

IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI 'G' BENCH, MUMBAI.

Before Shri B.R. Baskaran (AM) & Shri Rahul Chaudhary (JM)

I.T.A. No. 4202/Mum/2016 (A.Y. 2011-12)

Prabhudas Liladhar P. Ltd. 3 rd Floor, Shadhna House 570, P.B. Marg, Behind Mahindra Tower, Worli Mumbai-400 018. PAN : AAACP2733Q (Appellant)	Vs.	Addl. CIT, Range-4(2) Aayakar Bhavan M.K. Road Mumbai-400 020. (Respondent)
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Assessee by	Shri Vipul Joshi & Shri Simoni Chouhan
Department by	Shri A.K. Das
Date of Hearing	17.11.2023
Date of Pronouncement	07.02.2023

O R D E R

Per B.R.Baskaran (AM) :-

The assessee has filed this appeal challenging the order dated 30.3.2016 passed by the learned CIT(A)-9, Mumbai and it relates to A.Y. 2011-12. Following issues are urged in this appeal :-

- a) Disallowance under section 14A of the I.T. Act.
- b) Disallowance of profession fees paid for proprietary trade.
- c) Disallowance of legal and professional fees.
- d) Disallowance of rent payment.
- e) Disallowance of interest under section 40A(2)(b) of the Act.
- f) Disallowance of expenditure under section 40(a)(ia) of the Act.
- g) Enhancement of income by the learned CIT(A) by disallowing claim of loss of error trade.
- h) Enhancement of income by the learned CIT(A) by disallowing claim of bad debts written off.

2. The assessee is a stock broker and also carries on business depository operations, portfolio management services and proprietary trading in stocks and securities.

3. The first issue relates to the disallowance made by the Assessing Officer under section 14A of the Act. During the year under consideration, the assessee has earned exempt dividend income of Rs. 7,78,893/-, which consisted of dividend income received from shares held in Bombay Stock Exchange Ltd of Rs. 6,11,208/- and dividend income received from the stock in trade and mutual funds of Rs.1,67,685/-. The assessee disallowed 10% of dividend income i.e. Rs. 77,889/- under section 14A of the Act. The Assessing Officer took the view that the disallowance has to be made as per the provisions of rule 8D of the I.T. Rules. Accordingly he computed the interest disallowance at Rs. 56,95,554/- under rule 8D(2)(ii) of the I.T. Rules and expenditure disallowance of Rs. 7,18,592/- under rule 8D(2)(iii) of the I.T. Rules, both aggregating to Rs.64,14,146/-, After giving set off of suo-motu disallowance of Rs.78,889/- made by the assessee, the AO made net disallowance of Rs.63,36,257/-. The learned CIT(A) confirmed the same.

3.1 We heard the parties on this issue and perused the record. The Ld A.R submitted that the total investment held by the assessee in the year under consideration was Rs. 3.68 crores, which was brought forward from the earlier year i.e. during the year under consideration, the assessee did not make any fresh investment or disposed of any earlier investment. He further submitted that the own funds available with the assessee was around Rs. 40 crores, which is in far excess than the value of investments. Accordingly, he submitted that no disallowance out of interest expenditure is called for as per the decision rendered by Hon'ble Bombay High Court in the case of HDFC Bank Ltd. (2014)(366 ITR 505). We agree with the above said submissions made by the Ld A.R. Admittedly, the own funds available with the assessee is far exceeds the value of investment and the Hon'ble Bombay High Court

has held in the above said case that in that kind of situation, it should be presumed that the investment have been made out of own funds. Hence no disallowance out of interest expenditure is called for. With regard to the expenditure, we noticed that the assessee has received major portion of dividend income from only one company and the remaining dividend income was incidental on account of holding of shares as stock in trade. Under these set of facts, we are of the view that the disallowance of Rs. 77,889/- made by the assessee voluntarily, would meet the requirement of section 14A of the Act. Accordingly, we set aside the order passed by the learned CIT(A) on this issue and direct the Assessing Officer to delete the addition of Rs.66,36,257/- made by him under section 14A of the Act.

4. The second issue relates to the disallowance of “professional fees paid for the proprietary trade”. During the year under consideration, the assessee claimed a sum of Rs. 4.46 crores as professional fees paid of carrying out of its proprietary trade (arbitrage/jobbing business). The Assessing Officer noticed that an identical claim had been made by the assessee in A.Y. 2010-11 and the same was disallowed under section 36(1)(ii) of the Act by the AO holding that the assessee has made this payment to its employees under the garb of professional fees to circumvent provisions of section 36(1)(ii) of the Act.

4.1 The facts relating to this issue needs little elaboration. The assessee engages jobbers/arbitrages for carrying on stock market operations. It was submitted that the independent agreements are entered between the assessee and the jobbers to carry on stock market business as a joint venture business on the terms and conditions mutually agreed between them. As per the agreement both the parties shall agree to share profit and loss in mutually agreed terms. Accordingly it was submitted that the relationship between the assessee and the jobbers are on Principal and Principal basis and hence, what is given to the jobbers/arbitrages is their

respective shares of profit as per the agreement. Accordingly, it was contended that there is no employer and employee relationship between them. Hence, it was submitted that the provisions of section 36(1)(ii) will not be applicable. The above said contentions were not accepted by the AO.

4.2 The Assessing Officer also noticed that the assessee, out of the above said amount of Rs.4.46 crores, has paid a sum of Rs.2.11 crores to a corporate entity named M/s. Aupera Financial Services Limited. The Assessing Officer noticed that the above said company is a related party of the assessee. He also noticed that some of the jobbers/arbitrators have worked for the assessee as well to the above said company. Accordingly, the Assessing Officer held that the professional fees of Rs. 2.11 crores paid to the above said company is also disallowable under section 40A(2)(b) of the Act. Accordingly the Assessing Officer disallowed by entire claim of Rs.4,46,48,327/-.

4.3 Before the learned CIT(A), it was contended that the addition made by the Assessing Officer in A.Y. 2010-11 under section 36(1)(ii) has been deleted by the learned CIT(A). it was also submitted that the assessee has made voluntary disallowance of Rs. 89,47,036/- out of the above said claim on account of non-deduction of TDS under section 40)a)(ia) of the Act while computing total income and it was not considered by the AO while making the disallowance, resulting in double disallowance. The learned CIT(A), however, held that the decision rendered in A.Y. 2010-11 need not be followed during the year under consideration, since the principle of res-judicata is not applicable to income tax proceedings. The learned CIT(A) held that the Assessing Officer has conducted independent inquiry during the year under consideration by issuing notice under section 133(6) of the Act. Further the Assessing Officer has invoked section 36(1)(ii) and also section 40A(2)(b) of the Act. Accordingly, he took the view that the main intention of the Assessing Officer was to make the disallowance on merits only. The

learned CIT(A) also held that quoting of wrong section will not vitiate the addition. Accordingly, he held that the objections raised by the assessee for invoking section 36(1)(ii) of the Act is liable to be rejected.

4.4 The learned CIT(A) examined the issue on the basis of the investigation made by the Assessing Officer. During the course of assessment proceedings the Assessing Officer had called for certain details from M/s. Aupera Financial Services Limited. From the reply received from the above said company, it was noticed by the Assessing Officer that the above said company has raised bills numbered as 01/2010-11 and the second 02/2010-11 and both bills are dated 31.3.2011. However, the above said bills have shown as received by the assessee on 5.8.2011. The learned CIT(A) also noticed that the assessee had made payment to the above said company prior to the receipt of bills. He further held that as per the agreement net profit is shown between the assessee and the jobbers. The said net profit would have been arrived at after debiting all expenses. Hence, further claim of expenditure against the net profit is tax avoidance method followed by the related party. From the financial statement of M/s. Aupera Financial Services Limited, the Assessing Officer had noticed that the above said company has claimed the expenditure of Rs. 1.89 crores against the income received from the assessee of Rs. 2.14 crores. Accordingly, the learned CIT(A) took the view that the genuineness of the transactions entered by the assessee with M/s. Aupera Financial Services Limited are doubtful. Accordingly he held that the professional fees of Rs. 2.14 crores paid to M/s. Aupera Financial Services Limited is liable to be disallowed under section 40A(2)(b) of the Act. With regard to the remaining payments, the learned CIT(A) took the view that the profit shared with jobbers cannot be claimed as deduction. Accordingly, he confirmed the disallowance made by the Assessing Officer.

4.5 We heard the parties on this issue and perused the record. We notice that the relief granted by Ld CIT(A) on an identical addition made in AY 2010-

11 has since been upheld by the Tribunal, vide its order dated 23-08-2017 passed in ITA No.2500 & 2501/Mum/2015. We notice that the Tribunal has held that the provisions of sec.36(1)(ii) as well as sec. 40(a)(ia) of the Act will not apply, as the relationship between the assessee and the jobbers/arbitrators is that of Principal to Principal. In the year under consideration, the Ld CIT(A) has taken the view that the AO has disallowed the claim on merits and quoting of wrong section will not vitiate the addition. The undisputed fact is that the assessee has entered a Joint Venture agreement with the jobbers/arbitrators and they have agreed to share the profits. What is given to these persons is only their respective share of profit. The Ld CIT(A) has expressed the view that this claim of the assessee is a method of tax avoidance. We are unable to understand the rationale behind this observation made by Ld CIT(A). When the agreements entered between the parties have not been doubted, how the share of profit paid to them as per the terms of agreement could be doubted with. Hence, we are unable to agree with the above said view expressed by Ld CIT(A).

4.6 With regard to the payments made to M/s. Aupera Financial Services Limited, the tax authorities have expressed the view that the same is liable to be disallowed u/s 40A(2)(b) of the Act. There should not be any dispute that the question of making disallowance of any expenditure u/s 40A(2)(a) of the Act shall arise only if the AO is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefits derived by or accruing to him there from. In that case, what is to be disallowed is the amount which is considered to be excessive or unreasonable. In the instant case, we notice that the AO has disallowed entire amount of Rs.2.41 crores. The AO has given certain reasons to disbelieve the transaction entered with the above said company. We notice that the assessee has not been given proper opportunity to explain the

transactions entered by it with the above said company. Further, the AO has also not properly followed the conditions prescribed in sec.40A(2)(b) of the Act. Under these set of facts, we are of the view that the issue of Rs.2.41 crores paid to M/s. Aupera Financial Services Limited requires fresh examination at the end of the AO.

4.7 With the regard to the remaining amount of expenditure, following the decision rendered by the co-ordinate bench in AY 2010-11 and also the discussions made supra, we direct the AO to delete the disallowance of remaining amount of expenditure.

4.8 Accordingly, we set aside the issue of payments of Rs.2.41 crores made to M/s Aupera Financial Services Ltd to the file of AO for examining it afresh after affording proper opportunity of hearing to the assessee. In the set aside proceedings, the assessee may bring to the notice of AO the issue of double disallowance or expenses not related to Proprietary trade, if any.

5. The third issue urged by the assessee relates to the disallowance of advocate fee of Rs.4.50 lakhs paid by the assessee company for taking anticipatory bail for its director and officials. The facts relating to that are explained in brief. A person named Shri Naresh Gupta was client of the assessee company by having a trading account with the New Delhi branch of the assessee company. The above said client noticed that unauthorized trades have been executed in his accounts by misusing the power of attorney given by him to the assessee company. Accordingly he lodged a FIR on 8th Jan, 2011 and the manager of the assessee company was arrested. Since the company apprehended that the directors and other officials of the company could be arrested, an application seeking anticipatory bail was made, for which advocate fee was paid. The AO took the view that the compliant has been lodged against the directors and officials in their personal capacity and hence this expenditure cannot be considered as related to the business of the

assessee. Accordingly, the AO held that this expenditure cannot be allowed as deduction u/s 37(1) of the Act. The Ld CIT(A) upheld the disallowance by following the decision rendered by Hon'ble Allahabad High Court in the case of Swadeshi Cotton Mills Co Ltd (1975)(100 ITR 59)(All).

5.1 We heard the parties and perused the record. We notice that the alleged fraud has happened in the account of client of the assessee and it has been alleged to have been committed by the employees of the assessee company. Since the fraud has happened in the assessee's own client account, there is inherent responsibility upon the assessee to redress the grievance of its client. Hence, we are of the view that this problem should be considered as the problem of the assessee company, i.e., it cannot be said that the FIR has been lodged in the personal capacity of the employees and directors. In the case of Swadeshi Cotton Mills Co Ltd (supra), the Hon'ble Allahabad High Court has held that this kind of claim should be decided depending upon the facts of each case. In the instant case, the compensation paid by the assessee to the above said client has been allowed as deduction in the hands of the assessee. Accordingly, we hold that the advocate fees paid for getting anticipatory bail for the directors and officials are in connection with the business carried on by the assessee. Accordingly, we set aside the order passed by Ld CIT(A) on this issue and direct the AO to delete the disallowance of Rs.4.50 lakhs.

6. The fourth issue urged by the assessee relates to partial disallowance of rent expenses.

- (a) The AO noticed that the assessee has paid rent of Rs.52,94,000/- to a related person named Shri Niraj Vora for a property located at Shop F-1, Mahalaxmi Centre, S.V Road, Opp.: Balbhati School, Kandivali (west), Mumbai. The AO further noticed that the very same address is being used by another group concern named M/s

Aupera Financial Services P Ltd. Hence the AO disallowed 50% of the above said rent payment.

- (b) The AO noticed that the assessee is claiming rent expenses of Rs.97.00 lakhs in respect of its registered address, viz., 3rd Floor, Sadhana House, 570 P B Marg, Worli, Mumbai – 400018. He further noticed that the very same address is being used by another two concerns, viz., M/s Sheth Financial Services and M/s Prabhudas Liladhar Advisory Services P Ltd. He also noticed that the assessee has also paid rent of Rs.1,20,000/- M/s Sheth Investment & Financial Consultancy Services P Ltd and Rs.37,47,401/- to M/s PL Fund Advisor Services P Ltd. Hence the AO disallowed 2/3rd of Rs.97.00 lakhs.
- (c) In total, the AO disallowed a sum of Rs.99,22,000/-.

The Ld CIT(A) also confirmed the same.

6.1 The Ld A.R submitted that the assessee has not made payment of Rs.97.00 lakhs for its registered office as observed by the AO. He further submitted that the AO has made this disallowance on presumptions. He also submitted that the rent has been paid by the assessee at commercial rates. He also submitted that the rent of Rs.1,20,000/- and Rs.37,47,401/- have been paid for some other premises.

6.2 A perusal of the order passed by the tax authorities would show that this disallowance has been made by the AO without properly examining the factual details. The main contentions of the assessee are that the rent payments were made at market rates; the two payments have been made for different premises and the assessee has not paid any rent for registered office and these factual aspects have not been considered by the AO. Accordingly, we are of the view that this issue requires fresh examination at the end of

AO. Accordingly, we set aside the order passed by Ld CIT(A) on this issue and restore the same to the file of AO for examining this issue afresh by duly considering the factual details and also considering the market rate of rent u/s 40A(2)(a) etc. The AO should afford adequate opportunity of being heard to the assessee.

7. The fifth issue urged by the assessee relates to the disallowance of interest expenditure u/s 40A(2)(b) of the Act. The AO noticed that the assessee has paid interest @ 12% p.a. to its sister concern named M/s Prabhudas Liladher Advisory Services P Ltd (PLASPL). It was noticed from the Credit arrangement letter dated 29-03-2010 issued by ICICI Bank that the bank has sanctioned credit limit Rs.63.90 crores @ 11.50% p.a titled as Optionally Convertible Loan (OCL) to PLASPL group, which included the assessee also. The AO further noticed that the assessee has actually borne the loan processing charges and also stood as guarantor, obligator and given contractual comfort for the above said loan. The AO also noticed that the entire loan has been disbursed to the assessee directly by the bank. However, the assessee has paid interest @ 12% to PLASPL on the above said amount, which, in turn, paid interest @ 11.50% to ICICI Bank. Hence the AO disallowed 0.50%, being excess interest paid by the assessee to PLASPL u/s 40A(2)(a) of the Act. The Ld CIT(A) also confirmed the same.

7.1 We heard the parties and perused the record. The main contentions of the assessee are that

- (a) the higher rate of interest is paid to PLASPL in order to cover overhead expenses.
- (b) the PLASPL is a profit making company and the assessee has incurred loss in this year. Hence, the group has paid tax on the alleged excess interest payment.

We noticed that the loan has been sanctioned to the group, but entire amount has been received and used by the assessee only. Further, it is the assessee which has incurred loan processing expenses. Hence, we do not find any reason to pay excess interest of 0.50% to another group company. Accordingly, we are of the view that the disallowance made by the AO out of interest expenditure u/s 40A(2)(a) is justified. Accordingly, we confirm the order passed by Ld CIT(A) on this issue.

8. The sixth issue urged by the assessee relates to the disallowance made u/s 40(a)(ia) of the Act. The assessee paid Rs.77.30 lakhs to a company named M/s Prompt Personnel Services P Ltd towards "Payroll Maintenance Charges". The assessee deducted TDS @ 0.33% as per the lower deduction certificate issued by the assessing officer of the payee company. However, the said certificate has put a cap of Rs.40.00 lakhs. Hence the AO disallowed the difference amount of Rs.37.30 lakhs. The Ld CIT(A) also confirmed the same.

8.1 We heard the parties on this issue and perused the record. The Ld A.R submitted that the provisions of sec.40(a)(ia) shall be applicable only in case of non-deduction of tax at source, where as the present case is that of short deduction of tax at source. In the alternative, the Ld A.R submitted that the payee has declared the amount paid by the assessee as its income and accordingly prayed that the benefit of the proviso to sec.40(a)(ia) be given. The Ld A.R also furnished copies of return of income filed by payee.

8.2 We find merit in the alternative contentions of the assessee. Since the assessee has filed the details of return of income filed by M/s Prompt Personnel Consultancy Services P Ltd (the payee), we restore this issue to the file of AO for examining the alternative claim of the assessee, after affording adequate opportunity of being heard to the assessee.

9. The seventh issue relates to disallowance of claim on loss on account of error trade. The AO assessee claimed error trade loss as part of operating expenses. The AO did not make any disallowance on this account. The Ld CIT(A), during the course of appellate proceedings, called for details of annual accounts and annual reports and also the details filed before the AO. On examination of those details, the Ld CIT(A) asked the assessee to furnish the details of loss of trade of Rs.7,19,367/- as part of "Operating Expenses". The assessee submitted that its staffs are bound to commit certain errors while punching the orders, For example, if the order is for shares of BHEL, it is possible that the staff may punch BEL. When this error is made good by making corresponding reversal orders, there may be loss and that loss cannot be passed on to the customers. Hence the assessee has bore this loss and claimed the same as part of operating expenses. It was submitted that this kind of loss is normal business loss allowable u/s 28(1) of the Act. The Ld CIT(A) observed that the assessee has made general submissions without actually furnishing the relevant details. Accordingly, he enhanced the income of the assessee by disallowing the above said claim of Rs.7,19,367/-.

9.1 We heard the parties on this issue and perused the record. The Ld A.R submitted that the Ld CIT(A) did not call for specific details and hence there was no occasion for the assessee to furnish the details. He further submitted that the loss on account of error trades is a common expenditure incurred by all share brokers. Further, the considering the volume of transactions carried on by the assessee, the claim of Rs.7.19 lakhs was nominal. He submitted that the assessee has not claimed any bogus expenses and the loss amount is credited to the concerned Customers account. Accordingly, he submitted that there is no requirement of making any disallowance.

9.2 We find merit in the submissions made by the assessee. The total operational income declared by the assessee is Rs.71.43 crores and the same

would translate into several crores if the value of transactions are considered. There cannot be any dispute that the error while punching the customers' order is incidental to carrying on share brokerage business. Considering the quantum of expenditure claimed by the assessee vis-à-vis the gross income declared and also considering the nature of trade and its vulnerabilities, we are of the view that there is no reason to disallow the claim of Rs.7.19 lakhs relating to loss on account of error trade. Accordingly, we set aside the order passed by Ld CIT(A) and direct the AO to delete the disallowance.

10. The last issue relates to disallowance of bad debts claim of Rs.41.89 lakhs. When the customers do not pay the amount due to the assessee, it claims the same as bad debts. The said claim was accepted by the AO. The Ld CIT(A), during the course of appellate proceedings, called for details of bad debts. The assessee furnished details of 131 persons containing Account code, Account name and the amount of bad debt. The Ld CIT(A) held it to be insufficient and accordingly disallowed bad debts claim of Rs.41.89 lakhs.

11. We notice that an identical disallowance made in AY 2010-11 has since been deleted by the ITAT. Further claim of the assessee is allowable as per the decision rendered by Hon'ble Bombay High Court in the case of CIT vs. Shreyas morakhia (342 ITR 285). With regard to the bad debts claim of money lending companies and share broking concerns, it is required to be shown that the outstanding amount is written off as bad. There is no dispute that the assessee has written off the outstanding amount as bad debt. Hence we are of the view that no disallowance is called. Accordingly, we set aside the order passed by Ld CIT(A) on this issue and direct the AO to delete the disallowance of bad debt amount of Rs.41.89 lakhs.

12. In the result, the appeal filed by the assessee is treated as partly allowed for statistical purposes.

Pronounced in the open court on 07.02.2023

Sd/-
(RAHUL CHAUDHARY)
Judicial Member

Sd/-
(B.R. BASAKARAN)
Accountant Member

Mumbai; Dated : 07/02/2023

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent
3. The CIT(A)
4. CIT
5. DR, ITAT, Mumbai
6. Guard File.

//True Copy//

BY ORDER,

(Assistant Registrar)
ITAT, Mumbai

PS