IN THE INCOME TAX APPELLATE TRIBUNAL
Hyderabad ' SMC ' Bench, Hyderabad

Before Shri Rama Kanta Panda, Accountant Member

ITA Nos.144 & 148/Hyd/2020		
Assessment Years: 2014-15 & 2016-17		
Smt. Lakshmi Shankar Gumudavelli D.No.8-2-293/174/12-1, Srivilash, Road No. 14 Banjara Hills Hyderabad-500 034 PAN : AAPPG6517R	Vs.	ITO, Ward-17(4) Signature Towers, Kondapur Road Hyderabad-500 084
(Appellant)		(Respondent)
Assessee by:	Shri A.V.Raghuram, Advocate	
Revenue by:	Shri Dinesh Paruchuri, Sr.AR	
Date of hearing:	01.06.2022	
Date of pronouncement:	30.06.2022	

O R D E R

Per Shri Rama Kanta Panda, A.M.

ITA No. 144/Hyd/2020 filed by the assessee is directed against the order dated 13.11.2019 of the Learned Commissioner of Income Tax (Appeals)-5, Hyderabad relating to AY 2014-15. ITA No. 148/Hyd/2020 filed by the assessee is directed against the order dated 17.10.2019 of the Learned Commissioner of Income Tax (Appeals)-5, Hyderabad relating to AY 2014-15. For the sake of convenience both the appeals were heard together and are being disposed-of by this common order.

ITA No. 144/Hyd/2020

2. There is a delay of '10' days in filing of this appeal by the assessee for which the assessee has filed a condonation application. After considering the contents of the condonation

application and after hearing the ld. DR , the appeal is admitted for adjudication.

3. Facts of the case, in brief, are that the assessee is the Director in M/s Vivilash Colour Labs Private Limited and filed her return of income for the A.Y. 2014-15 on 22/01/2015 declaring total Income of RS.33880/- (Salary Rs.96,000/-+ Income from House Property at Rs.9,79,874/- + Income from Other Sources at Rs.4,38,162/-) after claiming interest on loan from Chola-IDBI invested as Capital in firms of Rs 15,85,752/- and Chapter VIA deduction of Rs.62,120/-. The assessment was completed u/s 143(3) vide order dated 19/12/2016 by accepting the income returned

3.1 On verification of record and the assessment order dated 19/12/2016, it was noticed by the AO that in the computation of total income, partners salary and interest from Vivilash Digital Imaging Centre and Vivilash Colour labs is shown at Nil. However, interest on loan from Chola-IDBI invested as capital in firms of RS.15,85,752/- was claimed arriving at business income of Rs.(-) 15,85,752/-. The net profit of Rs 2,558/- from Vivilash Digital Imaging Centre and Rs.1,36,416/- from Vivilash Color Labs was claimed as exempt. As the loan amount from Chola-IDBI is utilized in earning exempt income and no income from business was derived during the year, interest of Rs.15,85,752/- claimed on the loan is not allowable under head business The interest is not allowable under the head income from other sources as there is no nexus between the income admitted and the expenditure. He therefore issued a notice u/s. 154 of the Act asking the assessee to furnish her objections if any regarding disallowance of the interest expenditure of Rs. 15,85,752/- claimed under the head income from business. In absence of any reply from the side of the assessee, the AO construed that assessee has no objection. Since

the mistake was apparent from the record, the AO passed the order u/s. 154 of the Act by rectifying the order passed u/s. 143(3) and made disallowance of Rs. 15,85,752/-

4. In appeal, the ld.CIT(A) upheld the action of the AO by observing as under:-

"6. The assessment order u/ s. 143(3) was passed and the claim of the appellant of interest of Rs. 15,85,752/- being paid to Chola IDBl was allowed. The AO issued notice u/s. 154 to disallow the said interest on account of the fact that the money was invested in the capital of the firms, to earn exempt income, therefore the interest has to be disallowed. In the adjudication for A. Y. 2015- 16 in ITA No. 0191/2017-18/CITIA)-5, dated 17.05.2018, wherein 143(3) was passed on 10.11.2017, it was noted that the appellant was neither deriving any interest income nor remuneration from these partnership firms and the interest expenditure was thus disallowed. The adjudication is reproduced as under:-

" ..... The AO noted that the appellant has set off the interest paid of Rs. 14,33,370/- to Chola and IDBI, which was invested in the capital of partnership firms. The AO verified that the IDBI loan was taken for personal use and chola loan was a home loan by the appellant and was invested as a capital of the partnership firm. The AO further noted that the share capital introduced in the firms namely Ms VDIC, wherein the appellant had 25% shares and Ms VDCL wherein the appellant had 45% shares.

The AO noted that no business income was derived during the year under consideration and therefore the same was to earn exempt income and therefore disallowed the interest claim of Rs. 14,33,370/- accordingly.

The appellant stated that the said loss was set off against Income from Other Source and Income from House Property by the appellant. The appellant further stated that the sources of the partnership capital were the loans taken from Chola Mandalam Finance and IDBI and these loans were directly invested as the capital of the firm. The appellant relied on the judgment of SA Builders Vs. CIT as reported in 288 ITR 1 and the judgment of Punjab Stainless Steel Industries V. CIT 324 ITR 396 and stated that the capital must have been borrowed by the appellant for the purpose of business for the allowance of the interest on that capital and therefore the disallowance should be deleted

The appellant further relied on the fact that the said interest was allowed as a deduction in the earlier year and relied on certain judgments on consistency in this regard.

It is very clear that the appellant has invested the funds so borrowed as the share capital of the firms. From the statement of income, the appellant is not receiving any interest on the capital so deployed, nor receiving any remuneration as a working partner in the firm. From these facts it is clear that from the said firms, there was no occasion of generating business income as no remuneration and no interest was to be received in the capacity of the partner of these firms.

Therefore, the only profit which could have been achieved from this deployment was the share of profit of the partnership firms, which is exempt u/s 10.

Thus, the said investment could only result in an exempt income and no income could be generated under the head Profit and Gains from Business and Profession or Income from Other Sources.

Thus all the other heads of income have been snatched away in the manner in which the investment has been made.

Thus the interest expenditure has been incurred for the purpose of earning an exempt income and therefore cannot be allowed as a business expenditure u/s. 36(1)(iii) of the Income Tax Act as no business activity has been carried out by the appellant and merely an investment has been made which can only generate an exempt income and no taxable income at all for the year under consideration.

The judgment cited by the appellant has no relevance to the issue under consideration as this is an investment in capital of the firms by the appellant and not for the purpose of business expediency or preservation of capital. The judgment of SA Builders has itself been considered for consideration by the Honourable Apex Court in the case of Tulip Star Hotels Limited.

In view of the above, the submission of the appellant is rejected.

As regards the claim of consistency, the appellant cannot claim an illegal allowance in an earlier year by the AO, as a matter of right being conferred upon it as law, which has not even been provided in the Income Tax Act by the Parliament. An error in granting an allowance in one year does not become a rule in the case of an appellant for a life time.

In view of the above the claim of the appellant is rejected in toto and the second ground of appeal is dismissed accordingly.

The first and third grounds being general in nature need no adjudication. To slim up appeal is dismissed ...

From the above, it is clear that there is only nexus of the loans advanced with the share in the partnership firm, from where only the share of profit arises to the appellant. The share of profit is exempt from tax, therefore, it is prima facie that the interest has to be disallowed as per the available ,records of the appellant including AY 2015-16.

The above issue is, therefore, not debatable in nature as the partnership deeds have been already considered and has no change.

In view of the same, the ground no. 2 and 3 are dismissed accordingly. The ground no. 4 is dismissed as the same has been already adjudicated and is a prima facie fact based on records. The ground no. 1 and 5 being general in nature needs no adjudication.

'To sum up appeal is dismissed."

5. Aggrieved with such order of the ld.CIT(A), the assessee is in appeal before the Tribunal by raising the following grounds:-

1. On the facts and in the circumstances of the case, the order passed by the ld. commissioner of Income Tax (Appeals)-5, Hyderabad, is erroneous and unsustainable.

2. The CIT(A) erred in sustaining the action of the AO in disallowing interest expenditure of Rs.15,85,752, which issue is highly debatable, in a proceeding under section 154 of the Act.

3. The finding of the CIT(A) that the issue is not debatable is legally incorrect in as much as investment in capital account not only earns prof1t (which is exempt from tax) but also interest income to be paid to partner, which is taxable. The CIT(A)failed to appreciate that the partnership deed provided for payment of interest to partners and the same was not paid for want of sufficient income.

For these and other grounds that may be urged, it is prayed that the appeal may be allowed.

6. The Ld. Counsel for the assessee, at the outset submitted that debatable issues cannot be rectified u/s. 154 of the I.T.Act. He submitted that the partnership deed provides for interest on capital and if such interest is received, it is assessable under the head 'business' and this interest expenditure is allowable against the same. He submitted that even though there is no interest received from the firm in absence of any profit, the provisions of section 36 are not such that the expenditure could be allowed only when there is income.

7. Referring to the decision of Hon'ble Supreme Court in the case of Eastern Investments Ltd. vs. CIT reported in 20 ITR 1, he submitted that the Hon'ble Supreme Court in the said decision has held that the expenditure is allowable, even when there is no income. He accordingly submitted that this is a debatable issue and therefore, debatable issues cannot be rectified u/s. 154 of the I.T.Act.

8. Referring to the decision of the Bangalore Bench of the Tribunal in the case of Suresh Sreeram vs. ITO in ITA No. 1605/Bang2019, dated 28.01.2021, he submitted that the

Tribunal in the said decision has held that loss and income receivable by all the partners from the firm could be set-off against the other income earned by the partners under the same head i.e interest and salary.

9. Referring to the decision of Hon'ble Supreme Court in the case of CIT vs. Rajendra Prasad Mody 1978 CTR: 115 ITR 519, he drew the attention of the bench to the following paragraph

"3.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. The argument of the Revenue was that unless the expenditure sought to be deducted resulted in the making or earning of income, it could not be said to be laid out or expended for the purpose of making or earning such income. The making or earning of income, said the Revenue, was a sine qua non to the admissibility of the expenditure under section 57(iii) and, therefore, if in a particular assessment year there was no income, the expenditure would not be deductible under that section. The Revenue relied strongly on the language of section 37(1) and contrasting the phraseology employed in section 57(iii) with that in section 37(1), pointed out that the Legislature had deliberately used words of narrower import in granting the deduction under section 57(iii). Section 37(1) provided for deduction of expenditure laid out or expended wholly and exclusively for the purpose of the business or profession in computing the income chargeable under the head 'Profits or gains of business or profession'. The language used in section 37(1) was "laid out or expended-for the purpose of the business or profession" and not "laid out or expended-for the purpose of making or earning such income" as set out in section 57(iii). The words in section 57(iii) being narrower, contended the Revenue, they cannot be given the same wide meaning as the words in section 37(1) and hence no deduction of expenditure could be claimed under section 57(iii) unless it was productive of income in the assessment year in question. This contention of the Revenue undoubtedly found favour with two High Courts but we do not think we can accept it. Our reasons for saying so are as follows.

4.What section 57 (iii) requires is that the expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning income. 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. Section 57(iii) does not require that this purpose must be fulfilled in order to qualify the expenditure for deduction. It does not say that the expenditure shall be deductible only if any income is made or earned. There is in fact nothing in the language of section 57(iii) to suggest that the purpose for which the expenditure is made should fructify into any benefit by way of return in the shape of income. The plain natural construction of the language of section 57(iii) irresistibly leads to the conclusion that to bring a case within the section, it is not necessary that any income should in fact have been earned as a result of the expenditure. It may be pointed out that an identical view was taken by this Court in Eastern Investments Ltd. v. Commissioner of Income tax, where interpreting the corresponding provision

in section 12(2) of the Income Tax Act, 1922 which was ipsissima verba in the same terms as section 57(iii), Bose, J., speaking on behalf of the Court observed:

"It is not necessary to show that the expenditure was a profitable one or that in fact any profit was earned".

It is indeed difficult to see how, after this observation of the Court, there can be any scope for controversy in regard to the interpretation of section 57(iii)."

10. He accordingly submitted that since the issue is a highly debatable one, therefore, the ld.CIT(A) is not justified in upholding the action of the AO

11. The ld. DR on the other hand heavily relied on the order of the ld.CIT(A).

12. I have considered the rival arguments made by both the sides, perused the orders of the AO and ld.CIT(A) and the paper book filed on behalf of the assessee. I have also considered the various decisions cited before me. I find the assessment in the instant case was completed u/s. 143(3) on 19.12.2016 by accepting the returned income of Rs. 33,880/-. Subsequently, the AO in the order passed u/s. 154 modified the said income to Rs. 16,19,632/-, wherein he made addition of Rs. 15,85,752/- being the interest on loan from Chola-IDBI, which was claimed as set-off against her other income. I find the ld.CIT(A) upheld the action of the AO, the reasons of which have already been reproduced in the preceding paragraph. It is the submissions of the ld.Counsel for the assessee that in view of the various decisions including decision of Hon'ble Supreme court in the case of Rajendra Prasad Mody (supra) & Eastern Investment Ltd.(supra) and various other decisions, there need not be income to claim expenditure u/s. 57 of the I.T.Act. Same is the case even for business income. Therefore, it is his submission that the issue being a debatable one, the provisions of section 154 cannot

be applied to the facts of the present case and therefore, the order of the ld.CIT(A) upholding the 154 rectification proceedings by the AO is not in accordance with the law.

13. I find sufficient force in the above arguments by the ld.Counsel for the assessee. The assessee in the instant case is a partner in the firm M/s. Vivilash Digital Colour Labs Pvt.Ltd and has invested in the firm by borrowing from financial institutions i.e Chola-IDBI on which she has paid interest of Rs. 15,85,752/-. There is also a provision in the partnership deed to pay interest on capital to the partners. Since, there was no sufficient profit, interest was not provided by the firm on the capital. The assessee claimed interest income as expenditure and set-off the same against other income. This was also accepted by the AO in the order passed u/s. 143(3). It has been held in various decisions, which are relied on by the ld.counsel for the assessee that there need not be income to claim the expenditure u/s. 57. It is also held that such interest expenditure is allowable, even when there is no income. Thus, the issue as to whether the assessee has correctly claimed the set-off such interest paid to Chola-IDBI, in absence of any interest income for the firm is a highly debatable issue. It has been held in various decisions that provisions u/s. 154 for rectification of the order cannot be applied to debatable issues. The Hon'ble Supreme Court in the case of T.S.Balaram vs Volkart Brothers reported in (1971) 82 ITR 50 has held that a mistake apparent on the record must be an obvious and patent mistake and not something which can be established by a long drawn process of reasoning on points which there may be conceivably two opinions. It was held that a decision on a debatable point is not a mistake apparent from the record. I, therefore set aside the order of the ld.CIT(A) on this issue and the grounds raised by the assessee are allowed.

14. In the result, the appeal filed by the assessee is allowed.

ITA No.148/Hyd/2020

15. There is a delay of '15' days in filing of this appeal for which the assessee has filed a condonation application along with an affidavit. After hearing both the sides, the delay in filing of the appeal is condoned and appeal is admitted for adjudication.

16. Facts of the case, in brief, are the assessee filed the return of income admitting total income of Rs. 1,04,600/-. The case was selected for scrutiny. During the course of the assessment proceedings, the AO noted that assessee has set-off interest expenditure under the business income of Rs. 12,65,808/- as the interest on loan taken from Chola/IDBI invested as Capital in Firms. The entire loss was set off to the House Property and income from Other Sources. A notice u/s. 133(6) of the I.T.Act, was issued to IDBI and Cholamandalam investment and Finance company Limited calling for information during the scrutiny proceedings of AY 2015-16. In response to the same, the IDBI clarified that the FD/OD Account No. 0026651000001519 was opened in the name of the assessee in the Year 2011 for personal use and the first disbursement amount was transferred to the current account of Vivilash Digital Color Labs. The same has been admitted as total exempt towards share capital. With regard to the Chola- interest on loan, the same was clarified that the Loan Agreement No. XOHEHYD000000844189 has been sanctioned on 31/10/2012 as a "Home Equity Loan". The Share Capital introduced in the Firms: M/s Vivalash Digitai Imaging Centre @ 25% and Mis Vivilash Digital Color labs @ 45% have been admitted as per the schedule IF of Income tax return filed. Further as per the Sch BF expenses of Rs.12,65,808/- pertaining

to M/s. Vivilash Digital Imaging center (AADFV0911 V) admitted as loss has been disallowed.

16.1 As the loan amount from Chola IDBI was utilized in earning exempt income and no income from business has been derived during the year under consideration, the expenses in relation to the partners of the firm as shown in the schedule BP of Rs. 12,65,808/- claimed from the firm VIVILASH DIGITAL IMAGING CENTER (AAOFV0911V) cannot be allowed as there is no nexus between the income admitted and the expenditure. Therefore Rs. 12,65,808/- claimed as exempt income under "Income from Business" was disallowed by the AO.

17. In appeal, the ld.CIT(A) upheld the action of the AO by observing as under:-

6.1 In the case, the AO has noted that the appellant had set off interest expenditure of Rs. 12,65,808/-(on loans taken from Cholamandalam Investment and Finance Co Ltd/IDBI) to the House Property and Income from Other Sources during the year. It was also noted that the AO during the course of assessment proceedings for the AY 2015-16, issued notice u/s. 133(6) to M/s. chola and IDBI and the IDBI clarified that the said account was opened for personal use and M/s. Chola clarified that the loan was sanctioned as Home Equity Loan. The similar issue has come up in the appellant's own case for the AY 2015-16 wherein the interest paid of Rs. 14,33,370/- was disallowed by the AO and the addition was upheld by the CIT(A) vide order in ITA No. 0191/2017-18, dated 17.05.2018. The adjudication in the above referred appellate order is reproduced as under:-

"6. Decision:

" ..... The AO noted that the appellant has set off the interest paid of Rs. 14,33,370/- to Chola and IDBI, which was invested in the capital of partnership firms. The AO verified that the IDBI loan was taken for personal use and chola loan was a home loan by the appellant and was invested as a capital of the partnership firm. The AO further noted that the share capital introduced in the firms namely Ms VDIC, wherein the appellant had 25% shares and Ms VDCL wherein the appellant had 45% shares.

The AO noted that no business income was derived during the year under consideration and therefore the same was to earn exempt income and therefore disallowed the interest claim of Rs. 14,33,370/- accordingly.

The appellant stated that the said loss was set off against Income from Other Source and Income from House Property by the appellant. The appellant further stated that the sources of the partnership capital were the loans taken from Chola Mandalam Finance and IDBI and these loans were directly invested as the capital of the firm. The

appellant relied on the judgment of SA Builders Vs. CIT as reported in 288 ITR 1 and the judgment of Punjab Stainless Steel Industries V. CIT 324 ITR 396 and stated that the capital must have been borrowed by the appellant for the purpose of business for the allowance of the interest on that capital and therefore the disallowance should be deleted

The appellant further relied on the fact that the said interest was allowed as a deduction in the earlier year and relied on certain judgments on consistency in this regard.

It is very clear that the appellant has invested the funds so borrowed as the share capital of the firms. From the statement of income, the appellant is not receiving any interest on the capital so deployed, nor receiving any remuneration as a working partner in the firm. From these facts it is clear that from the said firms, there was no occasion of generating business income as no remuneration and no interest was to be received in the capacity of the partner of these firms.

Therefore, the only profit which could have been achieved from this deployment was the share of profit of the partnership firms, which is exempt u/s 10.

Thus, the said investment could only result in an exempt income and no income could be generated under the head Profit and Gains from Business and Profession or Income from Other Sources.

Thus all the other heads of income have been snatched away in the manner in which the investment has been made.

Thus the interest expenditure has been incurred for the purpose of earning an exempt income and therefore cannot be allowed as a business expenditure u/s. 36(1)(iii) of the Income Tax Act as no business activity has been carried out by the appellant and merely an investment has been made which can only generate an exempt income and no taxable income at all for the year under consideration.

The judgment cited by the appellant has no relevance to the issue under consideration as this is an investment in capital of the firms by the appellant and not for the purpose of business expediency or preservation of capital. The judgment of SA Builders has itself been considered for consideration by the Honourable Apex Court in the case of Tulip Star Hotels Limited.

In view of the above, the submission of the appellant is rejected.

As regards the claim of consistency, the appellant cannot claim an illegal allowance in an earlier year by the AO, as a matter of right being conferred upon it as law, which has not even been provided in the Income Tax Act by the Parliament. An error in granting an allowance in one year does not become a rule in the case of an appellant for a life time.

In view of the above the claim of the appellant is rejected in toto and the second ground of appeal is dismissed accordingly.

The first and third grounds being general in nature need no adjudication. To slim up appeal is dismissed ...

6.2. In the above adjudication it was clearly brought out that the loans obtained by the appellant were for personal/house loan purposes and not for any business purposes as clarified by the Financiers.

The AR contends that the CIT(A) has not considered the issue that the appellant might received interest if there are profits in the firm. The above is a contingent situation and not a right of receipt of interest by the appellant for the capital so deployed. Thus interest earning is only contingent in nature and cannot be called an active business deployment and nor that the investment was made to earn interest income. Thus there is no nexus as claimed by the appellant and therefore this contention is rejected.

In view of the above discussion and the adjudication, the ground no.3 & 4 are dismissed."

18. Aggrieved with such order of the ld.CIT(A), the assessee is in appeal before the Tribunal by raising the following grounds:-

1. On the facts and in the circumstances of the case, the order passed by the ld. commissioner of Income Tax (Appeals)-5, Hyderabad, is erroneous and unsustainable.

2. The CIT(A) erred in sustaining the action of the AO in disallowing interest expenditure of Rs.12,65,808

3. The CIT(A) failed to appreciate that investment in capital account not only earns profit(which is exempt from tax) but also interest income to be paid to partner, which is taxable and therefore the AO could not have disallowed interest expenditure claimed by the Appellant. The CIT(A) failed to notice that the partnership deed provided for payment of interest to partners and the same was not paid for want of sufficient income.

19. I have heard the rival arguments made by both the sides and perused the orders. Although identical issue had been decided by me in assessee's own case for AY 2014-15 in the preceding paragraphs, however, the same is not applicable for the present year, since there is no rectification done by the AO and disallowances has made in the order passed u/s. 143(3). The ld.CIT(A) in the instant case, while deciding the issue has given justifiable reasons as to why the interest expenditure cannot be set-off. The Ld. Counsel for the assessee could not bring any material before me so as to take a contrary view than the view taken by the ld.CIT(A) on this issue. Accordingly, the grounds raised by the assessee are dismissed.

20. In the result, ITA No. 144/Hyd/2020 filed by the assessee is allowed, whereas ITA No. 148/Hyd/2020 filed by the assessee is dismissed.

Order pronounced in the Open Court on 30th June, 2022.

Sd/-

	(RAMA KANTA PANDA) **ACCOUNTANT MEMBER**

Hyderabad, dated 30th June, 2022.

Thirumalesh/sps

Copy to:

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4	DR, ITAT Hyderabad Benches
5	Guard File
6	Pr.CIT-5, Hyderabad

By Order