IN THE INCOME TAX APPELLATE TRIBUNAL "D" BENCH, MUMBAI

BEFORE SHRI ABY T. VARKEY, JM AND SHRI GAGAN GOYAL, AM

आयकर अपील सं/ I.T.A. No.5058/Mum/2017
(**निर्धारण वर्ष** / Assessment Years: 2011-12)

M/s. Maharashtra Steels Rolling Mills Pvt. Ltd. 190, LBS, Marg, Bhandup (W), Mumbai-400078.	**बनाम** / Vs.	ACIT-Cen, Cir-35 Mumbai.
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : AABCM6109Q		
(अपीलार्थी **/Appellant**)	..	(प्रत्यर्थी / **Respondent**)

Assessee by:	Shri Pramod Parida/Ms. Kiran
Revenue by:	Smt. Mahita Nair (Sr. AR)

सुनवाई की तारीख / Date of Hearing: 28/07/2022
घोषणा की तारीख /Date of Pronouncement: 05/09/2022

आदेश / O R D E R

PER ABY T. VARKEY, JM:

This is an appeal preferred by the assessee against the order of the Ld. Commissioner of Income Tax (Appeals)-54, Mumbai dated 05.04.2017 for the assessment year 2011-12.

2. Ground no. 1 of the assessee is against the action of the Ld. CIT(A) confirming the action of the AO disallowing Rs.1,00,08,377/- u/s 14A of Income Tax Act 1961 (herein after the Act), read with Rule 8D of the Income Tax Rule, 1962 (hereinafter "the Rule").

3. Brief facts the AO noted on this issue is that the assessee had earned exempt income in the nature of dividend of Rs.41,920/- and tax free profit of Rs.7,50,256/- from partnership firm. The AO noted that the assessee had debited interest expenditure in his profit and loss account and that no expenditure has been treated as attributable to the earning of exempt income. Therefore, he gave show cause notice to the

assessee which according to him, elicited no relevant information from the assessee regarding expenditure incurred for earning the exempt income. The AO accordingly applied Rule 8D of the Rules and made an addition of Rs.89,28,935/- under Rule 8D(2)(ii) and Rs.10,79,442/- under Rule 8D (2)(iii). Thus, on this issue, total disallowance of Rs.1,00,08,377/- was made against the assessee. Aggrieved, the assessee preferred an appeal before the Ld. CIT(A) which was confirmed. Aggrieved, the assessee is before us.

4. At the time of hearing, the Ld. AR of the assessee submitted that the assessee have own funds (share capital to the tune of Rs.1.47 crores) and Reserve & Surplus to the tune of Rs.17.08 crores. Thus, has total own funds to the tune of Rs.19.33 crores. He further drew our attention to page no. 47 of the P.B wherein the balance-sheet is found placed as well as schedule – 6 which shows the investment in the equity-shares was to the tune of Rs.21.13 crores. Therefore, according to the Ld. AR, the disallowance made under Rule 8D (2)(ii) ie. with regard to the interest expenditure for earning the dividend income should not be made and for that proposition relied on the decision of the Hon'ble Bombay High Court in the case of Reliance Utility and Powers Ltd. Vs. CIT 313 ITR 340 (Bom) wherein the Hon'ble High Court has held that when the assessee is possessed of mixed funds which includes it's own funds in sufficient quantity, a presumption that its own funds were utilized for the advances (interest-free) is to be drawn in respect of the advances given (interest free). Therefore, according to the Ld. AR, the disallowance made for earning dividend

income of total Rs.41,920/- may be deleted. Further, he also pointed out that the assessee had received tax free amount of Rs.7,50,256/- (profit) earned from the firm. It was pointed out by the Ld. AR that the assessee had taken over this firm in the year 1994 by investing Rs.20 Lakhs from own funds and no borrowed funds have been used for purchasing the firm. According to him therefore, no disallowance was warranted u/s 14A of the Act read with Rule 8D. Per contra, the Ld. Sr. DR supported the orders of the lower authorities.

5. We have heard the rival submissions. It is noted that the assessee had derived aggregate exempt income of Rs.7,92,176/- and therefore applicability of Section 14A of the Act in the instant facts of the case cannot be ruled out. The decision of Hon'ble Bombay High Court in the case of Reliance Utility and Powers Ltd. Vs. CIT (supra) is found to be factually distinguishable as the own funds of the assessee (Rs.19.33 crores) is not sufficient to cover the cost of investments (Rs.21.13 crores). But, as noted earlier, the total exempt income earned was Rs.7,92,176/-. According to us, the disallowance u/s 14A of the Act cannot exceed the exempt income. Useful reference in this regard may be made to the decision of the Hon'ble Delhi High Court in the case of Joint Investments (P) Ltd Vs CIT reported in 372 ITR 694. Following the same, the AO is directed to restrict the disallowance u/s 14A to the extent of Rs.7,92,176/- and delete the balance sum. Ground No. 1 is therefore partly allowed.

6. The next ground is against ad-hoc disallowances made by the AO of Rs.2,29,354/- i.e. 10% of Telephone expenses, Car Expenses, Conveyance and Petrol, Entertainment and Misc. Expenses & Diwali & Toll parking expenses. We have heard both the parties. Having considered the submissions of the assessee along with the documents placed on record before us, it is noted that the books of accounts of the assessee company were audited and the ledgers of the expenses in question were furnished before the AO. We note that there is no provision in law which permits ad-hoc disallowance of expenses. According to us, the AO could have ventured into the act of estimation only after rejecting the books of accounts u/s 145(3) of the Act which has not been done in the facts of the present case. On these facts, we hold that the AO could not have resorted to estimated disallowance of expenses on suspicion and conjectures, without pointing out specific infirmity in the details provided by the assessee. Having said so, we hasten to add that if there was any deficiency in vouchers or bills which did not support the claim of expenses, then at the most, those item wise expenses which was not supporting the claim of expense could have been disallowed by the AO, rather than resorting to ad-hoc disallowance of expenses, which action of the AO is held to be arbitrary/whimsical in nature and has no sanction of law, hence cannot be sustained. We therefore delete the ad-hoc disallowance of expenses sustained by the Ld. CIT(A). Ground No. 2 is therefore allowed.

7. Ground No. 3 is against the AO's action of adding the profit on sale of fixed asset of Rs.54,702/- excluded from the computation of business income, by way of short-term capital gain. Heard both the parties. It is noted that, for accounting purposes, the net profit/gain arising from sale of fixed asset is credited in P&L A/c. On the other hand, for income-tax purposes, the entire sale consideration received on sale of fixed assets is adjusted from the block of assets in terms of Section 43(6) read with Section 32 of the Act and only if the block ceases to exist, then the positive/negative figure remaining therein, is taxable as deemed short term capital loss/gain in terms of Section 50 of the Act. Having perused the material placed before us, we do not find any infirmity in the action of the assessee of excluding the profit on sale of fixed asset of Rs.54,702/- while computing business income. It is noted that the gross sale consideration (including the profit element embedded therein) was adjusted from the block of assets in accordance with Section 43(6) of the Act. Since the block of asset did not cease to exist, there was no charge of capital tax arising in terms of the deeming fiction set out in Section 50 of the Act. On these facts therefore, the action of the lower authorities confirming the addition of Rs.54,702/- by way of short-term capital gain is held to be unsustainable and hence deleted.

8. The next ground relates to disallowance of Rs.2,409/- made by the lower authorities on account of late deposit of employees' contribution on account of PF, on the ground that the same were not deposited within the due date prescribed under the Act. However, this

issue is now no longer res-integra as has been decided in favour of the assessee by the Hon'ble Bombay High Court in case of **CIT v. Ghatge Patil Transports Ltd. (368 ITR 749)** by confirming the order passed by the Tribunal that deduction claimed by the assessee on account of employees contribution to PF & ESIC well before the due date of filing return of income is allowable deduction. Following the binding precedent (supra), we are of the considered view that since the amended provisions contained under section 43B read with section 36(1)(*va*) of the Act are not applicable for the year under consideration *i.e.* A.Y. 2011-12 as the amendment will be effective from A.Y. 2021-22 and therefore AO/ Ld. CIT(A) have erred in disallowing the same. Consequently, the impugned addition is deleted and therefore Ground No. 4 is allowed.

9. Next comes the disallowance u/s 36(i)(iii) to the tune of Rs.3,43,70,730/-. The AO on perusal of the balance-sheet of the assessee noted that the assessee had advanced huge amounts of sums as loans and advances and on the other hand, it has also taken secured and unsecured loans. According to the AO, the interest paid on borrowed funds were significantly higher than the interest received on the loan and advances given by the assessee. Therefore, according to him there was a possibility that interest bearing funds were being diverted towards non-business purpose by giving loans and advances on which no interest was earned. Thereafter, he made disallowance of Rs.3,43,70,736/- by holding as under: -

"13.2. The assessee was also asked to submit a break up of loans taken and loans and advances given clearly giving a party-wise break up of interest - paid/received, rate of interest charged etc. A party-wise break up for the same was given by the assessee which showed that other than sub-heads such as deposits and advance for suppliers, loans and advances were also extended to related parties. In this regard no justification was given for extending interest free loans and advances for purposes other than business nor was any evidence given to justify that the same has any nexus to the earning of business income. From the party wise break up given by 'the assessee, the following details are relevant:

Head	Amount
Secured Loans	24,41,67,812
Unsecured loans on which interest is paid	91,95,880
Interest received	83,27,827
Loans and advances not related to business given *	21,37,48,411
Interest paid	6,11,95,933

*Loans and advances not related to business

Current a/c with M/s. Eagle Steel		3,08,46,894
Advance Recoverable		
Hariprasad Shah Current Account	4,61,325	
Ritu J. Shah Current Account	13,70,416	
Janki Shah	36,29,730	
Atul Shah	1,00,000	
Bharat Shah	1,50,000	
Maharashtra Power Trans struct P. Ltd.	16,66,14,046	
Maharashtra Steels Investments P. Ltd.	1,05,76,000	18,29,01,517
Total		21,37,48,411

13.3. No justification for extending interest-free loans and advances for nonbusiness purposes, has been given by the assessee. It can be seen that interest-free advances have also been given to related parties such as Janki Shah(director) and sister concerns like Maharashtra

Power Transmission Structure Pvt Ltd and Maharashtra Steels Investment Pvt . Despite an opportunity being given the assessee has not'submitted any proof or given any reasons to prove that the same was done for business purposes. Thus it is held that the assessee has diverted interest bearing funds towards nonbusiness purposes and proportionate interest is disallowed. Total loans taken Rs 25,33,63,692/- (24,41,67,812 + 91,95,880), loans and advances given which are not related to business are Rs 21,37,48,411/-.

Interest to be disallowed = Interest paid * (loans given/loans taken)

6,11,95,933 * (21,37,48,411/ 25,33,63,692)

= 5,16,27,498

13.4. As the assessee has received interest of Rs 83,27,827/- and a sum of Rs 89,28,935/- has already been disallowed wrt expenditure u/s 14A, a sum of Rs 3,43,70,736/- (5,16,27,498 - 83,27,827 - 89,28,935) is hereby disallowed as interest paid on borrowed funds diverted for non-business purposes..

10. Aggrieved, the assessee preferred an appeal before the Ld. CIT(A) who confirmed the action of AO. The assessee brought to our notice the following facts as under: -

"7.1 The appellant had Rs.22.94 crores secure loan as on 31.03.2011 and Rs.92.96 lacs as unsecured loan as on 31.03.2010 and as on 31.03.2011 the secured loan figure stand as Rs.24.42 crores and unsecured loan at Rs.91,96 lacs, it could be seen that during the year only Rs.1.48 crores was the appreciation figure. The said amount of income pertains primarily the added amount because of the interest charged by bank of Baroda and Bank of India as could be seen from the Schedule 3 of Balance-Sheet.

7.2 It is humbly stated that entire borrowed funds were utilized for business diverted for non-business purpose as had been summarily alleged.

Schedule-3

Balance Sheet-47

BOB utilization 186-198

BOI utilization 197-198

7.3 During the year the appellant has borrowed Rs.1,46,68,775/- and the total borrowings stands at Rs.24,41,67,812/-

(Balance Sheet-47)

(Loan & Advance-40)

7.4 Interest free funds available with the appellant stands at Rs.30,79,20,441/- compressing of:

Reserve Surplus	Rs.17,85,20,552/- (45 of P.B)
Received from Sundry Debtors	Rs.12,93,99,889/- (55 of P.B)
Turn over Achieved	Rs.183 Crores (48 of P.B)

7.5 Having narrated above, and it is humbly urged to accept that no borrowed funds had been diverted. Therefore, no-business purposes. Therefore, the disallowed of interest is uncalled for.

7.6 Thus the proposition raised had been accepted by Hon'ble ITAT while passing the order for.

7.7 By passing current account and its utilization	186-198
7.8 By passing current account and its utilization	198-238
7.9 BOB and BOI ledger Account	239-264

11. We have heard both the parties and perused the records. Before us, the assessee has raised two alternative pleas viz., (a) the own funds of the assessee were sufficient to justify the interest free advances and

(b) the interest free advances were given for business purposes and therefore any interest expenditure relatable thereto was allowable u/s 36(1)(iii) of the Act. As far as the first plea is concerned, the Ld. AR of the assessee contended that the assessee free reserves of Rs.17.85 crores and sundry debtors of Rs.12.93 crores, aggregating to Rs.30.79 crores as against interest free advances of Rs.21.37 crores [and the turnover of Rs 180 crores, which when examined (page 48PB) we find expenditure was also the same, and profit before tax was only Rs 23 lakhs, so this contention is rejected]. Further, we are unable to agree with the calculation of the assessee in respect of own funds, i.e, Rs 30.79crores. Because, the sundry debtors of Rs.12.93 crores represent the dues which are realizable from customers. Hence, the contention of the assessee that sundry debtors were utilized against interest free advances is erroneous and untenable. Further, while arguing the first ground [regarding investment to earn dividend (supra)], it was contended that the free reserves were utilized to make investments and in the same breath, the assessee now seeks to telescope the free reserves against interest free advances, which contention is not possible in the facts of the case; and moreover, the assessee's main contention is that these interest-free advances took place in earlier years, so the argument that the interest-free advances can be traced to the own funds of this year cannot be countenanced. For the reasons as aforesaid, we reject the first plea raised by the assessee against the interest disallowed by the AO u/s 36(1)(iii) of the Act.

12. Coming to the second alternative plea, the Ld. AR of the assessee pointed out that both the interest-bearing loans and interest free advances were brought forward from earlier year/s and that the change in the figure of interest-bearing loans was majorly attributable to the interest accrued thereon. According to him, the interest free advances were given in the course of business in the earlier years for which he drew our attention to the utilization statements placed at Pages 186-238 of paper book. He pointed out that the majority of the interest free advances were attributable to associate entities viz., (a) M/s Maharashtra Power Transmission Structures Pvt Ltd, which was engaged in the business of manufacture of galvanized and ungalvanized tower parts whose principal raw material was angles which was manufactured and supplied by the assessee, and (b) M/s Maharashtra Steels Pvt Ltd. which was engaged in similar line of business of manufacturing rolling steel products. Therefore, according to Ld. AR, in order to ensure continuity of the businesses of these entities which also had a bearing on the business activities of the assessee, interest free advances were given to them in the regular course of business. He submitted that the business/commercial expediency was the reason behind these interest free advances, which were given in earlier years, and the same had been accepted in the earlier income-tax assessments and accordingly, no disallowance of corresponding interest paid on loans was made u/s 36(1)(iii) of the Act in earlier years. Therefore, according to assessee in absence of change of facts and law, and moreover, since there were no fresh advances

given during the relevant year under consideration, it was contended that the principle of consistency should have been followed by the AO and accordingly no disallowance u/s 36(1)(iii) of the Act ought to have been made by him.

13. This second plea of the assessee appears convincing at first blush. It is noted that, apart from making a sweeping remark, the AO has not any material to show that the interest free advances were for non-business purpose. At the same time, we also note that no documents or evidence has been placed before us by the assessee to back their contention that these interest free advances were for business purposes/commercial expediency. Indeed, the interest free advances were given in the earlier years, but nothing has been brought on record to show that their business expediency was enquired into in the earlier income-tax assessments. Similarly, no evidence has been adduced before us to show that due to commercial expediency, the assessee advanced the interest-free advances to its associates. In the fitness of the matters therefore, we set aside this issue back to the file of the AO to examine it de-novo and even the argument of assessee regarding application of principle of consistency, which is left open. Needless to say that assessee should be heard before adjudicating the issue and it is at liberty to file documents to substantiate its contention regarding advances given in earlier years and its acceptance by the department to support its contention of consistency. Further, the AO while adjudicating this issue may also keep in mind the following

observations made by the Hon'ble Supreme Court in the case S.A Builders Vs CIT (288 ITR 1) regarding commercial expediency:-

> **34.** We agree with the view taken by the Delhi High Court in *CIT* v. *Dalmia Cement (Bharat) 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.
>
> **35.** We wish to make it clear that it is not our opinion that in every case interest on borrowed loan has to be allowed if the assessee advances it to a sister concern. It all depends on the facts and circumstances of the respective case. For instance, if the Directors of the sister concern utilize the amount advanced to it by the assessee for their personal benefit, obviously it cannot be said that such money was advanced as a measure of commercial expediency. However, money can be said to be advanced to a sister concern for commercial expediency in many other circumstances (which need not be enumerated here). However, where it is obvious that a holding company has a deep interest in its subsidiary, and hence if the holding company advances borrowed money to a subsidiary and the same is used by the subsidiary for some business purposes, the assessee would, in our opinion, ordinarily be entitled to deduction of interest on its borrowed loans.

14. For the reasons set out above, Ground No. 5 is allowed for statistical purposes.

15. In the result, the appeal of the assessee is partly allowed for statistical purposes**.**

Order pronounced in the open court on this 05/09/2022.

Sd/-	Sd/-
(GAGAN GOYAL)	**(ABY T. VARKEY)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

मुंबई Mumbai; दिनांक Dated : 05/09/2022.
Vijay Pal Singh, (Sr. PS)

आदेश की 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.

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