

| आयकर अपीलीय अधिकरण न्यायपीठ, मुंबई |
IN THE INCOME TAX APPELLATE TRIBUNAL
"G" BENCH, MUMBAI

BEFORE SHRI SAKTIJIT DEY, HON'BLE VICE PRESIDENT
&
SHRI NARENDRA KUMAR BILLAIYA, HON'BLE ACCOUNTANT MEMBER

I.T.A. No. 4899/Mum/2024
Assessment Year: 2016-17

Shringar Developers Private Limited 303, Unique Tower Gaiwadi Industrial Estate Behind Petrol Pump Off S.V. Road Goregaon (W) Mumbai - 400062 [PAN: AAJCS6868G]	Vs	ITO, Ward - 13(2)(3), Mumbai
अपीलार्थी/ (Appellant)		प्रत्यर्थी/ (Respondent)

Assessee by :	Shri Yogesh Thar & Shri Deep Chauhan, A/Rs
Revenue by :	Shri Bhangepatil Pushkaraj Ramesh, Sr. D/R

सुनवाई की तारीख/Date of Hearing : 24/02/2025
घोषणा की तारीख /Date of Pronouncement: 28/02/2025

आदेश/ORDER

PER NARENDRA KUMAR BILLAIYA, AM:

This appeal by the assessee is preferred against the order dated 07/08/2024 by NFAC, Delhi [hereinafter 'the Id. CIT(A)'], pertaining to AY 2016-17.

2. The grievance of the assessee reads as under:-

"1. GROUND NO. 1: DISALLOWANCE OF RS. 35,67,897/- U/S.14A R.W.R. 8D:

1.1 On the facts and in the circumstances of the case and in law, the Id. CIT (A) erred in confirming the disallowance of Rs. 35,67,897/- u/s. 14A r.w.r. 8D incurred allegedly in relation to exempt income in the form of share of profit earned from a partnership firm.

1.2 The Id. CIT(A) failed to appreciate and ought to have considered that since interest income earned is more than interest expense for the year, no interest disallowance was warranted u/s. 14A.

1.3 The Id. CIT(A) further erred in ignoring that no disallowance of administrative expenses ought to have been made by the Id. AO in excess of expenditure debited to Profit and Loss Account.

1.4 The Appellant prays that the disallowance of Rs. 35,67,897/- made u/s. 14A r.w.r. 8D be deleted.

2. GROUND NO. 2: DISALLOWANCE OF INTEREST OF RS. 7,67,050/- U/S. 36(1)(iii):

2.1 On the facts and in the circumstances of the case and in law, the Id. CIT(A) erred in confirming the disallowance of Rs. 7,67,050/- although u/s. 36(1)(iii) as against the one made u/s. 14A by the Id. AO, which itself was not sustainable at first place.

2.2 The Id. CIT(A) failed to appreciate and ought to have considered that the interest expense incurred by the Appellant was for the purpose of its business and therefore ought to have been allowed.

2.3 The Appellant prays that disallowance of interest of Rs. 7,67,050/- made u/s. 36(1)(ii) be deleted.

GENERAL:

The Appellant craves leaves to add to, alter, amend and /or delete the above grounds of appeal."

3. Briefly stated the facts of the case are that the assessee filed its return of income electronically on 28/09/2016 declaring total income of Rs.7,13,020/- which was processed u/s 143(1) of the Act by the CPC on 28/09/2018. Thereafter, the return was selected for scrutiny assessment under the CASS and accordingly statutory notices were issued and served upon the assessee.

4. While scrutinising the return of income, the AO found that the assessee has shown investment of Rs.5,32,20,195/- in the partnership firm Karwa & Kewal Kiran Realtors and Mahavir Developers. The AO noticed that the assessee has utilized interest bearing funds for the investment in the partnership firm from which it claimed exemption of share of profit from the firms. The assessee was asked to showcause why disallowance u/s 14A r.w.r 8D, should not be applied. The assessee

filed detailed reply explaining the capital contribution in partnership firms which is as under:-

<i>Name, PAN & PSR of the Firm</i>	<i>Capital Contribution as at 31/03/2016</i>	<i>Share of Profit for the year</i>	<i>Interest on Capital for the year</i>
<i>Mahavir Developers (PAN AAOFM0447P (PSR-50%)</i>	<i>Rs. (15,11,346/-)</i>	<i>Rs. (76,238/-)</i>	<i>Nil</i>
<i>Karwa & Kewal Kiran Realtors (PAN AAKFK3662N)</i>	<i>Rs. 5,47,31,542/-</i>	<i>Rs. 95,38,965/-</i>	<i>Rs.48,53,903</i>
<i>Total</i>	<i>Rs. 5,32,20,196</i>	<i>Rs.94,62,727</i>	<i>Rs.48,53,903/-</i>

4.1. It was explained that the assessee has earned taxable interest from Karwa & Kewal Kiran Realtors and also exempt income being share of profit. However, no such income was earned from the partnership firm Mahavir Developers. It was strongly contended that any contribution by the partner to the capital of the partnership firm out of the borrowed funds on which interest was paid, such interest expenditure cannot be assumed to be an expenditure incurred for earning shares of profits from such partnership firm which is exempt u/s 10(2A) of the Act. Similar explanation was given for the other partnership firm.

4.2. The contention of the assessee did not find any favour with the AO who proceeded by computing the disallowance u/s 14A r.w.r. 8D and computed the disallowance as under:-

Table -1: Proportionate disallowance u/s 14A of the I.T. Act 1961

Sub Rule 2(i) Direct Expenses	(1)	Rs. 41,04,638
Sub Rule 2(iii) -Indirect expenses	(2)	Nil
Value of investments as on 31.03.2016	(3)	Rs. 5,32,20,195
Value of investments as on 31.03.2015	(4)	Rs. 3,89,03,565
0.5% of average of (3) & (4) =Rs. 4,60,61,880 0.5XRs. 4,60,61,880	(5)	Rs.2,30,309
Disallowances u/s 14A (Rs. 41,04,638+Rs.2,30,309)		Rs. 43,34,947

4.3. The assessee carried the matter before the Id. CIT(A). The Id. CIT(A) after considering the detailed submissions and facts, was of the opinion that interest expenditure under Rule 8D(2)(i) amounting to Rs. 41,04,638/- is uncalled for and deleted the addition on account of average investment amounting to Rs. 2,30,309/-. However, the Id. CIT(A) was of the opinion that the interest paid on the capital contribution in Mahavir Developers cannot be allowed as such being not related with any commercial expediency and further disallowed Rs. 35,67,897/- u/s 14A of the Act.

5. Before us, the Id. Counsel pleaded for netting off of the interest expenditure and further contended that the disallowance for want of commercial expediency is without any basis as the capital contribution in a partnership firm itself shows that there was a business need.

Per contra, the Id. D/R supported the findings of the AO and placed reliance on the decision of the Special Bench in the case of *Vishnu Anant Mahajan vs. ACIT in [2012] 16 ITR 621 (Ahmedabad-ITAT)*.

6. We have carefully perused the orders of the authorities below. The undisputed fact is that the assessee had borrowed money for investment in the partnership firm in the form of capital contribution. The assessee has earned taxable interest amounting to Rs. 48,53,903/-

and has paid interest of Rs.41,04,638/- thereby showing positive interest income which is taxable.

7. We are of the considered view that netting off of the interest is permissible in such circumstances as held by the Hon'ble High Court of Bombay in the case of *CIT v. Jubilant Enterprises P. Ltd.* (2019) 416 ITR 58 (Bom) (HC), wherein the Hon'ble High Court was seized *interalia* with the following substantial question of law:-

"(i) Whether on the facts and in the circumstances of the case and in law, the Tribunal was justified in holding that the disallowance made under Section 14A read with Rule 8D on the basis of the netting of interest relying upon the decision of its Co-ordinate benches in Paresh K. Shah (ITA No.8214/M/2011) and M/s. Trade Apartments Ltd. ?"

7.1. And the Hon'ble High Court held as under:-

"(a) The impugned order of the Tribunal dismissed the Revenue's appeal holding that the disallowance of interest under Section 14A of the Act should be made with reference to net interest loan. This was by following the decision of its Co-ordinate bench at Mumbai in case of Paresh K. Shah v. Dy. CIT [IT Appeal No. 8214 (Mum.) of 2011, dated 5-6-2013] and the decision of its Calcutta Bench in Dy. CIT v. Trade Apartments Ltd. [IT Appeal No. 1277 (Kol.) of 2011, dated 30-3-2012]. Mr. Kotangale, the learned counsel appearing for the Revenue is unable to point out whether the decision of the Tribunal in Paresh K. Shah (supra) has been challenged in appeal. This in view of absence of any instructions from the officers of the Revenue. In the above view, one has to proceed on the basis that the decision of the Mumbai Bench of the Tribunal in Paresh K. Shah (supra) has been accepted by the Revenue. In any case, no distinguishing features in facts or law has been pointed to us from those in the case of Paresh K. Shah (supra) which would justify the disallowance on the gross interest paid and not on net interest."

7.2. Similarly, the Hon'ble Gujarat High Court in the case of *PCIT vs. Nirma Credit & Capital (P.) Ltd.* [2017] 85 taxmann.com 72 (Gujarat), on similar set of facts, has held as under:-

"■ Section 14A, pertains to expenditure incurred in relation to income not includible in total income. Sub-section (1) of section 14A provides that for the purpose of computing total income under Chapter IV, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income. As per sub-section (2) of section 14A, if the Assessing Officer having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure, he would

determine the same in accordance with the method as may be prescribed. Such method has been prescribed under rule 8D.[Para 8]

Sub-rule (1) of rule 8D substantially uses the same language as is used in sub-section (2) of section 14A and further provides that in such a situation the expenditure to be disallowed would be determined as per the provisions contained in sub-rule (2). The expenditure in relation to income not forming part of the total income would be aggregate of the three computations provided in clauses (i), (ii) and (iii) of sub-rule (2). Under clause (i) would come the amount of expenditure directly relating to income which does not form part of the total income. Clause (ii) provides for a formula to be applied where the assessee has incurred expenditure by way of interest during the previous year which is not directly attributable to any particular income or receipt. Under clause (iii) an ad-hoc disallowance of an amount equal to one half per cent of the average of the value of investment not forming part of total income would be further disallowed in addition to those mentioned in clauses (i) and (ii) of sub-rule (2) of rule 8D.[Para 9]

■ *Formula under clause (ii) of sub-rule (2) of rule 8D is $A \times B/C$, where 'A' represents the amount of expenditure by way of interest other than the amount of interest included in clause (i) incurred during the previous year, 'B' represents the average of value of investment, income from which does not form part of the total income, as per the balance sheet on the first and the last day of the previous year and 'C' is the average of total assets as per the balance sheet again on the first and the last day of the previous year. As per this formula therefore, interest expenditure to be disallowed would be the total interest expenditure which is in proportion of assessee's average value of investment not forming part of the total income to the average total assets. The legislature has therefore provided that whenever it is not possible to correlate with precision a certain interest expenditure for the purpose of earning income not forming part of the total income, disallowance of such expenditure would be in the proportion of assessee's average investment earning income not forming part of the total income, to the average value of assessee's total assets.[Para 10]*

■ *It is in this context that the computation of factor 'A' in the said formula assumes significance. In plain terms, 'A' represents the amount of expenditure by way of interest ignoring the interest expenditure already included in clause (i). The expression used by the legislature is 'amount of expenditure by way of interest'. When the legislature has therefore, used this expression 'amount of expenditure', the said term shall have to be interpreted in the manner that will bring about the correct legislative intent and equitable application thereof. As in case on hand, when the assessee pays interest on borrowings as also earns taxable interest on investments made by him during a particular year, his interest expenditure has to be considered as one which is the net of interest paid minus interest earned. Any other view would give the unintended computation of factor 'A' provided in clause (ii) of sub-rule (2) of rule 8D which will in turn distort the computation of disallowable expenditure under the said clause. It is true that the legislature has not given any further indication as to how such amount of expenditure would be ascertained. Therefore, reasonable test would have to be applied to interpret the provision as is most likely to give effect to legislative intent for disallowance of expenditure by an assessee for earning income which is not accountable to tax. It is true that investment made by the assessee out of such borrowed funds will continue to be factored in denominator*

in the formula provided in clause (ii) of sub-rule (2) since factor 'C' which forms the denominator refers to average of total assets of assessee as on the first and the last day of the previous year. However, ignoring taxable interest earned by the assessee for the purpose of ascertaining the amount of expenditure incurred by the assessee by way of interest, would amount to distorting the factor 'A' provided by the legislature in clause (ii) of sub-rule (2) of rule 8D. It may be possible for variety of reasons that in a given financial year the assessee might have earned interest income which is higher than the interest paid on the borrowed funds. This may be because assessee's investments may have earned interest at rates higher than the interest rate paid by the assessee on the borrowings or may also be because assessee's investment in earning interest may be higher in value than the assessee's borrowings, inviting interest. In such a situation, essentially, the assessee would have earned more interest than the interest paid. If the interpretation suggested by the revenue is accepted and the formula by computing factor 'A' by taking into account interest paid ignoring the interest earned is applied, there would be disallowance under this formula even if in the net result, the assessee may have not paid any interest on borrowings.[Para 11]

■ *Significantly the rule refers to interest expenditure and not interest paid. Expenditure in the present context must mean interest paid minus taxable interest earned.[Para 12]*

■ *Therefore, it is held that for the purpose of applying the factors contained in clause (ii) of sub-rule (2) of rule 8D, prior to its amendment with effect from 2-6-2016, what would be considered as amount of expenditure by way of interest would be the interest paid by the assessee on the borrowings minus the taxable interest earned during the financial year.[Para 14]*

7.3. The decision of the Co-ordinate Bench in the case of *Vishnu Anant Mahajan vs. ACIT (supra)*, is on different set of facts and hence not applicable.

8. Respectfully following the decision of the Hon'ble High Court (*supra*), we hold that no disallowance is to be made u/s 14A of the Act as the net taxable interest is higher.

9. Coming to the disallowance u/s 36(1)(iii) of the Act, we are of the considered view that investment of borrowed funds as capital contribution in a partnership firm in itself is a business justifying the commercial expedience of the transactions. Therefore, in our considered view, any interest on such borrowed capital has to be allowed.

Therefore, we direct the AO to allow the claim of interest paid on borrowed capital invested in Mahavir Developers.

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

Order pronounced in the Court on 28th February, 2025 at Mumbai.

Sd/-

(SAKTIJIT DEY)
VICE-PRESIDENT

Sd/-

(NARENDRA KUMAR BILLAIYA)
ACCOUNTANT MEMBER

Mumbai, Dated 28/02/2025

S.S.P.

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

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2. प्रत्यर्थी / The Respondent
3. संबंधित आयकर आयुक्त / Concerned Pr. CIT
4. आयकर आयुक्त (अपील)/ The CIT(A)-
5. विभागीय प्रतिनिधि , आयकर अपीलीय अधिकरण, मुंबई /DR,ITAT, Mumbai,
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