

आयकर अपीलीय अधिकरण, अहमदाबाद न्यायपीठ
**IN THE INCOME TAX APPELLATE TRIBUNAL,
RAJKOT BENCH, RAJKOT**

**BEFORE SHRI WASEEM AHMED, ACCOUNTANT MEMBER,
And
SHRI SIDDHARTHA NAUTIYAL, JUDICIAL MEMBER**

आयकर अपील सं./ITA No. 192/Rjt/2017
निर्धारण वर्ष/Asstt. Years: 2013-2014

Sureshkumar H. Chandarana, A-75 New Market Yard, Village Bedi, Rajkot. PAN: ABCPC8536E	Vs.	I.T.O., Ward-2(1)(5), Rajkot.
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Assessee by :	Shri Mehul Ranpura, A.R
Revenue by :	Shri B.D. Gupta, Sr. D.R

सुनवाई की तारीख / **Date of Hearing** : **06/07/2022**
घोषणा की तारीख / **Date of Pronouncement**: **16/09/2022**

आदेश/ORDER

PER BENCH:

The captioned appeal has been filed at the instance of the Assessee against the order of the Learned Commissioner of Income tax (Appeals)-2, Rajkot, dated 09/03/2017 arising in the matter of penalty order passed under s.143(3) of the Income Tax Act, 1961 (here-in-after referred to as "the Act") relevant to the Assessment Year 2013-14.

2. The assessee has raised the following grounds of appeal:

1. *The grounds of appeal mentioned hereunder are without prejudice to one another.*
2. *The learned Commissioner of Income-tax (Appeals)-2 [hereinafter referred to as the Id.CIT(A)] erred on facts as also in law in confirming disallowance of interest expense of Rs.25,33,075/- u/s.14A r.w.s. 8D of the Act by holding that appellant has paid interest for funds borrowed which was invested in earning exempt income. The disallowance made by the AO and as confirmed by the Id.CIT(A) is totally unjustified on facts as also in law and may kindly be deleted.*
3. *Your Honor's appellant craves leave to add, amend, alter or withdraw any or more grounds of appeal on or before the hearing of appeal.*

3. The only issue raised by the assessee is that the learned CIT-A erred in confirming the disallowance of Rs. 25,33,075.00 under the provisions of section 14A read with rule 8D of Income Tax Rule.

4. The facts in brief are that the assessee in the present case is an individual and engaged in the business of trading and as commission agent of agricultural produce. The AO during the assessment proceedings found that the assessee has borrowed fund on which interest is being paid at different rates ranging from 12% to 21% per annum. The amount of interest paid by the assessee stands at ₹ 60,79,380 only. On the other hand the assessee has made investment in the partnership firm and earning interest thereon at the rate of ₹7 percent only. Likewise the assessee has also advanced money for nonbusiness purposes without charging of the interest.

5. Accordingly, the AO was of the view that the disallowance under the provisions of section 14A is required to be made. As per the AO, the prevailing interest rate on the loan is 12% whereas the assessee earning interest at the rate of 7% only. Thus the difference in the rate of interest being 5% have been considered for the purpose of the disallowance. The AO finally worked out the amount of excess interest in the manner as detailed below:

The Average rate of interest @ 12% is taken into consideration for computing excess disallowance of interest. Accordingly, the difference between the average interest rate and interest recovered from the firm is taken for consideration which is again given as under:

*Interest on unsecured Loan X Excess rate (5%)
Average interest rate 12%*

$$=Rs.60,79,380 \times \frac{5\%}{12\%} = Rs.25,33,075/-$$

From the above computation, it can be seen that interest received from the partnership firm is taken into consideration. Only the difference of average rate of interest and interest recovered from the firm is considered for the determination of disallowance of interest. Accordingly, the excess interest of Rs.25,33,075/- is disallowed and added back to the total income of the assessee.

6. Aggrieved assessee preferred an appeal to the learned CIT-A who has also confirmed the order of the AO by observing as under:

*Thus it can be said that **assessee having charged lesser interest from firm and having earned profit, which is exempt u/s Sec 10(2A), the assessee is liable for provision of Section 14A. In view of above, it is held that AO has correctly invoked provision of Section 14A in this case.***

I also find that the plea that the investments were made out of own capital is also not tenable as the capital of assessee is only Rs. 3.52 crores whereas his investments amounts to Rs. 7.23 crores and the loans raised by assessee amount to Rs. 14.81 cr. This contention is therefore rejected. As a corollary, the plea that nexus between funds borrowed and invested for earning exempt income is not established is also not .tenable.

The plea that no new investments have been made during the year is also not tenable because in the given case the investments have been made from borrowed funds and the charging of interest low rate on partners capital and paying higher interest on borrowings is a continuous process. The interest paid for funds borrowed and invested in earning exempt income do attract Section 14A. The case laws cited by the assessee are distinguishable on facts and therefore do not apply to case of the assessee. This plea of assessee is therefore rejected. . .

As regards to the contention that assessee has earned interest of Rs. 48,02,414/- and AO ought to have netted interest expenses I find that this contention has no merit as there is not such provision in Section 14A or the Rule 8D.

Therefore, I am of the considered opinion that the action of AO calls for no interference. Disallowance is confirmed. Ground of Appeal is rejected.

7. Being aggrieved by the order of the learned CIT-A, the assessee is in appeal before us.

9. The learned AR before us filed a paper book running from pages 1 to 61 and contended that no borrowed fund has been used for making the investments in the partnership firm. As such the assessee from the partnership firm was also earning remuneration as well which was taxable in his hands. Accordingly the learned AR submitted that no disallowance is warranted under the provisions of section 14-A read with rule 8D of Income Tax Rules.

9. On the other hand, the learned DR vehemently supported the order of the authorities below.

10. We have heard the rival contentions of both the parties and perused the materials available on record. From the preceding discussion, we find that the disallowance has been made by the AO under the provisions of section 14A but without making any reference to the rule 8D of Income Tax Rule. The provisions of section 14A requires that the expenditures incurred by the assessee in relation to the exempted income cannot be allowed as deduction. The AO shall determine such income as per the method prescribed under rule 8D of Income Tax Rule. However, we find that the disallowance has been made by the AO taking the excessive rate of interest paid by the assessee on the unsecured loan. According to the AO the assessee was paying interest at the different rates ranging from 12% to 21% which was excessive. At the same time, the assessee was earning interest income on the money contributed as capital to the partnership firm at the rate of 7% per annum. First of all, we note that it is the prerogative of the assessee for making the payment of the interest on the loan borrowed by him. The revenue is not expected to interfere in the decision-making of the assessee. The Assessing Officer does not have any power to question the rate of interest or to disallow the deduction by stating grounds like a rate of interest is unreasonable or is charged less rate of interest on monies which he lent.

10.1 Likewise, at what rate the assessee should contribute capital in the partnership firm is the prerogative of the partner of the firm. The revenue cannot

question on the same. It is because that it is the business decision taken by the assessee. Both the partner and the partnership funds are related and interconnected to each other. If the partnership firm is paying higher rate of interest than the firm will claim greater deduction on account of interest and vice versa. As such the amount of interest paid by the partnership firm to the partner is generally viewed as tax neutral exercise.

10.2 Undeniably, the assessee is also earning share of profit form from the partnership firm which is exempted in the hands of the assessee and therefore the same can be made subject to the disallowance under the provisions of section 14A read with rule 8D of Income Tax Rule. In the given case, the dispute relates to the fact that the rule 8D was not invoked by the AO but made the disallowance on ad hoc and summarily manner considering the rate of interest paid by the assessee as excessive. It is also significant to note that there was the interest income earned by the assessee amounting to ₹ 48,02414.00 which have not been considered while calculating the amount of disallowance. As such the revenue was supposed to take net amount of interest for the purpose of disallowance under the provisions of section 14A of the Act.

10.3 Once the AO was not satisfied with the books of accounts of the assessee in the context of making the disallowance under the provisions of section 14A of the Act, the only option left with the revenue was to resort to the provisions of rule 8D of income tax rule, having regard to the books of accounts of the assessee. However, we note that the revenue has nowhere invoked the provisions of rule 8D of Income Tax Rule. Accordingly we hold, in the light of the above stated discussion, that the disallowance has been made by the AO on ad hoc, surmise and conjecture basis without referring to the provisions of rule 8D of income tax rule. Thus, such disallowance made by the AO which was subsequently confirmed by the learned CIT-A is not sustainable. Accordingly, we set aside the finding of the learned CIT-A

and direct the AO to delete the addition made by him. Hence the ground of appeal of the assessee is allowed.

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

Order pronounced in the Court on 16/09/2022 at Ahmedabad.

**Sd/-
(SIDDHARTHA NAUTIYAL)
JUDICIAL MEMBER**

**Sd/-
(WASEEM AHMED)
ACCOUNTANT MEMBER**

Ahmedabad; Dated 16/09/2022
Manish
(True Copy)