IN THE INCOME TAX APPELLATE TRIBUNAL
"A" BENCH : BANGALORE

BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER
AND SMT. BEENA PILLAI, JUDICIAL MEMBER

MP Nos. 18 to 20/Bang/2022 [ITA Nos. 692, 676 & 677/Bang/2021
Assessment year: 2016-17

1. Arjun Murthy Ranga 2. Anirudh Murthy Ranga 3. Guru Pavan Ranga All r/at Post Box No.52, # 1553, Vani Vilas Road, K.R. Mohalla, Mysuru – 570 004. **PAN : AENPR 3774F**	Vs.	The Principal Commissioner of Income Tax (Central), Bengaluru.
APPELLANT		RESPONDENT

Appellants by	:	Shri V. Srinivasan, Advocate
Respondent by	:	Shri T.N. Prakash, Addl.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	08.04.2022
Date of Pronouncement	:	13.05.2022

O R D E R

Per Chandra Poojari, Accountant Member

These miscellaneous petitions filed by the assessee arises out of the orders of the Tribunal dated 14.02.2022 in ITA No.692/Bang/2021 and ITA Nos. 676 & 677/Bang/2021. The issues in these petitions are common, as such they were heard together and disposed of by this common order for the sake of convenience.

2. The ld. AR submitted that there are certain errors in the above orders of the Tribunal to be rectified. He submitted that while disposing of the appeals, the Bench while dealing with the grounds on merits of the disallowance directed to be made u/s. 57[iii] of the Act, has held in para 34 of the order in ITA No. 676/BANG12021 dated 14/0212022, as under:-

> "34. In view of the above, in our opinion, unless funds are borrowed for making deposit to earn interest income, such interest paid on borrowings cannot be allowed as deduction in the computation of income from other sources, **which in this case, is interest earned from mutual funds**. In the facts stated above, there is no doubt that the funds borrowed from HSBC Bank was never used for investment to earn interest income. On the other hand, it has been used to make investment in CGDA Scheme **and interest paid on borrowings cannot be set off against interest earned from mutual funds, as borrowed fund is not converted into mutual fund which yielded interest income.** Therefore, in our opinion, there is no merit in the arguments of the assessee that interest incurred is to be allowed as a deduction u/s. 57(iii) of the Act out of interest earned from mutual funds which was taxed under the head 'income from other sources'. Accordingly, the grounds of the assessee on this issue are rejected the appeal is dismissed."
>
> (emphasis supplied)

3. It is submitted that the Bench has erred in observing that the Petitioner had earned interest income on mutual funds that was offered to tax under the head 'Other Sources'. It is submitted that the Petitioner had earned interest income from deposits made in the Capital Gains Account Scheme [CGDA] against which deduction was claimed for interest paid on loans availed from HSBC Invest Direct Financial Services [I] ltd and the same is also clearly brought out in the impugned order passed *u/s.* 263 of the Act.

4. Thus, the aforesaid conclusions and findings reached and recorded in para 34 of the order is contrary to the facts and material on record, which has also been observed in opening part of Para 32 of the Order, as under:

> "32. In the present case, the borrowings were made by the assessee to deposit in the CGDA Scheme so as to avail the benefit u/s. 54F of the Act. The assessee has paid interest on the loan availed for the purpose of making investment in CGDA scheme. ……."

5. However, thereafter, in Para 32 of the Order, it has been erroneously considered as follows:-

> "32. ….. The assessee used the sale consideration received
>
> on sale of shares in mutual funds **and earned interest out of it. The assessee wants to set off the interest paid on loan amount out of interest income received from mutual funds**. As seen from the above, the borrowings are not made to make investment in the mutual fund and earn interest therefrom. The borrowed amount was used to make investment in CGDA scheme. The interest income was received by the assessee from mutual funds only was totally independent of the borrowings. The interest expenditure is incurred not for the purpose of earning income, but it is on the borrowings used for investment in CGDA scheme."
>
> (emphasis supplied)

6. It is submitted that there is an error committed by the Hon'ble Bench in observing that the Petitioner had derived interest income from mutual funds and there was no nexus between the borrowed funds and income earned. In fact, the direct nexus between the borrowed funds and the interest income earned from deposits was also pointed out in course of hearing of the appeal by referring to pages 14 to 16 of the Paper book where the loan account from HSBC Bank and deposit made in CGDA has been placed. It is clear that there is a direct nexus between the borrowed funds and the deposits made in the CGDA scheme from which interest has been earned and offered to tax under the head "Other Sources".

7. Furthermore, in the order passed by the Bench, reliance has been placed on the judgement of the Hon'ble Karnataka High Court in the case of Karnataka Forest Plantations Corporation Limited reported in 156 ITR 275 [Kar.], which was neither cited by the Petitioner or the learned DR. It is submitted that the said judgement cited by the Bench is distinguishable and wholly inapplicable to the case of the Petitioner. In the said case, the funds were borrowed for business purposes. The said borrowed funds were kept in short term deposits from which interest was earned. The Hon'ble Court held that the provisions of section 57[iii] were not applicable since the funds were not borrowed for earning interest income.

8. In the Petitioner's case, it is submitted that there is no dispute that the funds were borrowed for making investments in the CGDA scheme. Interest earned on the deposits therefore has an intimate and proximate connection with the interest paid on borrowed funds. Hence, provisions of section 57[iii] of the Act are clearly applicable to the case of the Petitioner. On this aspect of the matter, the Hon'ble Bench has also failed to notice the decision of the Hon'ble Karnataka High Court relied upon by the learned DR in the case of Master Subraya M Pai reported in 150 ITR 251 [Kar]. In the said case, the Hon'ble High Court has considered whether excess interest repaid to banks on premature withdrawal of FD for the purpose of investment in shares is deductible u/s.57[iii] of the Act against the dividend income earned. It was held that the action of the assessee was similar to the act of borrowing money for the purposes of investment in shares. The assessee, instead of borrowing money had availed himself of his fixed deposit by pre-mature termination. The interest paid to bank was therefore an expenditure laid out wholly and exclusively for the purposes of earning dividend income. The assessee was therefore entitled to the deduction of the interest paid to bank from dividend income. It submitted that the ratio of

the said decision is squarely applicable to the facts of the appellant's case, which has not been considered.

9. In view of the above, it is submitted that the findings in the order of the Tribunal that the Petitioner had earned interest from mutual funds and there was no nexus between the borrowed funds and interest earned on mutual funds constitute a mistake apparent from the record. Furthermore, the omission to consider the decision of the Hon'ble jurisdictional High Court in the case of Master Subraya M Pai reported in 150 ITR 251 [Kar] is also a mistake apparent on record and the same is rectifiable u/s 254(2) of the Act.

10. Accordingly, it is prayed that the Tribunal may be pleased to amend the order by holding that there was a direct nexus between the borrowed funds and the income earned from deposits made in the CGDA scheme and accordingly, the Petitioner is entitled to deduction u/s. 57[iii] of the Act, for the advancement of substantial cause of Justice.

11. The ld. DR submitted that certain errors in the orders of the Tribunal may be rectified.

12. We have heard both the parties and perused the material on record. In these orders, the Tribunal has given a finding in para 34 in ITA Nos. 676 & 677/Bang/2021 dated 14.02.2022 as follows:-

> "34. In view of the above, in our opinion, unless funds are borrowed for making deposit to earn interest income, such interest paid on borrowings cannot be allowed as deduction in the computation of income from other sources, which in this case, is interest earned from mutual funds. In the facts stated above, there is no doubt that the funds borrowed from HSBC Bank was never used for investment to earn interest income. On the other hand, it has been used to make investment in CGDA Scheme and interest paid on borrowings cannot be set off against interest earned from mutual funds, as borrowed fund is not converted into mutual fund which yielded interest income. Therefore, in our

> opinion, there is no merit in the arguments of the assessee that interest incurred is to be allowed as a deduction u/s. 57(iii) of the Act out of interest earned from mutual funds which was taxed under the head 'income from other sources'. Accordingly, the grounds of the assessee on this issue are rejected the appeal is dismissed."

13. On going through the argument of the assessee's ld. counsel, we find that there are certain errors in the orders of the Tribunal which is required to be corrected. Accordingly, para 34 of the order of the Tribunal in ITA No.676 & 677/Bang/2021 is modified and substituted to read as under:-

> **"34.** In view of the above, in our opinion, unless funds are borrowed for making deposits to earn interest income, such interest paid on borrowings cannot be allowed as deduction in the computation of income from other sources, which in this case, is interest earned from CGDA Scheme. In the facts stated above, there is no doubt that the funds borrowed from HSBC Bank was used for investment to earn interest income in the CGDA Scheme. The assessee wants to set off the interest paid to HSBC Bank with interest earned from CGDA Scheme. As per section 54F of the Act, the whole consideration of capital asset to be used for deposit in CGDA Scheme. In the present case, the assessee diverted the sale consideration of capital asset in investment in mutual funds. However, the assessee borrowed money from HSBC Bank to make investment in CGDA Scheme. The funds which ought to have been used for investment in CGDA Scheme is the amount received on sale consideration of capital asset. Because the assessee has mis-used the sale consideration to invest in mutual fund, the self-made mistake cannot be a reason to set

off the interest paid to HSBC Bank out of interest earned from CGDA Scheme. Therefore, in our opinion, there is no merit in the arguments of the assessee that interest paid to HSBC Bank is to be allowed as a deduction u/s. 57(iii) of the Act out of interest earned from CGDA Scheme. Accordingly, these ground of the assessee in both the appeals are dismissed.**"**

14. Thus, there is no change in the final result in ITA Nos. 676 & 677/Bang/2021.

15. With regard to ITA No.692/Bang/2021, para Nos. 30 to 31 are substituted to be read as follows:-

"30. At this stage, it is appropriate to examine provisions of section 57(iii) of the Act which reads as follows:-

"**57.** The income chargeable under the head "Income from other sources" shall be computed after making the following deductions, namely :—

(i) ……

(ii) ……

(*iii*) any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income;"

31. This section provides for deduction of any other expenditure not being in the nature of capital expenditure laid out or expended wholly and exclusively for the purpose of making or earning such income from other sources. Section 57 allows certain specific deduction of other income referred to in section 56. The deduction u/s. 56 is allowable only if they are within one or other clauses enumerated in that section, not otherwise.

32. In the present case, the borrowings were made by the assessee to deposit in the CGDA Scheme so as to avail the

benefit u/s. 54F of the Act. The assessee has paid interest on the loan availed for the purpose of making investment in CGDA scheme. The assessee used the sale consideration receive on sale of shares in mutual funds and earned interest out of it. The assessee wants to set off the interest paid on loan amount out of interest income received from mutual funds. As seen from the above, the borrowings are not made to make investment in the mutual fund and earn interest therefrom. The borrowed amount was used to make investment in CGDA scheme. The interest income was received by the assessee from mutual funds only was totally independent of the borrowings. The interest expenditure is incurred not for the purpose of earning income, but it is on the borrowings used for investment in CGDA scheme. At this stage, it is appropriate to place reliance on the case of *Karnataka Forest Plantations Corpn. Ltd. v. CIT, 156 ITR 275 (Kar)* wherein it was held as under:-

"12. The borrowings were not made to make investments and earn interest from them. The borrowed amounts kept in short-term deposits undoubtedly yielded interest. The interest income from such deposits was from such deposits only and was incidental to and was the result of the same. The interest income was totally independent of the borrowings. As pointed out by the Bombay High Court in CIT v. Jagmohandas J. Kapadia [1966] 61 ITR 663 at page 669 in interpreting the corresponding section 12(2) of the 1922 Act relied on by the ITO also, the expenditure incurred must be for the purpose of making or earning the income; which is not the position in the present case. In examining the claim, the incongruities and hardship caused, cannot obviously blur our approach. From this it necessarily follows that the conclusions of the ITO concurred with by the Commissioner are unexceptionable.

13. In Eastern Investments Ltd. v. CIT [1951] 20 ITR 1 (SC) that interpreted section 12(2) which is the leading case on the point and around which a volume of case law has grown and which were all relied on, by Shri Sarangan the facts in brief were these: Eastern Investments Ltd. an investment company under an arrangement with one of its major shareholder reduced its share capital and issued him debentures with the approval of the High Court under the Companies Act, 1956, paid out interest

to that shareholder and claimed that as deduction under section 12(2) as paid out wholly and exclusively for earning its other income which was negatived by the income-tax authorities and the Calcutta High Court. But, the Supreme Court in reversing the decision of the Calcutta High Court and accepting the case of the assessee expressed thus:

> "This being an investment company, if it borrowed money and utilised the same for its investments on which it earned income, the interest paid by it on the loans will clearly be a permissible deduction under section 12(2) of the Income-tax Act. Whether the loan is taken on an overdraft, or is a fixed deposit or on a debenture makes no difference in law. The only argument urged against allowing this deduction to be made is that the person who took the debenture was the party who sold the ordinary shares. It cannot be disputed that if the debentures were held by a third party, the interest payable on the same would be an allowable deduction in calculating the total income of the assessee-company. What difference does it make if the holder of the debentures is a shareholder? There appears to be none in principle in view of the fact that no suggestion of fraud is made in respect of the transaction which is carried out between the company and the Administrator and which has been sanctioned by the Court. If the debentures had been paid for in cash by the same party, no objection could have been taken to allowing the interest amount to be deducted. In principle, there appears to us no difference, if instead of paying in cash the payment of the price is in the share of giving over shares of the company, when the transaction is not challenged on the ground of fraud and is approved by the Court in the reorganisation of the capital of the company. In our opinion, therefore, the ground on which the Income-tax Appellate Tribunal and the High Court disallowed the claim of the assessee is not sound." (p. 7)

What was paid by the assessee in that case was interest or an expenditure in respect of its income and it was on that basis, the Supreme Court found that the case attracted section 12(2). But, that is not the position in the present. In my view the true ratio of this case far from supporting the case of the petitioner, supports the case of the revenue.

14. In Seth R. Dalmia v. CIT [1977] 110 ITR 644, the Supreme Court was again dealing with a case under section 12(2) on expenditure incurred in the acquisition of shares by the assessee as such. Even the principles enunciated in this case that reiterate the principles enunciated in Eastern Investments Ltd.'s case (supra) do not support the case of the petitioner. The numerous other cases of other High Courts relied on by Shri Sarangan to which it is not necessary to make a detailed reference, did not deal with the exact question that arises for determination in these cases on similar fact situations and, therefore, do not really bear on the point and assist the petitioner.

15. In Traco Cable Corpn. Ltd. v. CIT [1969] 72 ITR 503, a Division Bench of the Kerala High Court was dealing with a case of receipts or interest paid on share deposits and the deductions claimed by the assessee on them under section 57(iii) The Division Bench speaking through Isaac, J., rejected the same in these words:

> "A reading of the above provision is sufficient to repudiate the contention that the expenditure incurred by the company during the accounting year was incurred for the purpose of making or earning the interest received by the company on the deposit of the share capital. Office and establishment expenses unconnected with the earning of the company or keeping the company alive are not permissible deductions under section 57 of the Act vide the decision of the Calcutta High Court in CIT v. Bihar Spg. & Wvg. Mills Ltd. [1953] 24 ITR 108 (Cal.)." (p. 506)

With great respect to their Lordships, I am in complete agreement with these views. On the application of these principles also, the claim of the petitioner for deduction under section 57(iii) cannot be allowed.

16. On the above discussion, it follows that the order of the Commissioner refusing to interfere with the assessments made by the ITO for the two assessment years though he had not fully dealt with the cases and examined the same, as the law expects him to do, is undoubtedly correct and the same does not call for my interference which means that these writ petitions have necessarily to be dismissed. But, before doing that, I deem it

proper to suggest to the Government to examine the feasibility of granting relief by amending the Act."

33. Further in the case of Smt. Padmavathi Jaikrishna v. Addl. CIT, 166 ITR 176 (SC), it was held as follows:-

"7. In CIT v. Rajendra Prasad Moody [1978] 115 ITR 519 (SC), this Court observed :

"The determination of the question before us turns on the true interpretation of section 57(iii) and it would, therefore, be convenient to refer to that section, but before we do so, we may point out that section 57(iii) occurs in a fasciculus of sections under the heading, 'F—Income from other sources'. Section 56, which is the first in this group of sections, enacts in sub-section (1) that income of every kind which is not chargeable to tax under any of the heads specified in section 14, items A to E shall be chargeable to tax under the head 'Income from other sources' and sub-section (2) includes in such income various items, one of which is 'dividends'. Dividend on shares is thus income chargeable under the head 'Income from other sources'. Section 57 provides for certain deductions to be made in computing the income chargeable under the head 'Income from other sources' and one of such deductions is that set out in clause (iii) which reads as follows :

** ** **

The expenditure to be deductible under section 57(iii) must be laid out or expended wholly and exclusively for the purpose of making or earning such income..... " (p. 521)

In the said decision this Court clearly indicated that:

".....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. . . ." (p. 522)

The taxing authorities as also the High Court have clearly recorded a factual finding facts that the expenditure in this case was to meet the personal liability of payment of income-tax and wealth-tax and annuity. From the order of the Tribunal as also the

judgment of the High Court it appears that the assessee had taken the stand that even if the claim relating to income-tax and wealth-tax was not admissible, that part of the claim relatable to annuity deposit should have been admitted as it fetched interest. We are inclined to agree with the High Court that so far as meeting the liability of income-tax and wealth-tax is concerned, it was indeed a personal one and payment thereof cannot at all be said to be expenditure laid out or expended wholly and exclusively for the purpose of earning income. So far as annuity deposit is concerned, the Tribunal and the High Court have come to the right conclusion that the dominant purpose was not to earn income by way of interest but to meet the statutory liability of making the deposit. The test to apply is that the expenditure should be wholly and exclusively for the purpose of earning the Income. The fact-finding authorities have come to the conclusion that no part of the expenditure came within the purview of section 57(iii)."

"34. In view of the above, in our opinion, unless funds are borrowed for making deposits to earn interest income, such interest paid on borrowings cannot be allowed as deduction in the computation of income from other sources, which in this case, is interest earned from CGDA Scheme. In the facts stated above, there is no doubt that the funds borrowed from HSBC Bank was used for investment to earn interest income in the CGDA Scheme. The assessee wants to set off the interest paid to HSBC Bank with interest earned from CGDA Scheme. As per section 54F of the Act, the whole consideration of capital asset to be used for deposit in CGDA Scheme. In the present case, the assessee diverted the sale consideration of capital asset in investment in mutual funds. However, the assessee borrowed money from HSBC Bank to make investment in CGDA Scheme. The funds which ought to have been used for investment in CGDA Scheme is the amount received on sale consideration of capital asset. Because the assessee has mis-used the sale consideration to invest in mutual fund, the self-made mistake cannot be a reason to set off the interest paid to HSBC Bank out of interest earned from CGDA Scheme. Therefore, in our opinion, there is no merit in the arguments of the assessee that interest paid to HSBC Bank is to be allowed as a deduction u/s. 57(iii) of the Act out of interest earned from CGDA Scheme. Accordingly, these ground of the assessee in both the appeals are dismissed."

31. The facts and circumstances of the case in the present case being identical to the above case (supra) decided by the Tribunal, following the same and taking a consistent view, we find no merits in the grounds raised by the assessee and reject the same."

16. In the result, all the miscellaneous petitions are allowed.

Pronounced in the open court on this 13th day of May, 2022.

Sd/-	Sd/-
(BEENA PILLAI)	(CHANDRA POOJARI)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Bangalore,
Dated, the 13th May, 2022.

/*Desai S Murthy /*

Copy to:
1. Appellants 2. Respondent 3. CIT 4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.