IN THE INCOME TAX APPELLATE TRIBUNAL

NAGPUR BENCH, NAGPUR

BEFORE SHRI V. DURGARAO, JUDICIAL MEMBER AND

SHRI K.M. ROY, ACCOUNTANT, MEMBER

ITA no.193/Nag./2019
(Assessment Year : 2013–14)

M/s. Tiwari Traders
Near State Bank,. Buldhana Road
At Post & Tq. Malkapur 443 101
Dist. Buldhana PAN – AAAFT6614P ……. Appellant

v/s

Income Tax Officer
Ward–2, Khamgaon ……. Respondent

Assessee by : Shri Rachit Thakkar
Revenue by : Shri Abhay Y. Marathe

Date of Hearing – 11/02/2025	Date of Order – 04/03/2025

O R D E R

PER V. DURGA RAO, J.M.

Aforesaid appeal by the assessee is against the impugned order dated 03/06/2019, passed by the learned Commissioner of Income Tax (Appeals)–1, Nagpur, [*"learned CIT(A)"*], for the assessment year 2013–14.

2. The assessee has raised following grounds:–

"1] Learned C.I.T.(A) erred in disallowing the part of interest amounting to Rs.5,30,902/- out of total interest claimed by the appellant amounting to Rs.9,20,513/- U/s.36(i)(iii) of I.T. Act 1961.

2] Learned C.I.T.(A) erred in confirming the disallowance amounting to Rs.3,89,611/-.

3] Learned C.I.T.(A) erred in disallowing interest amounting to Rs.1,57,844/- U/s.40(a)(ia) of I.T.Act, 1961.

4] Learned C.I.T.(A) and A.O. both have not properly consider assessee's submission and various documents filed before them.

3] Appellant craves to urge additional grounds at the time of hearing, if necessary."

3. The assessee is a partnership firm engaged in the business of grains, pulses and oil seeds, etc. For the year under consideration, the assessee filed its return of income on 23/09/2013, declaring total income of ₹ 1,01,430. The case was selected for scrutiny under CASS. The Assessing Officer concluded assessment determining total income of ₹ 11,79,787, by making addition of ₹ 9,20,513, as interest under section 36(1)(iii) of the Income Tax Act, 1961 (*"the Act"*) and addition of ₹ 1,57,844, under section 40(a)(ia) of the Act.

4. The learned CIT(A), on the issue of disallowance of interest paid by the assessee of ₹ 9,20,513, under section 36(1)(iii) of the Act, while dealing with the issue, vide Para–7.0 to 7.4 / Page–11 to 13, held that interest amount attributable to the interest free advances shall be allowed to the assessee. The findings of the learned CIT(A) are as under:–

"7.0 Ground No. 2: The appellant has challenged the addition made by AO of Rs.9,20,513/-u/s.36(1)(iii) on account disallowance of interest paid by the appellant. The AO has observed that certain advances extended by the appellant firm to the tune of Rs.62,43,130 are without receiving any interest on it. However, while substantiating the list of advances, the AO quantified such advances at Rs.60,11,031. The AO contended that, the said advances have been extended by the appellant firm to those parties which/who are not connected with the appellant in its business activities. Therefore, the said advances are interest free advances extended by the firm out of the borrowed funds against which the appellant is claiming deduction of interest. As the interest expenditure is not deductible if the funds are not utilized having nexus with the business, the proportionate interest paid by the firm on the aforesaid advances are disallowable u/s.36(1)(iii).

7.1 Further, the appellant submitted that the advances given to M/s. Dhanraj loner et Inc Enterprises, (Rs.3,80,970), M/s. Jai Bharat Oil Mill (Rs.37,59,144), Kundan Traders. Malkapur (Rs.3,24,743), Mahesh Metal Container (Rs.5,43,148) relates to earlier years. Hence, it can be easily and conveniently

interpreted that no borrowed funds of current years are invested in the said advances. Therefore, there is no question of charging any interest or there is no question of disallowance of any interest paid on borrowed funds by the assessee. In this regard, it is observed that the interest bearing loans were taken by the appellant in the earlier years only. It is also a fact that the AR in his submission has not demonstrated how the funds advanced are not related to borrowed funds even if it is related to earlier year. Therefore, I am of opinion that, even if no funds are advanced in the current year, the interest is being paid by the appellant on the loans availed by it in earlier years too and hence, the interest bearing funds were applied for non-business purpose.

7.2 Further, the appellant also submitted that, M/s. Dhanraj Enterprises, is the proprietary concern of the partner, Shri Dhanraj Radhakisan Tawari. The advances given to M/s. Dhanraj Enterprises, to the tune of Rs.3,80,970, should be treated as withdrawal of capital. The credit balance on capital account of Shri. Dhanraj Tawari as on 31/03/2013 was Rs. 18,84,147. Hence, naturally, there will be reduction in the credit balance of capital account of the partner. Once, the debit balance is treated as withdrawal of capital, there was no question of charging of interest on the debit balance of Rs.3,80,970.

7.3 The above submission of the appellant is vague in nature. The appellant has submitted that the debit balance of proprietorship concern of partner should be treated as withdrawals of capital and accordingly the said amount shall not tantamount to interest free advances extended by firm. As per the accounting principles, the same is not shown as withdrawals in the books of accounts by the appellant. FURTHER, it is worth noting that the interest on partner's capital account is paid on whole amount of Rs.18,84,147/- and not after deduction of Rs.3,80,970/-. The interest paid to partner is claimed as expenses by the firm, whereas no interest is charged on the amount of Rs.3,80,970/- extended to his proprietorship concern. As the appellant firm has availed deduction of interest on whole of the amount of partner's capital balance, there is no reason to consider the advance extended to his partnership as withdrawal of the capital. Therefore, the submission made by the appellant in this regard is not considered as it contains misleading information and poorly stated facts and therefore rejected.

7.4 Further the appellant has also submitted that it has accepted interest free loan to the tune of ₹35,39,351, from the under mentioned parties:

Sr. no.	*Name of Party*	*Deposit Accepted*
1.	*Dhanshree Sales, Pune*	*3,00,000*
2.	*Kushal Tawari*	*16,20,000*
3.	*Late Shri Radhakisan Tawari*	*8,94,298*
4.	*Laxminarayan Kalantri*	*1,15,053*
5.	*Smt. Sadakawar Rathi*	*4,60,000*
6.	*Vishal Nabira*	*1,50,000*
	Total ₹	*35,39,351*

The AO has disregarded the submission on the reason that the appellant has not established the nexus between the interest free funds availed and interest

free advances extended. I find the action of the AO unjustified as the business of any assessee is run on the basis of practicality and therefore, one-on-one nexus cannot be necessarily proved. The appellant has submitted the audited financial statements to the AO. The AO can reasonably assess the position of assets and liabilities of the appellant on its basis and can also verify whether the interest free loan availed and interest free advances extended are present or not. If these are available in the financial statement, it suffices the purpose, unless an adverse finding of the AO is brought on record. The AO did not bring on records any evidence to prove that only interest-bearing loans are directly extended as interest free advances. Therefore, the action of the AO is unjustified. The appellant's submission that it has availed the non-interest-bearing funds and the same should be treated as utilized for extending interest free advances, is quite acceptable in view of the audited financial statement of the appellant. Therefore, interest amount attributable to the interest free advances shall be allowed to the appellant.

7.5 The appellant also attempted to establish that the capital of partners is more that the advances granted to their firms and consequently, the said interest free advances given are to be considered as out of interest free funds. In order to establish the partner's capital as interest free fund, the appellant contended that "For capital accounts of the partners is nothing but always equity of the firm and interest on capital account is a special allowance granted by the statue in place of profit. This contention of the AR is baseless. The profit of the firm is generally divided among the partners by way of Remuneration, Interest and Share in Profit. However, the remuneration to partner and interest are allowed as deduction in the hands of the firm from the taxable profit. So far as Income Tax Act, 1961 is concerned, the remuneration and interest on partner's capital is considered as expenditure and their allowability is governed by provision of section 40(b). As a specific provision is enacted to govern the deduction towards interest on capital, the contention of the appellant that the interest on capital is in lieu of share of profit is not acceptable. As the firm is enjoying the deduction of interest as expenditure, it establishes that the capital of partner is interest bearing funds for the firm.

7.6 In conclusion, the AO erred in not considering that interest free advances were out of interest free loan availed by the appellant. Consequently, the interest of Rs.5,30,902 i.e., 15% of Rs.35,39,351 (interest free advances) deserves to be deleted from the total addition of Rs.9,20,513/- made by the AO u/s.36(1)(iii). Accordingly, the addition is reduced by Rs.5,30,902/-. Therefore, the addition is restricted to an amount of Rs.3,89,611/- which is sustained. Ground No.2 is partly allowed."

5. Further, the learned CIT(A), on the issue of addition on account interest paid at ₹ 1,57,844, under section 40(a)(ia) of the Act, on which tax is not deducted at source, held as under:–

"8.0 Ground No.3: The appellant also challenged the addition of Rs.1,57,844/- made by the AO u/s.40(a)(ia) towards interest paid on which tax is not deducted at source. The appellant in this regard submitted that the interest, to

the tune of Rs.1,57,844/- has been deducted by the said Shri. Shivnathrai S. Agrawal, from the payments of sale proceeds payable to the appellant. Shri. Shivnathhrai S. Agrawal Delhi was the consignment agent of the appellant. There was dispute in respect of these interest charges. The appellant has taken objection on levy of such interest in respect of some part of payment received in advance, time by time. Hence, as interest is not paid by the appellant and as the said interest is deducted by the party, directly from the amount payable to the appellant, the provisions of section 194A of the Act are not applicable to these business transactions. The impugned amount is not in the nature of the interest on deposit, but are charges imposed by the consignment agent, which is nothing but a trading liability. As stated earlier, the real nature of said charges is not interest, but compensation for goods lying with consignment agent and money blocked in stock.

8.1 I have carefully perused the submission of the appellant. The AR of the appellant has tried to establish inflated facts by trying to pass on the interest liability as trading liability to escape from provision of section 194A. The appellant itself submitted that the amount deducted by the person was towards interest as his money was blocked in the stock. In general business sense and parlance, the compensation towards money given/taken is called as interest, and the interest, whether paid or payable in commercial transactions lies well within the scope of section 194A. Therefore, the facts are duly established that the amount so deducted by Mr. Agrawal towards any compensation, is in nature of the interest and hence shall be tax-deductible by virtue of section 194A.

8.2 Further, in order to escape from the rigors of provision of section 194A vis-à-vis section 40(a)(ia), the appellant submitted as under:

> *"Alternatively and without prejudice to the above, if it is presumed that the charges, paid to Shri. Shivnathrai S. Agrawal, is nothing but interest, still the provisions of section 40(a)(ia) are not applicable to the facts of the case. For the said amount of interest has actually been deducted (paid) by the said party from the amount of trade liability receivable to the appellant. The provisions of section 40(a)(ia) are applicable only in respect of amount payable as on the date of balance sheet. In other words, if expenditure (Interest) is actually paid in the said financial year, the provisions of section 40(a)(ia) can not been invoked. The appellant relies on the decision of hon'ble courts mentioned hereunder. The copies of judgments are enclosed herewith for ready reference.*
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> *a) M/.s Arcadia Share & Stock Brokers Pvt. Ltd. vs DCIT, Range 4(1), Mumbai, ITA No. 1871/Mum/2013 dated 22.12.2014, ITAT Bench, Mumbai*
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> *b) Shri. Jitendra Mansukhalal Shah vs DCIT Mumbai, ITA No. 2293/Mum/2013, dated 04.03.2015, ITAT "J" Bench, Mumbai. (Page No. 80 to page No. 82 of paper book of other documents).*
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> *c) ACIT 22(3) vs Amit Naresh Sinha, ITA No. 4154/Mum/2013, dated 10.09.2014, ITAT "A" Bench, Mumbai. (Page NO. 83 Page No. 84 of paper book of other documents)*
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> *d) Merilyn Shipping and Transport vs Additional Commissioner of Income Tax (2012) 146 TTJ 0001, ITAT, Vishakhapattnam Bench, (Page No. 85 to Page No. 86 of paper book of other documents).*

Here the appellant contended that the provision of section 40(a)(ia) is applicable only on amount of interest "payable". In this regard, the provision of section 40(a)(ia) applicable for the subject assessment year is produced hereunder:

40. Notwithstanding anything to the contrary in sections 30 to [38], the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",-

(a) in the case of any assessee-

*(1) any interest ********

(ia) any interest, commission or brokerage, [rent, royalty.] fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work), on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, [has not been paid on or before the due date specified in sub-section (1) of section 139:] [Provided that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.]

The following second proviso shall be inserted in sub-clause (ia) of clause (a) of section 40 by the Finance Act, 2012, w.e.f. 1-4-2013:

Provided further that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the resident payee referred to in the said proviso.

8.3 From the plain reading of provision of section 40(a)(ia), it can be seen that the section uses the phrase "payable". In grammatical sense, the terms "paid" and "payable are different in nature and are anonyms to each other. As the section uses the phrase "payable", the appellant has cited various judicial pronouncement of Hon'ble Tribunals in its favour. However, the prolonged debate of "paid" and "payable" is now already settled by Hon'ble Supreme Court in the case of Palam Gas Services v. CIT, 517 Taxpundit 101 (Civil Appeal No. 5512 of 2017, judgment dated 3-5-2017) where it has approved the view of Hon'ble Calcutta High Court in the case of Commissioner of Income Tax v. Crescent Export Syndicate, which reads as under:

22. The same view was taken by a Division Bench of the Calcutta High Court in Commissioner of Income Tax v. Crescent Export Syndicate, (supra). It was held:-

"12.3. It is noticeable that Section 40(a) is applicable irrespective of the method of accounting followed by an assessee. Therefore, by using the term 'payable' legislature included the entire accrued liability. If assessee was following mercantile system of accounting, then the moment amount was credited to the account of payee on accrual of liability, TDS was required to be made but if assessee was following cash system of accounting, then on making payment TDS was to be made as the liability was discharged by making payment. The TDS provisions are applicable both in the situation of actual

payment as well of the credit of the amount. It becomes very clear from the fact that the phrase, 'on which tax is deductible at source under Chapter XVII-B', was not there in the Bill but incorporated in the Act. This was not without any purpose." We approve the aforesaid view as well. As a fortiorari, it follows that Section 40(a)(ia) covers not only those cases where the amount is payable but also when it is paid. In this behalf, one has to keep in mind the purpose with which Section 40 was enacted and that has already been noted above.

We have also to keep in mind the provisions of Sections 1940 and 200. Once it is found that the aforesaid Sections mandate a person to deduct tax at source not only on the amounts payable but also when the sums are actually paid to the contractor, any person who does not adhere to this statutory obligation has to suffer the consequences which are stipulated in the Act itself. Certain consequences of failure to deduct tax at source from the payments made, where tax was to be deducted at source or failure to pay the same to the credit of the Central Government, are stipulated in Section 201 of the Act. This Section provides that in that contingency, such a person would be deemed to be an assessee in default in respect of such tax.

While stipulating this consequence, Section 201 categorically states that the aforesaid Sections would be without prejudice to any other consequences which that defaulter may incur. Other consequences are provided under Section 40(a)(ia) of the Act, namely, payments made by such a person to a contractor shall not be treated as deductible expenditure. When read in this context, it is clear that Section 40(a)(ia) deals with the nature of default and the consequences thereof. Default is relatable to Chapter XVIIB (in the instant case Sections 1940 and 200, which provisions are in the aforesaid Chapter). When the entire scheme of obligation to deduct the tax at source and paying it over to the Central Government is read holistically, it cannot be held that the word 'payable' occurring in Section 40(a)(ia) refers to only those cases where the amount is yet to be paid and does not cover the cases where the amount is actually paid. If the provision is interpreted in the manner suggested by the appellant herein, then even when it is found that a person, like the appellant, has violated the provisions of Chapter XVIIB (or specifically Sections 194C and 200 in the instant case), he would still go scot free, without suffering the consequences of such monetary default in spite of specific provisions laying down these consequences. The Punjab & Haryana High Court has exhaustively interpreted Section 40(a(ia) keeping in mind different aspects. We would again quote the following paragraphs from the said judgment, with our complete approval thereto: "26. Further, the mere incurring of a liability does not require an assessee to deduct the tax at source even if such payments, if made, would require an assessee to deduct the tax at source. The liability to deduct tax at source arises not on account of the assessee being liable to the payee but only upon the liability being discharged in the case of an assessee following the cash system and upon credit being given by an assessee following the mercantile system. This is clear from every section in Chapter XVII." (Emphasis supplied as relevant to the present case, in underlines.)

8.4 As the prolonged ambiguity on the use of phrases "paid" and "payable" with different views of various tribunals and high courts on it has been removed by the Apex Court by providing deep insight on the matter, and respectfully relying on the same, the addition made by the AO is upheld, and confirmed. Accordingly Ground No.3 is dismissed."

6. We have heard the rival arguments, perused the material available on record and gone through the orders of the authorities below. On the issue of

disallowance of interest paid by the assessee of ₹ 9,20,513, under section 36(1)(iii) of the Act is concerned, we notice that the Assessing Officer did not consider the interest free advances which were available to extend interest free loan by the assessee. Therefore, the interest of ₹ 5,30,902 i.e., 15% of ₹ 35,39,351 (interest free advances) from the total addition of ₹ 9,20,513 made by the Assessing Officer under section 36(1)(iii) of the Act was rightly reduced by the learned CIT(A) and the addition was restricted to an amount of ₹ 3,89,611. The learned CIT(A) has passed a well–reasoned order which calls for no interference. The learned Authorised Representative for the assessee failed to highlight any issue which will persuade us to take a different view. Accordingly, we uphold the impugned order passed by the learned CIT(A) by dismissing the grounds no.1 and 2, raised by the assessee.

7. Insofar as the issue relating to the addition on account interest paid at ₹ 1,57,844, under section 40(a)(ia) of the Act, on which tax is not deducted at source, we find that the learned Authorised Representative for the assessee has not brought on record any cogent evidence to buttress that the payees have discharged the tax liability on their own account. Thus, there is a complete failure to abide by the provisions of section 40(a)(ia) of the Act. Moreover, there is no apparent incongruity or observations in the conclusion drawn by the learned CIT(A). Thus, ground no.3, is dismissed.

8. Grounds no.4 and 5, do not call for separate adjudication. Thus, in effect, the impugned order passed by the learned CIT(A) is undisturbed.

9. In the result, appeal by the assessee stands dismissed.

Order pronounced in the open Court on 04/03/2025

Sd/-	**Sd/-**
K.M. ROY	**V. DURGA RAO**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

NAGPUR, DATED: 04/03/2025

Copy of the order forwarded to:

(1) The Assessee;

(2) The Revenue;

(3) The PCIT / CIT (Judicial);

(4) The DR, ITAT, Nagpur; and

(5) Guard file.

True Copy
By Order

Pradeep J. Chowdhury
Sr. Private Secretary

Sr. Private Secretary
ITAT, Nagpur