

**IN THE INCOME TAX APPELLATE TRIBUNAL “B” BENCH, MUMBAI
BEFORE SHRI D. KARUNAKARA RAO, AM AND SHRI RAVISH SOOD, JM**

आयकर अपील सं./ I.T.A. No. 2998/Mum/2013
(निर्धारण वर्ष / Assessment Year: 2007-08,)

M/s. Mohit Diamonds Pvt. Ltd. BC-7011, Bharat Diamond Bourse, G-Bolck, Bandra Kurla Complex, Bandra (East), Mumbai – 400 051	बनाम/ Vs.	ACIT 5(1), Aayakar Bhavan, M.K. Road, Mumbai – 400 020
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No.		AAACM2843A
(अपीलार्थी /Appellant)	:	(प्रत्यर्थी / Respondent)

अपीलार्थी की ओर से / Appellant by	:	Shri B.V. Jhaveri
प्रत्यर्थी की ओर से/Respondent by	:	Miss. Anupama Singh

सुनवाई की तारीख / Date of Hearing	:	06/09/2016
घोषणा की तारीख / Date of Pronouncement	:	02.12.2016

आदेश / ORDER

PER RAVISH SOOD, JUDICIAL MEMBER:

The present appeal is directed against the order passed by the CIT(A) – 9, (Mumbai), which arises from the order passed by the A.O u/s 271(1)(c) of the Income Tax Act, 1961 (for short ‘Act’), therein imposing penalty of Rs. 6,25,000/- on the assessee. The brief facts of the case are that the assessee which is a Private

Limited Company engaged in the business of manufacturing and export of cut and polished diamonds, had e-filed its return of income for A.Y. 2007-08 as on 26.10.2007, declaring total income of Rs. 6,25,26,230/-. That the case of the assessee was taken up for scrutiny proceeding, wherein the A.O after carrying out the following disallowances/additions:-

S. No.	Particulars	Amount
1.	Disallowance u/s 36(1)(iii) of interest relatable to investment made by assessee towards purchase of property at Bharat Diamond Bourse, Mumbai (for short 'BDB')	Rs. 17,59,299/-
2.	Disallowance u/s 36(1)(iii) of interest relatable to interest free loan advanced to subsidiary company.	Rs. 45,78,389/-
3.	Disallowance u/s 14A.	Rs. 10,28,567/-
Total		Rs. 73,66,255/-

, assessed the income of the assessee at Rs. 7,02,50,334/-.

2. The assessee being aggrieved filed an appeal with the CIT(A), who vide his order dated 05.01.2011 sustained the disallowance of Rs. 17,59,299/- (supra), and thus partly allowed the appeal of the assessee. The order of the CIT(A) upholding the disallowance of Rs. 17,59,299/- in the quantum appeal was accepted by the assessee, and the same thus attained finality.

3. That the A.O on the basis of penalty proceedings which were initiated u/s 271(1)(c) at the time of framing of the assessment, issued show-cause notice to the assessee, calling upon it to explain as to why penalty u/s 271(1)(c) for furnishing of inaccurate particulars of income as regards the interest on borrowed capital of Rs. 17,59,299/- (supra), which addition had been upheld by the CIT(A), may not be imposed. The assessee during the course of the penalty proceedings, vide his reply dated 15.03.2012, submitted before the AO :-

- (i) That the assessee had not raised any term loan to make payment of margin money or subsequent instalment in respect of investment made towards purchase of property at 'BDB'.
- (ii) That the investment towards purchase of the property at 'BDB' was made out of sale proceeds and the surplus/ profit generated by the assessee from its business during the year under consideration, and no part of the borrowed funds was utilized for making of the said investment.
- (iii) That in the backdrop of the aforesaid facts as regards availability of substantial interest free funds with the assessee, coupled with the surplus/profit generated during the year under consideration, it was categorically submitted by the assessee that in light of the judgement of the **Hon'ble Bombay High Court** in the case of **CIT VS Reliance Utilities and Power Limited (2009) 313 ITR 340 (Bom)**, wherein the **Hon'ble**

High Court had held that if there are interest free funds available with the assessee, which are found to be sufficient to meet the investments, then it could safely be presumed that the investment was made from the interest free funds generated or available with the assessee.

- (iv) Alternatively, it was further submitted by the assessee that no such disallowance u/s 36(1)(iii) with respect to investment made towards property at 'BDB' was made by the AO while framing the assessment for the immediately succeeding year, i.e. A.Y. 2008-09.

The AO however being of the view that as the assessee had failed to substantiate that the investment in the premises at 'BDB' was made out of own surplus funds, and the interest bearing borrowed funds have not been utilized for making of the said investment, therefore such amount was not allowable as an expenditure u/s 36(1)(iii) of the 'Act'. Thus in the backdrop of the aforesaid observations, the A.O holding a conviction that as the assessee had raised a wrong claim for deduction of such interest on borrowed capital as an expenditure, it was therefore to be held to have furnished inaccurate particulars of income and imposed penalty of Rs. 6,25,000/- in the hands of the assessee.

4. The assessee being aggrieved with the order of the A.O, carried the matter in appeal before the CIT(A). During the course of the appellate proceedings, the assessee again relied on the judgement of the **Hon'ble Jurisdictional High Court**

so passed in the case of **Reliance Utilities and Power Limited (supra)** and submitted that as it had substantial interest free funds which were sufficient enough to justify the investment in property at 'BDB', as well as the interest free advance so given to its subsidiary, which therein aggregated to Rs. 7.31 crore, therefore in light of availability of substantial interest free funds, which could safely be related to the investment made in the property at 'BDB', no penalty u/s 271(1)(c) as regards said disallowance u/s 36(1)(iii) could be imposed in its hands. The assessee in addition to its submissions made before the AO, further in order to fortify its contention as regards availability of substantial interest free funds with it, therein submitted before the CIT(A) that at the end of the year under consideration, it had shareholder funds including share capital and reserves and surplus to the tune of Rs. 72.19 crore, as against the corresponding figure of Rs. 67.85 crore of the preceding year, which factual position could be gathered beyond any scope of doubt from a perusal of the balance sheet. The CIT(A) however being of the view that as the assessee by not carrying the matter in further appeal before the Tribunal, after the said disallowance/addition was upheld by his predecessor, was thus to be taken to have accepted the disallowance made by the A.O u/s 36(1)(iii) of the 'Act'. The CIT(A) in order to fortify his view that interest paid on the loans availed for buying the immovable property at 'BDB', but not put to use during the year under consideration, was not to be allowed as an expenditure, placed reliance on the following judicial pronouncements:

(i). Power Drugs Limited Vs CIT

(2011) 245 CTR (P&H) 623

(ii). CIT Vs Vardhaman Polytex Limited

(2008) 214 CTR (P&H) (FB) 561,

The CIT(A) thus in the backdrop of his aforesaid observations, therein concluded that as the assessee had raised a wrong claim towards deduction of interest on borrowed capital on the investment made for purchase of property at 'BDB', it could thus safely be held to be have furnished inaccurate particulars of income, and thus held that the A.O was justified in imposing penalty u/s 271(1)(c).

5. That the assessee being aggrieved had assailed before us the order of the CIT(A) sustaining the penalty imposed u/s 271(1)(c). The Learned Authorized Representative for the assessee (for short 'A.R') reiterating the submissions made before the lower authorities, therein submitted that the investment towards the purchase of the property at 'BDB' was made out of substantial interest free funds so available with it, as well as the surplus/profits generated during the year under consideration. The Ld. A.R in order to fortify his contention, therein drew our attention to Page 27 of the 'Paper Book' (for short 'APB'), which is a 'Cash Flow Statement' for the year under consideration, i.e. A.Y. 2007-08. The Ld. A.R further took us to Page 10 of the 'APB', which is the 'Profit and loss account' of

the assessee for the year under consideration, which therein revealed that Profits/surplus after tax as had been generated by the assessee during the year amounted to Rs. 4,27,81,772/-. It was thus in the backdrop of the aforesaid facts submitted by the Ld. A.R that now when substantial interest free funds along with profits /surplus generated during the year under consideration were available with the assessee, it could therefore safely be concluded that the assessee was having substantial interest free funds and profits/surplus with it, which could justifiably be related to the investment made by the assessee towards purchase of property at 'BDB'. It was thus submitted by the Ld. A.R that in light of the aforesaid factual background, no penalty u/s 271(1)(c) was liable to be imposed. The Ld. A.R placing reliance on the judgment of the **Hon'ble Bombay High Court** in the case of **CIT VS Reliance Utilities and Power Limited (2009) 313 ITR 340 (Bom)**, therein averred that the said judgment of the **Hon'ble Jurisdictional High Court**, which seized the issue under consideration, was though brought to the notice of both the AO and the CIT(A), however neither of said lower authorities had taken cognizance of the same. The Ld. A.R in order to fortify his contention therein took us to the relevant pages of the 'APB', which clearly revealed that the assessee in support of his aforesaid claim had relied on the judgment of the **Hon'ble Jurisdictional High Court** in the case of **Reliance Utilities and Power Limited (Supra)** before the lower authorities. That on the other hand the Ld. Departmental

Representative (for short 'D.R') heavily relied on the orders of the lower authorities and therein submitted that the order of CIT(A) may be upheld.

6. We have heard both the parties, perused the material on record and have given a thoughtful consideration to the issue before us. We are of the considered view that the assessee had at length submitted before both the AO as well as the CIT(A) that it was having substantial interest free funds in the form of shareholders fund, as well as substantial profits/surplus generated during the year under consideration itself, which could justifiably be related to the investment made towards purchase of property at 'BDB', as well as advancing of interest free advances to its subsidiaries during the year under consideration. Thus in the backdrop of the aforesaid factual position read with the settled position of law, it was submitted by the Ld. A.R that it could safely be concluded that the investment so made towards purchase of property at 'BDB' was funded from the said interest free funds available with the assessee. It was thus submitted by the Ld. A.R that as no nexus of any part of interest bearing funds which as a matter of fact remained injected in the business of the assessee, was established with the making of the investment towards purchase of property at 'BDB', therefore the assessee could at least not be held to have furnished inaccurate particulars by claiming such interest on borrowed capital as an expenditure in the 'Profit & loss a/c'. We find that the assessee had throughout relied on the judgment of the **Hon'ble High Court of**

Bombay in the case of **CIT Vs. Reliance Utilities and Power Limited (2009) 313 ITR 340 (Bom)**, in support of its aforesaid contention before the lower authorities, but are surprised to find that neither of the lower authorities had taken cognizance of the said judgement, which seizes the issue under consideration. The **Hon'ble High Court of Bombay** in the aforesaid case had held as under:

“10. If there be interest free funds available to an assessee sufficient to meet its investments and at the same time the assessee had raised a loan it can be presumed that the investments were from the interest free funds available. In our opinion the Supreme Court in East India Pharmaceutical Works Ltd. (supra) had the occasion to consider the decision of the Calcutta High Court in Woolcombers of India Ltd. (supra) where a similar issue had arisen. Before the Supreme Court it was argued that it should have been presumed that in essence and true character the taxes were paid out of the profits of the relevant year and not out of the overdraft account for the running of the business and in these circumstances the appellant was entitled to claim the deductions. The Supreme Court noted that the argument had considerable force, but considering the fact that the contention had not been advanced earlier it did not require to be answered. It then noted that in Woolcomber's case (supra) the Calcutta High Court had come to the conclusion that the profits were sufficient to meet the advance tax liability and the profits were deposited in the overdraft account

of the assessee and in such a case it should be presumed that the taxes were paid out of the profits of the year and not out of the overdraft account for the running of the business. It noted that to raise the presumption, there was sufficient material and the assessee had urged the contention before the High Court. The principle therefore would be that if there are funds available both interest free and overdraft and/or loans taken, then a presumption would arise that investments would be out of the interest free fund generated or available with the company, if the interest free funds were sufficient to meet the investments. In this case this presumption is established considering the finding of fact both by the CIT(A) and Tribunal.”

7. We are further of the considered view that the lower authorities while justifying imposing of penalty u/s 271(1)(c) in the hands of the assessee, and sustaining of the same thereafter, had emphasized more on the fact that the assessee by not assailing the order of the CIT(A) so passed in its quantum appeal, wherein the disallowance/addition u/s 36(1)(iii) of Rs. 17,59,299/-, pertaining to interest relatable to investment made by the assessee in property at ‘BDB’ had been upheld, thus could safely be held to have accepted the said disallowance. We are of the considered view, that no doubt a finding of the A.O while making an addition in the course of the assessment proceedings does have a persuasive value

in the course of the penalty proceedings, but then we cannot shut our eyes to the settled position of law as had been emphasized by different Hon'ble Courts, that as penalty proceedings are separate and distinct from assessment proceedings, therefore merely because an addition had been made by the A.O, or sustained by an appellate authority, the same solely on the said count cannot form the basis of imposing or sustaining of a penalty in the hands of an assessee, as the A.O remains under a statutory obligation to establish that over and above the making of addition/disallowance in the hands of the assessee during the course of the assessment proceedings, it can safely be concluded that the said addition/disallowance had emerged on account of either 'Concealment of income' or 'furnishing of inaccurate particulars of income', as the case may be, by the assessee. Thus to be brief and explicit, in light of the settled position of law as had been so laid down by the **Hon'ble Supreme Court** in its landmark judgment so passed in the case of :**Hindustan Steels Limited Vs. State of Orissa (1972) 83 ITR 26 (SC)**, that penalty proceedings are in the nature of quasi criminal proceedings, therefore we are of the considered view that mere making of an addition by the A.O in the case of the quantum proceedings, solely on the said count cannot justify imposition or sustaining of penalty u/s 271(1)(c) in the hands of the assessee. We further find that the reliance placed by the CIT(A) on the judgments of the **Hon'ble Punjab & Haryana High Court** in the case of : **Power drugs Ltd. (supra)** and **Vardhman Polytex Ltd. (supra)**, are found to be

distinguishable on facts, as both of the said cases before the **Hon'ble High Court** were on the issue of disallowance made u/s 36(1)(iii) of the 'Act', in light of the facts involved in the said respective cases, and not as regards the issue of maintainability of penalty imposed u/s 271(1)(c) as regards a disallowance made u/s 36(1)(iii), which is the issue involved in the present case before us.

8. We are of the considered view that in light of the facts of the present case as they so remain, the assessee had *prima facie* demonstrated before us the factum of availability of substantial interest free funds, as well as the profits/surplus generated during the year, which as claimed by the Ld. A.R was lying available with the assessee, from which the investment towards the purchase of property at 'BDB' could be justifiably explained. It was thus averred by the Ld. A.R that in the backdrop of the aforesaid facts, as no part of the interest bearing funds available with the assessee could be related to the making of such investment, and in light of the availability of sufficient interest free funds and the profits/surplus generated during the year, which all could justifiably explain the investment made in the property at 'BDB', therefore no penalty u/s 271(1)(c) as regards the same was called for in the hands of the assessee. We however in all fairness and appreciation of the facts in totality, restore the matter to file of the A.O for fresh adjudication, and direct him to verify from the records of the assessee the factum of availability of sufficient interest free funds with the assessee, from where the

aforesaid investment made towards purchase of property at 'BDB' could safely be explained, as had been so claimed and projected before us by the Ld. A.R. That needless to say, the A.O during the course of the set aside proceedings shall afford reasonable opportunity to the assessee to substantiate its contention. That if the assessee on the basis of his records during the course of the set aside proceedings is able to establish before the A.O the factum of availability of such sufficient interest free funds during the year under consideration, then in light of the principle enunciated by the **Hon'ble Jurisdictional High Court** in the case of : **Reliance Utilities and Power Limited** (supra) , that if the interest free funds so available with the assessee are sufficient to meet the investments so made, the same could safely be presumed to be related to such interest free funds, then without prejudice to the fact that the assessee had allowed the quantum addition pertaining to the disallowance of interest so made in its hands u/s 36(1)(iii) to attain finality, no penalty so imposed upon it u/s 271(1)(c) of the 'Act' on the said count, which has been assailed before us by the assessee, shall be allowed to survive. That as a word of caution, we herein direct the A.O to dispose of the issue which is being restored to him for fresh adjudication, as per the parameters laid down by the **Hon'ble Jurisdictional High Court** in the case of **Reliance Utilities and Power Limited (supra)**.

9. Thus the ground of appeal no. 1 & 2 are allowed for statistical purposes.

The appeal of the assessee is allowed for statistical purposes.

Order pronounced in the open court on 02.12.2016

Sd/-

(D. Karunakara Rao)

लेखा सदस्य / Accountant Member

Sd/-

(Ravish Sood)

न्यायिक सदस्य / Judicial Member

मुंबई Mumbai; दिनांक Dated :02.12.2016

Sr.PS Biswajit

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

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent
3. आयकर आयुक्त(अपील) / The CIT(A)
4. आयकर आयुक्त / CIT – concerned
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard File

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt. Registrar)

आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai