

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH “SMC”,MUMBAI**

**BEFORE SHRI ABY T VARKEY (JUDICIAL MEMBER)
AND
MS. PADMAVATHY S. (ACCOUNTANT MEMBER)**

I.T.A. No.2506/Mum/2023
(Assessment year: 2016-17)

M/s Ila Sanat Jhaveri, CC-5073, Bharat Diamond Bourse, Bandra Kurla Complex, Bandra East, Mumbai-400 051 PAN : AAAPJ7079C	vs	Assistant Commissioner of Income- tax, Circle-19(1), Mumbai Matru Mandir, Tardeo, Mumbai-400 007
APPELLANT		RESPONDENT

Present for the Assessee	Shri Aadi Varma / Manoj Mundra
Present for the Department	Shri Rajesh Meshram – Sr AR

Date of hearing	25/10/2023
Date of pronouncement	30/10/2023

ORDER

Per Padmavathy S (AM):

This appeal of the assessee is against the order of Commissioner of Income-Tax (Appeals), National Faceless Appeal Centre (NFAC), Delhi [in short, CIT(A)] dated 16/05/2023 for the assessment year 2016-17.

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

1. Under the facts and in law, the learned CIT(A) erred in confirming disallowance of Interest expense claimed to the extent of Rs.27,39,000/-.

1.1 Under the facts and in law, the learned CIT(A) erred in restricting Interest allowance to the extent of 3% as against actual Interest paid @ 9%.

1.2 The learned CIT(A) erred in stating that the appellant had tried to reduce the tax liability by entering into arrangement of reducing her income by charging lower rate of interest on funds provided to the Partnership Firm and paying more interest on borrowed funds.

1.3 Under the facts and in law, the learned CIT(A) failed to appreciate the submission made by the appellant. The learned CIT(A) failed to appreciate the fact that the Interest paid is for the purpose of business and the same is allowable u/s 36(1)(iii) of the Income Tax Act 1961

1.4 Without prejudice to above, the learned CIT(A) failed to appreciate the fact that if appellant would have charged Interest at higher rate to Partnership Firm then it would had paid tax on lower amount, so the transaction is tax neutral.”

3. The assessee is an individual and filed the return of income for A.Y.2016 - 17 declaring total income at Nil. The case was selected for scrutiny under CASS and the statutory notices were duly served on the assessee. On perusal of the details submitted by the assessee, the Assessing Officer noticed that the assessee has received interest income at Rs.8,45,422/- on the capital account with partnership firm, M/s D A Jhaveri @3%. Against the said interest, the Assessing Officer noticed that the assessee has claimed a deduction under section 36(1)(iii) of the Income-tax Act (the Act, in short) towards interest paid at Rs.41,08,512/- resulting in a claim of loss of Rs.32,63,090/-. The Assessing Officer issued a show cause notice to the assessee calling for details pertaining to the interest claimed as a deduction. The assessee submitted that she has borrowed a loan from Life

Insurance Corporation of India against the Life Insurance policy of her son, Shalin S Jhaveri bearing interest @9% p.a. The assessee further submitted that the loan borrowed of Rs.4,82,48,750/- during assessment year 2015-16 was invested as loan to the partnership firm for the purpose of business enhancement and therefore, the deduction under section 36(1)(iii) has been claimed against the interest earned on the loan amount from the partnership firm. The assessee further filed the bank statement and the partnership account as evidences in support of the claim. The Assessing Officer did not accept the submissions made by the assessee. The Assessing Officer was of the view that no prudent businessman would ever engage in loss making activity and that there is no reason why the assessee would lend money at a lower rate (3%) while paying interest at a higher rate (9%). The Assessing Officer relied on the judgment of the Hon'ble Supreme Court in the case of SA Builders Ltd vs CIT (2007) 288 ITR 1 where the Hon'ble Court has opined that the correct test in such a case is whether the advance made is as a measure of commercial expediency. Accordingly, the Assessing Officer disallowed the entire loss of Rs.32,63,090/- and brought to tax the income against which such loss was set off.

4. Aggrieved, the assessee filed appeal before the CIT(A). The CIT(A) held that the assessee has borrowed at high interest rate which invested the same by lending loan to the partnership firm where low interest was charged and that the assessee could not substantiate any cogent reason in support of the claim. The CIT(A) further held that the assessee has tried to reduce the tax liability by entering into arrangement by reducing her income by charging lower interest rate on funds provided to partnership firm and paying more interest on borrowed funds. Accordingly, the CIT(A) modified the disallowance to the differential interest of

6% whereby the disallowance is reduced to Rs.27,39,000/-. Aggrieved, the assessee is in appeal before the Tribunal.

5. The Ld.AR submitted that the source and the genuineness of the funds borrowed is not questioned by the revenue. Further, it was submitted that the revenue has not disputed the fact that the borrowed funds are invested in the partnership firm. Therefore, the Ld.AR submitted that there cannot be any proportionate disallowance as there is no legislature which provides for such a proportionate disallowance and that under section 36(1)(iii) once the interest is paid for business purposes, there cannot be any part disallowance. The Ld AR further submitted that interest paid at a higher rate than the rate at which the interest income is earned cannot be the sole reason for a disallowance under section 36(1)(iii). The Ld.AR also submitted that the loan was taken in June, 2014 the repayment of which continued till 2021 and that in subsequent assessment year i.e. AY 2017-18, the assessing officer has not made any disallowance. The Ld.AR relied on the decision of the Bombay High Court in the case of CIT vs Reliance Communications Infrastructure Ltd (2012) 21 taxmann.com 118. The Ld.AR also made a detailed written submission by relying on various other judicial pronouncements.

6. The Ld.DR, on the other hand, relied on the order of the lower authorities.

7. We heard the parties and perused the material on record. The assessee, in the given case, has borrowed loan from LIC of India bearing interest @9%. The assessee has introduced the funds into the partnership firm. As per clause 10 of the partnership deed (page 48 of PB) dated 01st April, 2008, the partners are entitled to interest @3% on loans and advances given to the firm and accordingly, the assessee earned an interest income of Rs.8,45,422/- during the year under

consideration. On perusal of computation of total income (page 57 of PB), it is noticed that the assessee has claimed a sum of Rs.41,08,512/- as a deduction towards interest paid under section 36(1)(iii) of the Act under the head “Profits and gains of business or profession”. It is also noticed that the overall business loss of Rs.23,82,004/- has been set off against the “Income from house property” and the “Income from other sources”. The contention of the revenue is that the assessee has borrowed money at a higher rate of interest which she has invested in the partnership firm on which the interest income is earned at a lower rate and that there is no commercial expediency to make such investment which has resulted in a loss. The contention of the Id AR is that once the money borrowed is utilized for business purposes there cannot be any proportionate disallowance under section 36(1)(iii) and that it is an undisputed fact that the assessee has lent the money to the partnership firm to be utilized for the purpose of business.

8. Before proceeding further, we will look at the relevant provisions of section 36(1)(iii), which reads as below:-

“36. (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28—

(iii) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession :

Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction”.

9. It is clear from the above that interest if paid in respect of capital borrowed for the purpose of business or profession, then the same shall be claimed as a deduction while computing the income under section 28. In assessee's case, the revenue has not disputed the fact that the assessee has used the money borrowed for the purpose of business in the partnership firm in which she is a partner. The revenue has also not disputed that the loan is borrowed from a genuine source. The only reason for the revenue to make the disallowance is the commercial expediency and in that revenue has relied on the decision of the Hon'ble Supreme Court in the case of SA Builders (supra). It is relevant here to note the following observations of the Hon'ble Supreme Court in the said case –

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.

10. From the above observations it is clear the test of commercial expediency does not lie in the fact the transaction is resulting in profit or not since the concept of commercial expediency is much wider in scope and includes all expenditure incurred to run the business more efficiently and not necessary profitably as has been held by the Apex Court. What is to be seen is the purpose for which

borrowed money is finally utilized and if the money is utilized in a way that makes commercial sense and helps in running the intended business of the assessee more efficiently, then it can be said that the interest paid in respect of borrowed money has been incurred for the purpose of commercial expediency. Further in our considered view the concept of proportionate disallowance may arise provided the revenue is able to establish that the amount advanced is not fully utilized for the purpose of business and a portion is used for non-business purposes such a personal expenditure etc. In assessee's case the revenue has not brought anything on record to show that the entire loan given by the assessee to the partnership firm has not been used for the purpose of business but has solely relied on the fact that the entire transaction is resulting in loss and therefore there is no commercial expediency. We have already discussed that earning profit is not the only factor to determine whether there is commercial expediency and therefore the disallowance made for the said reason in our view is not tenable. In view of these discussions and considering the facts of the present case, we hold that the disallowance made stating that there is no commercial expedience merely for the reason that the transaction is resulting in a loss is not correct and accordingly the disallowance made under section 36(1)(iii) towards differential interest is hereby deleted.

11. In the result, appeal is allowed.

Order pronounced in the open court on 30/10/2023

Sd/-

sd/-

(ABY T VARKEY)	(PADMAVATHY S)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Mumbai, Dt :30th October , 2023

Pavanan

प्रतिलिपि अग्रेषितCopy of the Order forwarded to :

1. अपीलार्थी/The Appellant ,
2. प्रतिवादी/ The Respondent.
3. आयकर आयुक्त CIT
4. विभागीय प्रतिनिधि, आय.अपी.अधि., मुंबई/DR, ITAT,
Mumbai
6. गार्ड फाइल/Guard file.

BY ORDER,

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**Asstt. Registrar / Senior Private Secretary
ITAT, Mumbai**