-13 and 2013-14.

21. On careful consideration of the rival submissions, we are of the considered view that since the assessee is following mercantile system of accounting, therefore, offering interest income on receipts as per cash system is not applicable to the case of the assessee. In the present case, the assessee is coming forward with changing explanation on the issue and the AO rightly held that interest accrued on advance of Rs.50 lakhs @ 8% amounting to Rs.3,20,000/- has to be treated as interest accrued on this advance for A.Y. 2011-12 and he was also right in adding the same total taxable income of the assessee. He also submitted that in the tax jurisprudence, right income should be taxed in the right assessment year and in the present case, the assessee is following mercantile system of accounting, therefore, income has to be taxed in the hands of the assessee on accrual basis not at the time of receipt of cash system of accounting. The assessee cannot be allowed to adopt hybrid system i.e. mercantile or cash system as per his convenience, there the stand of the assessee was rightly dismissed by the authorities below, consequently, the addition made towards interest accrued on the amount of Rs.50 lakhs given to Shri E.Ramanatha Naidu is confirmed. Ground Nos.1 to 3 are dismissed.

22. In Ground Nos.4 to 5, the grievance of the assessee is that the Id CIT(A) erred in confirming the addition of Rs.1,60,00,000/- relating to the transaction with Mr Arjunlal Sunderdas.

23. We find that similar issue had come up for consideration for the assessment year 2012-13 in the appeal filed by the revenue and vide our order of even date in paras 3 to 8 (above), we have upheld the findings of the Id CIT(A) in deleting the addition. Hence, in line with our observation, we direct the AO to allow the claim of the assessee..

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

Order pronounced u/r 34(4) of ITAT Rules, 1963 on 31/3/2022.

Sd/-
(Arun Khodpia)
ACCOUNTANT MEMBER

sd/-
(Chandra Mohan Garg)
JUDICIAL MEMBER

Chennai; Dated 31/03/2022
B.K.Parida, SPS (OS)

Copy of the Order forwarded to :

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