

**IN THE INCOME TAX APPELLATE TRIBUNAL
“C” BENCH : BANGALORE**

**BEFORE SHRI N.V. VASUDEVAN, VICE PRESEIDENT
AND
Ms. PADMAVATHY S, ACCOUNTANT MEMBER**

ITA Nos. 2717 to 2719/Bang/2018 & 1820/Bang/2019
Assessment years : 2011-12, 2013-14, 2014-15 & 2012-13

M/s. Hemavathy Power & Light Pvt. Ltd., Suit No.701 & 702, 7 th Floor, Prestige Meridian II, M.G. Road, Bengaluru – 560 001. PAN : AABCH 1245E	Vs.	The Deputy Commissioner of Income Tax, Circle 11(4) / Circle 3(1)(2) / 3(1)(3) / 3(1)(1), Bengaluru.
APPELLANT		RESPONDENT

Appellant by	:	Shri Narendra Sharma, Advocate
Respondent by	:	Smt. Priyadarshini Baseganni, Addl.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	21.06.2022
Date of Pronouncement	:	23.06.2022

ORDER

Per Padmavathy S., Accountant Member

These 4 appeals by the assessee are against the separate orders of the CIT(Appeals)-3, Bengaluru dated 24.7.2018 for the assessment years 2011-12, 2013-14, 2014-15 and dated 21.6.2019 for assessment

year 2012-13. They were heard together and disposed of by this common order for the sake of convenience and brevity.

2. The common issue arising out of various grounds raised in these appeals is the disallowance of interest (finance cost) u/s. 36(1)(iii) of the Income-tax Act, 1961 [the Act]. For assessment year 2011-12 alone the assessee raised grounds for one more issue pertaining to disallowance of depreciation on goodwill.

3. The assessee is engaged in the business of generation of power from Hydel resources. The brief facts pertaining to the AY 2011-12 are that the assessee filed return of income on 30.10.2011 declaring a total income of Rs.80,07,662. The case was selected for scrutiny and assessee was called for to produce various documents including the financials. The AO completed the assessment by making the following disallowances/ additions:

- (i) Disallowance of depreciation claimed on goodwill – Rs.61,42,542
- (ii) Addition u/s.68 of the Act – Rs.7,00,000
- (iii) Disallowance of finance cost – Rs.1,58,80,495

4. Aggrieved by the order of the AO the assessee preferred an appeal before the CIT(Appeals). The CIT(Appeals) deleted the addition made u/s.68 of the Act towards cash deposit and confirmed the disallowance of depreciation of goodwill and finance cost. Aggrieved, the assessee is in appeal before us.

Depreciation on goodwill – Rs.61,42,542

5. During the AY 2011-12, the assessee claimed a sum of Rs.61,42,542 as depreciation on goodwill. Before the AO, the assessee submitted that the assessee has recognized the difference between the value paid for purchase of Sandur Manganese & Iron Ores Ltd. [SMIORE] and the value of assets acquired and accounted the same in the books as goodwill on which depreciation is charged. The AO disallowed the depreciation stating that u/s. 32(1)(ii) of the Act goodwill is not explicitly eligible for depreciation.

6. Before the CIT(Appeals), the assessee submitted that M/s. K. B. Power International Inc., by virtue of an agreement styled as Power Purchase Acquisition Agreement dated 22.02.2001, purchased all the assets of the Power plant belonging to SMIORE. The agreement was later on assigned in favour of the assessee vide the approval from Karnataka Government. SMIORE was a Sick Industrial Company which had approached BIFR which passed an order wherein the sale of the assets of the power plant was approved. The sale consideration for the asset acquired was initially fixed at Rs.70,00,00,000/- which was later on reduced to Rs.63,00,00,000. Since the consideration paid was lump sum and there was no bifurcation available in the agreement assigning value to each asset, the assessee requested M/s. A. F. Ferguson & Co. expert valuer to value the assets. Since the valuer arrived at a value of Rs.57,40,00,060/- for all the assets, the assessee treated the differential amount in the books of accounts as Goodwill.

This treatment is in line with Accounting standard-14 of the ICAI. The assessee subsequently claimed depreciation on straight line method available for power generation units u/s. 32 of the Act. The assessee relied on the decision of Hon'ble Supreme Court in the case of *CIT v. Smiff Securities Ltd.*, 24 *taxmann.com* 222 (SC) in support of its contentions.

7. The CIT(Appeals), however, upheld the disallowance of depreciation on goodwill on the ground that :-

- i. Valuation report which is the basis for accounting goodwill is not produced;
- ii. The assets were acquired in a slump sale of a sick industry which would not have had any goodwill; &
- iii. The assessee was not able to prove that it has paid the amount for the purpose of goodwill.

8. Before us, the Id. AR submitted that the assessee had acquired the complete power project from SMIORE in the year 2003-04 with the permission obtained from Energy Dept., Govt. of Karnataka, by which all its rights on projects including rights under the Power Purchase and Land Lease Agreements are obtained by the assessee. The Id. AR submitted that the difference between the amount paid and the assets value by the Valuation Officer was recorded in the books in the year in which the acquisition took place i.e., 2003-04. He further submitted that goodwill has been part of the fixed assets Schedule of assessee's financials from 2003-04 and depreciation is being claimed since then. Hence he contended that the earlier year Written Down Value (WDV) cannot be questioned now. The Id AR drew our

attention to the decision of the coordinate Bench of this Tribunal in assessee's own case for the AY 2009-10 in ITA No.1684/Bang/2010, order dated 14.8.2013, where the Tribunal recorded a finding that goodwill has arisen because of acquisition of assets and not by revaluation of assets.

9. The ld. DR supported the order of the lower authorities.

10. We have considered the rival submissions and perused the material on record. We notice that this Tribunal in the assessee's own case for AY 2009-10 (*supra*) while dealing with an issue pertaining to section 115JB(2) of the Act has given a finding pertaining to the goodwill which is the issue under dispute in the current appeal. The relevant findings of the Tribunal are as under:-

“8. The CIT(Appeals) on a consideration of the above submissions held as follow:-

“3.5 The appellant has raised ground No.4 relating to the addition of Rs.79,87,590/- being depreciation on goodwill to the book profits computed u/s 115JB of the Act. The AO made this addition on the ground that he is empowered to make adjustment in the book profits by lifting the corporate veil where there is evasion of tax. The issue here is simple i.e. to examine whether the appellant prepared their profit and loss account for the period under consideration in accordance with the provisions of Parts II and III of Schedule VI of the Companies Act 1956. Under the Company Law the depreciation on goodwill is allowable while preparing the profit and loss account. There is no material also on record to show that there was any failure on the part of the appellant in the preparation of the profit and loss account under the Companies Act 1956 mentioned above. Therefore, the AO cannot make any

addition in this regard by disturbing the profit and loss account prepared by the assessee in accordance with the provisions of the Companies Act 1956 in view of the decision of the apex court in the case of Appollo Tyres Ltd. (174 CTR 521). Therefore, the appellant succeeds in respect of ground No.4 and the AO is directed to delete this addition made in the computation of book profits u/s 115JB of the Act.”

9. Aggrieved by the order of the CIT(Appeals), the revenue has preferred the present appeal before the Tribunal.

10. We have heard the submissions of the Id. DR, who reiterated the stand of the revenue by relying on the provisions of Explanation 1(g) to section 115JB of the Act. The Id. counsel for the assessee pointed out that in ground No.4, the revenue has raised the issue that depreciation of goodwill has arisen on account of revaluation of assets. According to him, this was never the case made out either before the AO or in the proceedings before the CIT(A) and that there was no factual basis to raise the aforesaid ground by the revenue. It was also submitted that goodwill has arisen because of acquisition of certain business by the assessee and not owing to any revaluation of assets.

11. We have considered the rival submissions. It is clear from the provisions of the Act, referred to earlier, that depreciation which is to be added to the net profit as per the profit & loss account prepared in accordance with the Part II of Schedule VI to The Companies Act, 1956 in terms of Explanation 1 (g) to section 115JB(2) has to be reduced as per clause (iia) below clause (a) to (j) of Explanation (1) to sub-section (2) of section 115JB of the Act. Such reduction need not be made if depreciation debited in the profit & loss account is on account of revaluation of assets. As rightly contended on behalf of the assessee, this was never the case made out by the AO or before the CIT(A). As rightly contended on behalf of assessee, there is no factual basis for the revenue to raise ground No.4 in the form in which it has been raised before the Tribunal. In the circumstances, we are of the view that depreciation in question

has to be reduced from the book profits as per the provisions referred to earlier.”

11. In the present case, it is the contention of the Id. AR that goodwill was recorded in the books of account of the assessee way back in 2003-04 when the Power Purchase Agreement was entered into and that depreciation is claimed on the same since then. Therefore it becomes important to examine that the goodwill was recorded in the year of entering into power purchase as claimed by the assessee for the purpose of deciding the allowability of the depreciation on goodwill in the current year under consideration in this appeal. If the goodwill has been recorded in the books in the year 2003-04, then the revenue authorities cannot question the depreciation which is claimed on the WDV of the goodwill. In view of the above discussion, we remit the issue back to the AO to factually verify the fact that goodwill has been recorded in the year of acquisition of power purchase agreement and that assessee has been claiming depreciation on the same since then. Upon verification of the fact, the AO is directed to allow depreciation accordingly as depreciation allowance cannot be denied on the WDV of the asset recorded in the books from 2003-04. It is ordered accordingly.

Disallowance of finance cost – Rs.1,58,80,495

12. During the course of assessment proceedings, the AO noticed that the assessee has advanced a sum of Rs.30,68,69,478 to the sister concerns as per Schedule 10 to the financials for the year ended

31.3.2011. The assessee submitted before the AO that the said loans had been advanced to the companies under the same management (sister concerns) to meet the purpose of business exigencies given out of assessee's own funds and there is no diversion of interest-bearing funds to the business of sister concerns. The AO rejected the claim of the assessee and proceeded to make a disallowance of Rs.1,58,80,495 applying 10.35% on the average of the advances given. The CIT(Appeals) upheld the disallowance observing as follows:-

“6.3 Although the appellant has argued that it had used its own interest free funds for providing such interest free loans to its sister concerns, however it has not brought anything on record to substantiate its claim. A perusal of the balance sheet of the appellant for the year under consideration shows that it had shareholders funds (Share capital and Reserves & surplus) of Rs.42crores as on 31.03.2010, which had reduced to Rs.39.9crores as on 31.03.2011. The remaining funds available with the appellant were the loan funds, the value of which was Rs.61.4crores as on 31.03.2010. These loan funds increased drastically to Rs.109.7crores as on 31.03.2011. As against the same the value of the fixed assets including capital work in progress (CWIP) as on 31.03.2010 was Rs.85.65 crores and Rs.81.78 crores as on 31.03.2011. The cash and bank balance of the appellant as on 31.03.2011 was Rs 23.86 crores. These facts make it evident that there were hardly any interest free funds available with the appellant to give interest free loans to other persons. In fact due to shortage of funds a part of the unsecured loans had also been utilized by the appellant for investment in fixed assets including CWIP. The value of loans to sister concerns was nil as on 31.03.2010 and the entire loans of Rs.30,68,69,478/- were given to them during the year under consideration. These aspects clearly shows that the loan funds were diverted by the appellant to its sister concerns as it was not having any interest free funds available with it.”

13. The Id. AR submitted that the interest-free advances are given to sister concerns out of own funds of the assessee and hence there cannot be any disallowance of finance cost u/s. 36(1)(iii) of the Act. Reliance was placed on the decisions of Karnataka High Court in *CIT v. Brindavan Beverages Pvt. Ltd., ITA No.67 of 2015* and Bombay High Court in *CIT v. Reliance Utilities & Power Ltd., 313 ITR 340*. The Id. AR brought to our attention the Balance sheet for the year ended 31.3.2011 to show that own funds are more than the amount advanced to sister concerns and therefore the ratio laid down in above decisions are applicable to the assessee's case where no disallowance is warranted.

14. The Id. DR relied on the orders of the CIT(Appeals). She drew our attention to the earlier year's Balance Sheet and submitted that the assessee's own funds are deployed for purchase of fixed assets in those years. She submitted that there significant movement in the term loan in the current year and the corresponding movement in the advances to sister concerns demonstrates that borrowed funds are utilized for giving interest free loans to sister concerns.

15. We have considered the rival submissions and perused the material on record. As on 31.3.2011, the assessee had given interest free advances to the companies under the same management to the tune of Rs.30,68,69,478. As per the Balance Sheet, the Share Capital and Reserves & Surplus, i.e., own funds is at Rs.40,00,00,000 and Rs.31,37,24,375 respectively. Hence there is merit in the claim that

the assessee has used own funds for giving interest free advances to sister concerns. We notice that the similar issue was considered by Hon'ble Karnataka High Court in the case of *CIT Vs. Micro Labs Ltd. (2016) 383 ITR 490*, where it was held that no disallowance out of interest expenditure is called for. The relevant extract of the observations made by Hon'ble Karnataka High Court in the above said case is as below

“40. We have heard the rival submissions. A copy of the availability of funds and investments made was filed before us which is at pages 38 to 42 of the assessee's paper book and the same is enclosed as ANNEXURE-III to this order. It is clear from the said statement that the availability of profit, share capital and reserves & surplus was much more than investments made by the assessee which could yield tax free income.

41. The Hon'ble Bombay High Court in *Reliance Utilities & Power Ltd. 313 ITR 340 (Bom)* has held that where the interest free funds far exceed the value of investments, it should be considered that investments have been made out of interest free funds and no disallowance u/s. 14A towards any interest expenditure can be made. This view was again confirmed by the Hon'ble Bombay High Court in *CIT v. HDFC Bank Ltd., ITA No.330 of 2012, judgment dated 23.7.14*, wherein it was held that when investments are made out of common pool of funds and non-interest bearing funds were more than the investments in tax free securities, no disallowance of interest expenditure u/s. 14A can be made.

42. In the light of above said decisions, we are of the view that disallowance of interest expenses in the present case of Rs.49,42,473 made under Rule 8D(2)(ii) of the I.T. Rules should be deleted. We order accordingly.”

Thereafter, it was held by Hon'ble Karnataka High Court as under:-

“The aforesaid shows that the Tribunal has followed a decision of the Bombay High Court in the case of CIT v. HDFC Bank Ltd. [2014] 366 ITR 505/226 Taxman 132 (Mag.)/49 taxmann.com 335 . When the issue is already covered by a decision of the High Court of Bombay with which we concur, we do not find any substantial question of law would arise for consideration as canvassed.”

16. The contention of the Id. DR that based on earlier years financials, the share capital & reserves are used for purchase of fixed assets is not relevant as the Balance Sheet of the year under consideration is what needs to be examined for deciding the issue contended here. Further there cannot be matching done based on review of financials to state that the term loan borrowed by the assessee is used for giving interest free advances merely based on the movement in these account lines.

17. Following the ratio laid down by the jurisdictional High Court in *Micro Labs Ltd. (supra)* and considering the fact that the assessee's own funds are more than the advances given to sister concerns, we hold that no disallowance is warranted u/s. 36(1)(iii) of the Act. We therefore delete the disallowance on this count.

18. The only issue arising out of the appeals filed for the AYs 2012-13 (**ITA No.1820/Bang/2018**), 2013-14 (**ITA No.2718/Bang/2018**) and 2014-15 (**ITA No.2719/Bang/2018**) is the similar disallowance of finance cost by the AO. The availability of own funds and the advances to sister concerns for the said years are as follows:-

Amount in Rs.

Particulars	AY 2012-13	AY 2013-14	AY 2014-15
Share Capital	31,37,24,375	41,37,24,375	41,37,24,375
Reserves & Surplus	18,17,39,138	19,61,51,109	20,64,75,071
Total Own Funds	49,54,63,513	60,98,75,484	62,01,99,446
Advance to sister concerns	4,82,02,376	7,68,42,874	8,23,10,541

19. From the above table, it is clear that in all these years the own funds of the assessee is more than amount advanced interest free to sister concerns. For reasons given in assessment year 2011-12, we hold that no disallowance is warranted for these assessment years also and the same is deleted.

20. In the result, the appeals of the assessee for assessment year 2011-12 is partly allowed, and allowed for assessment years 2012-13 to 2014-15.

Pronounced in the open court on this 23rd day of June, 2022..

Sd/-
(N V VASUDEVAN)
VICE PRESIDENT

Sd/-
(PADMAVATHY S)
ACCOUNTANT MEMBER

Bangalore,
Dated, the 23rd June, 2022.

/Desai S Murthy /

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.