

**IN THE INCOME TAX APPELLATE TRIBUNAL,
AGRA (SMC) BENCH, AGRA**

BEFORE : SHRI RAMIT KOCHAR, ACCOUNTANT MEMBER

**ITA No. 113/Agr/2021
Assessment Year: 2016-17**

Satish Prakash Agrawal, B-4, Alok Nagar, Jaipur House, Agra-282010, Uttar Pradesh	v.	ACIT, Circle 1(2)(1), Agra
PAN :AAUPA1917A		
(Appellant)		(Respondent)

Assessee by	Shri S.N. Agrawal, C.A.
Revenue by	Shri Shailendra Srivastava, Sr. DR

Date of hearing	26.12.2024
Date of pronouncement	07.02.2025

ORDER

This appeal in ITA No. 113/Agr/2021 for the assessment year 2016-17 has arisen from the appellate order dated 15.09.2021 [DIN & Order No. ITBA/NFAC/S/250/2021-22/1035585472(1)], passed by learned Commissioner of Income-tax (Appeals), NFAC, Delhi, which appeal before learned CIT(A) in turn has arisen from the assessment order dated 23.12.2018 passed by Assessing Officer u/s. 143(3) of the Income-tax Act, 1961(Order No. ITBA/AST/S/143(3)/2018-19/1014523221(1)).

2. Grounds of appeal raised by assessee in memo of appeal filed with ITAT, Agra Bench, Agra, reads as under :

1. That on the facts and in the circumstances of the case and in law, the Ld. Assessing Officer grossly erred in disallowing interest expense claimed as deduction in respect of unsecured loans by doubting the genuineness of interest expense more so when the Ld. Assessing Officer herself accepted the amount of unsecured loans as genuine thereby leaving no scope for doubting the genuineness of interest expense.

2. That on the facts and in the circumstances of the case and in law, the Ld. CIT (A), NFAC erred in restricting the deduction of interest expense only to the extent of interest income thereby maintaining the disallowance on account of interest expense to the extent of Rs. 20,46,265/- out of the total disallowance of Rs. 34,38,533/ made by the Ld. Assessing Officer without properly appreciating the facts of the case and submissions made before him.

3. That on the facts and in the circumstances of the case and in law, the Ld. CIT(A), NFAC erred in restricting the deduction of interest expense only to the extent of interest income thereby maintaining the disallowance on account of interest expense to the extent of Rs. 20,46,265/- out of the total disallowance of Rs. 34,38,533/ made by the Ld. Assessing Officer even when the entire amount of interest expense on unsecured loans was allowable as deduction under section 36(1)(iii) of the Income-Tax Act, 1961 since the unsecured loans were utilized for making investment in the partnership firm from where income in the form of interest and remuneration was earned and offered for tax in the income-tax return.

4. That on the facts and in the circumstances of the case and in law, the Ld. CIT(A), NFAC erred in restricting the deduction of interest expense only to the extent of interest income offered for tax under the head 'Income from Business and Profession' even when unsecured loans were also utilized for advancing loan to parties from whom interest income was earned and offered for tax under the head 'Income from Other Sources' and therefore the appellant prays to allow further deduction to the extent of interest income of Rs. 13,96,689/- offered for tax under the head 'Income from Other Sources'.

5. That on the facts and in the circumstances of the case and in law, the Ld. CIT(A), NFAC erred in not specifically directing the Ld. Assessing Officer to delete the addition of Rs. 10,06,265/- separately made by the Ld. Assessing Officer on account of disallowance of loss claimed under the head 'Income from Business and Profession' more so

when there remained no loss under the head 'Income from Business and Profession' after the Ld. Assessing Officer made addition of Rs. 34,38,533/- to the total income of appellant on account of disallowance of interest expense.

6. The appellant craves leave to add, alter, modify any grounds of appeal taken by him on or before the date of final hearing.”

2.2 The assessee has raised additional ground of appeal

“ Because the Assessment Order is bad in law in so far as the Id. AO has exceeded the mandate for which the process of scrutiny was initiated.”

3. Brief facts of the case are that the assessee is an individual. The assessee filed return of income on 06.03.2017, declaring income of Rs.5,17,690/-. Case was selected by Revenue for framing limited scrutiny under CASS to identify whether loss from partnership is admissible. Statutory notices u/s. 143(2) and 142(1) were issued by the Assessing Officer to the assessee, during the course of assessment proceedings. The assessee has declared income from house property, income from other sources and loss from business or profession, in the return of income filed with the Revenue. The assessee has shown loss of Rs.10,06,265/- from business or profession, which was sought to be set off/adjusted by the assessee with the income from house property and income from other sources. Assessing Officer observed that the assessee has taken interest bearing loans and the same were invested in the partnership firm namely Freedom Shoes LLP, from where the

assessee is earning income by way of remuneration, interest and share in profits. The assessee participated in the assessment proceedings at the fag-end when the assessment was getting time barred, and submitted the details, which were found by the Assessing Officer to be not complete. The assessee submitted before the AO during assessment proceedings that the assessee has taken loans and has invested funds in the partnership firm from where the assessee earns the income in the form of remuneration , interest and share in profits. That the assessee paid interest of Rs. 50,83,665/- on loan taken from ICICI Bank and other private persons. The assessee claimed to have enclosed confirmation of unsecured loans. The details of interest paid were also enclosed. The assessee also submitted that the assessee is not carrying any such business where the books of accounts are required to be maintained. Thus, the assessee submitted that there is no balance sheet or Profit & Loss Account. The assessee also enclosed unsecured loan list as well copy of bank statement. The AO observed from the many of the confirmation letters submitted that the assessee has given incomplete information in relation to Address & PAN no.. The AO observed that in some of the cases the assessee has not submitted confirmation letter nor the Address and PAN of the lenders. The AO deputed inspector to conduct enquiry in 6 cases where complete addresses were provided by

the assessee. The inspector submitted that the parties have confirmed advancing loan to the assessee and subsequent receipt of interest. However, they could not provide supporting documents such as ITR, computation of income and bank statement. In one case, the lender Mrs. Neelima Jain was not available as she was out of country. The AO observed that creditworthiness and genuineness of the unsecured loan was not fully established in the absence of documentary evidences. There were in all 33 lenders from whom the assessee borrowed the money as per list provided by the assessee before the AO during assessment proceedings. The assessee has in as many as 14 cases did not give PAN, addresses nor confirmation letters from the lenders from whom the assessee has borrowed the funds. The AO issued notices u/s 133(6) to 11 lenders out of which only 5 lenders responded to the enquiries made by the AO. The AO based on the analysis of the enquiry observed that the creditworthiness of the lender and genuineness of the interest could not be proved. The observations of the AO are recorded in the assessment order. The assessee even did not furnish the copy of partnership deed. The AO observed that the interest expenses incurred by the assessee can be deducted against income earned from the partnership firm. The AO further observed that interest paid cannot be permitted to be deducted against remuneration earned by the assessee

from the partnership firm. Thus, the Assessing Officer was not satisfied with the explanation given by the assessee, which led to the disallowance of Rs.34,38,533/-towards interest on loans, which was claimed by the assessee as deduction in relation to unsecured loans raised by the assessee, which was sought to be set off against income from remuneration from partnership firm, in which the assessee was partner, namely Freedom Shoes LLP, and further for rest of the interest expenses which is claimed as deduction against income earned by the assessee cannot be allowed as per AO because of the fact that the genuineness of the interest expenses claimed are not established.

3.2 The Assessing Officer further disallowed loss of Rs.10,06,265/- claimed by the assessee under the head “ Profits and Gains of Business and profession”, which the assessee sought to adjust/set off against income from house property and income from other sources. Thus, as against the returned income of Rs.5,17,690/-, the Assessing Officer assessed the income of the assessee to the tune of Rs.49,62,488/-.

4. Aggrieved, the assessee filed first appeal with the CIT(Appeals), and the Id. CIT(Appeals) partly allowed the appeal of the assessee. The Id. CIT(A) observed that the assessee has 25% share in partnership firm M/s Freedom Shoes LLP. The assessee has earned interest income of Rs. 30,37,400/- on capital employed in the said firm , and against that the

assessee has claimed interest expenses of Rs. 50,83,665/-.The Id. CIT(A) observed that the assessee has borrowed funds from the private parties at the rate of 15% , while the assessee borrowed funds from ICICI Bank at the interest rate of 12%. The Id. CIT(A) observed that the assessee has paid interest on higher rate compared to rate of interest on which interest is received from partnership firm on the loans given . As per Id. CIT(A), this is avoidance of tax. The onus is on the assessee to prove that money borrowed is not used for non-business purposes and the lending has been done keeping in view commercial expediency. Learned CIT(Appeals) observed that the excessive interest expenditure being the interest at the higher rate vis-a-vis interest income received by the assessee from partnership firm @ 12% needs to be disallowed, which led to disallowance of Rs.20,46,265/- being affirmed by Id. CIT(A), being the difference between the interest paid of Rs.50,83,665/- and interest received of Rs.30,37,400/-. The contention of the assessee that once the interest expenditure is disallowed then there cannot be separate disallowance of the loss of Rs.10,06,625/-, as there will be positive income under the head income from business or profession (after considering disallowance of interest expenditure) ,but this contention was not accepted by the Id. CIT(Appeals) and the same was dismissed.

5. Aggrieved, the assessee has filed second appeal with the Tribunal, and Id. Counsel for the assessee drew my attention to the written synopsis and the paper book filed by the assessee. It was submitted that the case of the assessee was selected for framing limited scrutiny under CASS for the reason whether loss from partnership firm is admissible. It was submitted that the Assessing Officer has made double additions, firstly disallowance of interest expenditure to the tune of Rs.34,38,533/- and secondly disallowance of business loss of Rs.10,06,265/- . The AO did not allow the set off of said losses against income from house property and income from other sources. It was submitted that once the expenditure of interest of Rs.34,38,533/- was disallowed by the Assessing Officer, there remains positive business income in the hands of the assessee and hence, there was no business loss remaining, which could have been set off against income earned under the other heads. Thus, total disallowance made by the Assessing Officer is not sustainable in the eyes of law. Learned CIT(Appeals) also erred in sustaining the addition by holding the interest expenditure paid by the assessee on the borrowed funds to be excessive vis a vis interest received by the assessee. It was submitted that as per provisions of the Income Tax Act, only interest @ 12% on capital invested by partners can be paid/allowed as deduction in the hands of the firm ,and rest is to be

disallowed as per provisions of the Act. Thus, there was no error on the part of the assessee charging 12% interest on the capital invested in the partnership firm, Freedom Shoes LLP. It was submitted that disallowance of Rs.10,06,265/- was double addition and the same ought to have been deleted.

6. Ld. Sr. DR, on the other hand, relied upon the order of Id. CIT(Appeals).

7. I have considered rival contentions and perused the material on record. I have observed that the assessee filed return of income on 06.03.2017, declaring total income of Rs.5,17,690/-. Assessee is drawing income from house property, income from other sources, and also income by way of remuneration, share of profits from the partnership firm namely Freedom Shoes LLP as well as income from interest from the said partnership firm on the capital contributed by the assessee. Case of the assessee was selected by Revenue for framing **limited scrutiny** under CASS for the **reasons whether loss from partnership firm is admissible**. The assessee has shown loss of Rs.10,06,265/- from business or profession in his return of income, which the assessee has sought to be set off against the income from house property and income from other sources. The assessee is a partner in the partnership firm, Freedom Shoes LLP. The assessee is having 25% share in the said

partnership firm. It is also observed from the computation of income filed by the assessee that the assessee being partner of the Partnership Firm M/s Freedom Shoes LLP has claimed to have earned share of profit from the partnership firm, M/s. Freedom Shoes LLP, to the tune of Rs.5,94,609/-, which was claimed to be exempt from income-tax keeping in view provisions of Section 10(2A). It is seen that the case of the assessee was selected by Revenue for framing **limited scrutiny** by CASS to identify **whether loss from partnership firm is admissible.** The share of profit from partnership is exempt from tax in the hands of the partner (Section 10(2A)). Thus, the assessee does not have any share of loss arising from the partnership firm Freedom Shoes, LLP. The case of the assessee was selected for framing limited scrutiny by CASS to identify **whether loss from partnership firm is admissible.** There is no share of loss arising from the partnership firm in the hands of the assessee. This is a case of limited scrutiny. Thus, the AO cannot proceed further with assessment beyond stipulated under limited scrutiny unless approvals are taken from higher authorities as prescribed by CBDT in its guidelines. There is no mention about the same in the order of the authorities below. Limited scrutiny cannot be converted into complete scrutiny unless with the approval of higher authorities as stipulated. Proceeding further, the assessing officer has earned remuneration of

Rs.10,40,000/- from the said partnership firm, M/s Freedom Shoes, LLP wherein the assessee is having 25% share in the said firm. The assessee also derived interest income of Rs.30,37,400/- from the said partnership firm Freedom Shoes, LLP on capital invested in the said firm. It is well settled that the remuneration earned from the partnership firm by the partners as well as interest income earned from the capital invested in the partnership firm are chargeable to tax under the head 'income from Profits and Gains from Business or Profession'. It is also stipulated in the Act that the partnership firm shall be allowed interest paid on capital of the partners @ 12% and any excess is to be disallowed in the hands of the partnership firm(Section 40(b)(iv)). The assessee has charged interest @ 12% from the said partnership firm. It is also observed that the assessee has incurred interest expenditure of Rs.50,83,665/-, which is sought to be adjusted under and head profits and gains from business or profession. Said expenses of Rs.50,83,665/- constitute interest on loan to the tune of Rs.49,90,463.25, brokerage expenses of Rs.31,500/- and processing fee on ICICI loan of Rs.61,701.50, paid by the assessee. The net income, which is declared under the head "profits and gain from business or profession" is a loss to the tune of Rs.10,06,265/-. Proceeding further, it is observed that the Assessing Officer made enquiries with respect to the interest paid on

various loans raised by the assessee. The Assessing Officer made enquiries and delved into finding out creditworthiness of the lenders and genuineness of the loans. The Assessing Officer after making enquiries has disallowed the interest to the tune of Rs.34,38,533/- and made additions of the said amount. Further, the Assessing Officer has disallowed business loss of Rs.10,06,265/-, which was claimed by the assessee to be set off against the income from other sources and house property. Ld. CIT(Appeals), on the other hand has disallowed the interest expenditure to the tune of Rs.20,46,265/- by observing that the assessee has made investment in capital in partnership firm of Rs.2,75,000/- (sic. Rs. 2,75,00,000/-) and the assessee has received interest of Rs.30,37,400/- on capital deployed in the partnership firm, whereas the assessee has paid interest of Rs.50,83,665/-, which establishes that the rate of interest paid is more than the rate of interest received in the partnership firm. ICICI Bank has given loans to the assessee at the interest rate of 12% while the assessee has raised unsecured loans bearing interest @ 15% from private parties. Learned CIT(Appeals) observed that there is tax avoidance and there is no commercial expediency for borrowing funds at the higher rate and thus, excessive interest of Rs.20,46,265/- was disallowed by the Id. CIT(Appeals). Similarly, contentions of the assessee that business loss of

Rs.10,06,265/- was disallowed by the Assessing Officer to be set off against income from house property and income from other sources, is the double addition as the interest expenditure stood already disallowed by the Assessing Officer, was rejected by the Id. CIT(Appeals) and the assessment order was affirmed. It is observed that the Assessing Officer disallowed interest expenditure of Rs.34,38,533/- by verifying the creditworthiness and genuineness of the transactions, but the Id. CIT(Appeals) has looked into the excessiveness of the interest charged from the partnership firm @ 12% as against borrowed funds on unsecured loans @ 15%. CIT(Appeals) also compared the loans raised from ICICI Bank, which was bearing interest @ 12% while other unsecured loans raised by the assessee from private parties were bearing interest @ 15%. Thus, it is observed that this change in stands by the Id. CIT(Appeals) in bringing to tax income of the assessee by way of disallowance of interest expenditure to the tune of Rs. 20,46,265/- being excessive and lacking commercial expediency as against the disallowance by the AO of the interest to the tune of Rs. 34,38,533/- on the ground that creditworthiness of the lender as also genuineness of the interest expenses could not be proved, is not challenged by the Revenue either by filing appeal against the order of Id. CIT(Appeals) nor any cross objection has been filed by the Revenue and hence, the order of

assessment which stood merged with CIT(Appeals)'s appellate order has attained finality so far as Revenue is concerned. In my considered view, the assessee has invested Rs.2,75,00,000/- in the capital of partnership firm Freedom Shoes LLP and said investment in capital of the partnership firm carries the interest @ 12% as claimed by the assessee. Income-tax Act itself stipulates that the partnership firm shall be allowed interest paid at the capital @ 12% and any excessive interest shall be disallowed in the hands of the firm and will not be allowed as deduction while computing income from business or profession. Reference is drawn to provisions of Section 28(v), 40(b) and Section 184. Thus, I do not hold any infirmity so far as charging of interest @ 12% by the assessee from the partnership firm, as it carries the force and mandate of law (Section 40(b)) so far as allowability in the hands of the partnership firm is concerned. The assessee has borrowed from ICICI Bank loans @ 12%, which is a Bank/Financial Institution governed by RBI regulations and other monetary controls. The assessee has also borrowed unsecured loans from private parties which carry higher interest @ 15%. These are private contracts, and the rate of interest @ 15% cannot be said to be unusually high, excessive or unconscionably exorbitant, which could be considered to be at alter of the conscious warranting disallowance. The assessee has also claimed to have earned interest income of

Rs.13,96,689/- from other parties, which were offered to tax under the head income from other sources. It was submitted that it was not the interest of only Rs.30,37,400/- earned by the assessee as interest on capital from partnership firm, but there was further interest earned of Rs.13,96,689/- from other parties. Thus, total interest earned was of Rs.44,34,089/-. The assessee is partner in the partnership firm Freedom Shoes LLP holding 25% shares, the assessee had made investment in the capital of the firm to the tune of Rs. 2,75,00,000/- claiming the same to be business requirements and the said amount carried interest@12%. There is no adverse material on record to prove that there was no commercial expediency in investing by the assessee in the partnership firm Freedom Shoes, LLP in which the assessee is partner to the tune of 25% share in profits. The said investment in the capital of the partnership firm bore interest @ 12% as stipulated under the Act albeit the assessee has paid higher interest on borrowed funds but merely because the excess interest is paid, the same cannot be disallowed unless it is brought on record that there is no commercial expediency or the rate of interest is unconscionably high or ex-orbitant, which is not the case in the instant appeal. Reference is drawn to the judgment of Hon'ble Supreme Court in the case of SA Builders Limited v. CIT, reported in AIR 2007 SC 482, 2007 Keeping in view the abovesaid discussions, I order deletion of

the addition as was made by the AO and sustained by Id. CIT(A). I order accordingly.

7.2. So far as the disallowance of loss of Rs.10,06,265/- is concerned, which the assessee has sought to set off against income from house property and income from other sources. The said loss has not arisen from the share of loss from partnership firm. There is share of positive profit from the partnership firm Freedom Shoes, LLP to the tune of Rs. 5,94,609/- which the assessee earned and claimed exemption u/s 10(2A). The aforesaid loss of Rs. 10,06,265/- has arisen from set off of interest paid on loans raised by the assessee from ICICI Bank and private parties to be set off against the income from remuneration from the partnership firm Freedom Shoes LLP and interest income from capital invested in partnership firm Freedom Shoes, LLP. The income from interest earned on capital invested in the partnership firm by the partner as well remuneration of partner from partnership firm is chargeable to tax under the head Profits and Gains of Business or Profession. The assessee has paid interest on loans borrowed from ICICI Bank and from private parties. The assessee has negative income after such set off under the head Profits and Gains of Business or Profession , which is sought to be set off against income from house property and

income from other sources. I do not find any restriction in such set off keeping in view the provisions of section 71, which reads as under :

Set off of loss from one head against income from another.

71. (1) Where in respect of any assessment year the net result of the computation under any head of income, other than "Capital gains", is a loss and the assessee has no income under the head "Capital gains", he shall, subject to the provisions of this Chapter, be entitled to have the amount of such loss set off against his income, if any, assessable for that assessment year under any other head.

(2) Where in respect of any assessment year, the net result of the computation under any head of income, other than "Capital gains", is a loss and the assessee has income assessable under the head "Capital gains", such loss may, subject to the provisions of this Chapter, be set off against his income, if any, assessable for that assessment year under any head of income including the head "Capital gains" (whether relating to short-term capital assets or any other capital assets).

(2A) Notwithstanding anything contained in sub-section (1) or sub-section (2), where in respect of any assessment year, the net result of the computation under the head "Profits and gains of business or profession" is a loss and the assessee has income assessable under the head "Salaries", the assessee shall not be entitled to have such loss set off against such income.

(3) Where in respect of any assessment year, the net result of the computation under the head "Capital gains" is a loss and the assessee has income assessable under any other head of income, the assessee shall not be entitled to have such loss set off against income under the other head.

(3A) Notwithstanding anything contained in sub-section (1) or sub-section (2), where in respect of any assessment year, the net result of the computation under the head "Income from house property" is a loss and the assessee has income assessable under any other head of income, the assessee shall not be entitled to set off such loss, to the extent the amount of the loss exceeds two lakh rupees, against income under the other head.

(4) Where the net result of the computation under the head "Income from house property" is a loss, in respect of the assessment years commencing on the 1st day of April, 1995 and the 1st day of April, 1996, such loss shall be first set off under sub-sections (1) and (2) and thereafter the loss referred to in section 71A shall be set off in the relevant assessment year in accordance with the provisions of that section.

7.3 Thus, in my considered view, the aforesaid loss of Rs.10,06,265/- is allowed to be set off against income from other sources as well as income from house property. It would be relevant to point out that the assessee has earned total interest income of Rs.44,34,089/-, out of which Rs.30,37,400/- was interest income from partnership firm while the remaining interest income of Rs.13,96,689/- is from other parties which is offered to tax under the head 'income from other sources'. The assessee has paid total interest expenditure of Rs.49,90,463.25 during the year under consideration. Further, the assessee has incurred expenditure of Rs.31,500/- under the head brokerage and Rs.61,701.50 for processing fee on loans from ICICI Bank. I find no bar in such set off. There is no such finding of the authorities below that these expenses were not on business account. Hence, I reverse the orders of the authorities below. The assessee succeeds in its appeal. I order accordingly.

8. In the result, appeal of the assessee is allowed.

Order pronounced in the open court on 07.02.2025

**Sd/-
(RAMIT KOCHAR)
ACCOUNTANT MEMBER**

Dated: 07.02.2025

*aks/-

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asst. Registrar, ITAT, Agra