IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "SMC", PUNE

BEFORE SHRI R.S. SYAL, VICE PRESIDENT

आयकर अपील सं. / ITA No.1687/PUN/2018
निर्धारण वर्ष / Assessment Year : 2009-10

Devakikrishna Keshav Prabhu, A-1, A-2, Kusum Society, Harekrishna Mandir Society, Shivajinagar, Pune – 411 016 Maharashtra PAN : AAUPP2953P	**Vs.**	DCIT, Circle-3, Pune
(Appellant)		(Respondent)

Appellant by	Shri Sharad A. Vaze
Respondent by	Shri Rajesh Gawali
Date of hearing	13-05-2019
Date of pronouncement	14-05-2019

आदेश / ORDER

PER R.S.SYAL, VP :

This appeal by the assessee arises out of the order passed by the CIT(A)-3, Pune on 05-06-2018 in relation to the assessment year 2009-10.

2. There is a delay of 33 days in presenting this appeal before the Tribunal. The assessee has filed an affidavit in support of the reasons which led to the filing of the instant appeal belatedly.

I am satisfied with the reasons. As such the delay is condoned and the appeal is taken up for disposal on merits.

3. The assessee has filed revised grounds. Ground nos. 1 to 3 are against confirmation of disallowance u/s.14A of the Income-tax Act, 1961 (hereinafter also called 'the Act').

4. Briefly stated, the facts of the case are that the assessee is engaged in the manufacturing of marine parts, reselling and exports. Exempt dividend income from mutual funds and shares was received during the year to the tune of Rs.22,09,471/-. No disallowance u/s.14A was offered. On being called upon to explain the reasons for not offering any such disallowance, the assessee filed certain replies with which the Assessing Officer (AO) was not satisfied. Invoking the provisions of section 14A of the Act, he computed disallowance at Rs.7,62,226/- as per rule 8D(2)(ii) and 8D(2)(iii). The ld. CIT(A) upheld the disallowance. The assessee is aggrieved by the confirmation of disallowance.

5. I have heard both the sides and gone through the relevant material on record. It is seen that the AO has made disallowance under Rule 8D(2)(ii) at Rs.2,73,504/- towards interest paid.

Copy of assessee's balance sheet has been placed at page 19 of the paper book from which it can seen that the assessee, an individual, has capital of Rs.13.40 crore. As against that, the balance of Investment accounts stands at Rs.10.08 crore.

6. Section 14A read with rule 8D(2)(ii) stipulates that in a case where the assessee has incurred expenditure by way of interest during the year which is not directly attributable to any particular income, the disallowance shall be made for an amount computed in accordance with the formula given therein. Sum and substance of disallowance under Rule 8D(2)(ii) is that the interest relatable to investments/securities yielding exempt income is to be disallowed.

7. At this juncture, it is relevant to note that section 36(1)(iii) provides for deduction of interest of the amount of interest paid in respect of capital borrowed for the purpose of business or profession. The essence of this provision is that the interest should be allowed so long as the capital borrowed, on which such interest is paid, is used for the purpose of business or profession. If, however, an assessee is having its own interest free surplus funds and such funds are utilised as interest free

advances even for a non-business purpose, there cannot be any disallowance of interest paid on interest bearing loans. The Hon'ble Bombay High Court in *CIT vs. Reliance Utilities and Power Ltd. (2009) 313 ITR 340 (Bom)*, has held that where an assessee possessed sufficient interest free funds of its own which were generated in the course of relevant financial year, apart from substantial shareholders' funds, presumption stands established that the investments in sister concerns were made by the assessee out of interest free funds and, therefore, no part of interest on borrowings can be disallowed on the basis that the investments were made out of interest bearing funds. In that case, the AO recorded a finding that a sum of Rs.213 crore was invested by the assessee out of its own funds and Rs.1.74 crore out of borrowed funds. Accordingly, disallowance of interest was made to the tune of Rs.2.40 crore. The assessee argued that no part of interest bearing funds had gone into investment in those two companies in respect of which the AO made disallowance of interest. It was also argued that income from operations of the company was Rs.418.04 crore and the assessee had also raised capital of Rs.7.90 crore, apart from receiving interest free deposit of Rs.10.03 crore. The assessee submitted

before the first appellate authority that the balance-sheet of the assessee adequately depicted that there were enough interest free funds at its disposal for making investment. The ld. CIT(A) got convinced with the assessee's submissions and deleted the addition. Before the Tribunal, it was contended on behalf of the Revenue that the shareholders' funds were utilized for the purchase of its assets and hence the assessee was left with no reserve or own funds for making investment in the sister concern. Thus, it was argued that the borrowed funds had been utilized for the purpose of making investment in the sister concern and the disallowance of interest was rightly called for. The Tribunal, on appreciation of facts, recorded a finding that the assessee had sufficient funds of its own for making investment without using the interest bearing funds. Accordingly, the order of CIT(A) was upheld. When the matter came up before the Hon'ble High Court, it was contended by the Department that the shareholders' funds stood utilized in the purchase of fixed assets and hence could not be construed as available for investment in sister concern. Repelling this contention, the Hon'ble High Court observed that : "In our opinion, the very basis on which the Revenue had sought to

contend or argue their case that the shareholders' fund to the tune of over Rs.172 crore was utilized for the purpose of fixed assets in terms of the balance-sheet as on March 31, 1999, is fallacious." In upholding the order of the Tribunal, the Hon'ble High Court held that: "If there be interest free funds available to an assessee sufficient to meet its investment 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". Thereafter, the judgment of the Hon'ble Supreme Court in the case of *East India Pharmaceutical Works Ltd. Vs. CIT (1997) 224 ITR 627 (SC)* and also the judgment of the Hon'ble Calcutta High Court in *Woolcombers of India Ltd. Vs. CIT (1981) 134 ITR 219 (Cal)* were considered. It was finally concluded that: "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 the investments would be out of interest free funds generated or available with the company, if the interest free funds were sufficient to meet the investment". Consequently the interest was held to be deductible in full. From the above judgment, it is manifest that there can be no presumption that the shareholders' fund of a company was

utilized for the purchase of fixed assets. If an assessee has interest free funds as well as interest bearing funds at its disposal, then the presumption would be that investments were made from interest free funds at the disposal of the assessee. Similar view has been taken by the Hon'ble Dehi High Court in *CIT vs. Tin Box Company (2003) 260 ITR 637 (Del),* holding that when the capital and interest free unsecured loan with the assessee far exceeded the interest free loan advanced to the sister concern, disallowance of part of interest out of total interest paid by the assessee to the bank was not justified.

8. Applying the above proposition in the context of section 14A, the Hon'ble Karnataka High Court in *CIT & Anr vs. Microlabs (2016) 383 ITR 490 (Kar)* has held that when investments are made from common pool and non-interest bearing funds are more than the investment in tax free securities, no disallowance of interest expenditure u/s 14A can be made. This view has been taken by following the judgment of the Hon'ble Bombay High Court in *CIT vs. HDFC Bank Ltd. (2014) 366 ITR 515 (Bom).* It is further observed that this issue is no more res integra in view of the recent judgment delivered by the

Hon'ble Supreme Court in *Godrej & Boyce Manufacturing Company Ltd. vs. DCIT (2017) 394 ITR 449 (SC),* in which it has been held that when interest free funds in the form of share capital and reserves are more than investment, then no disallowance of interest can be made u/s 14A. In view of the foregoing discussion, I am satisfied that the disallowance made by the AO has been wrongly sustained in the first appeal. I, therefore, order to delete the same.

9. The second component of disallowance u/s.14A read with Rule 8D(2)(iii) is 0.5% of the average value of the investments. The AO computed 0.5% of the average value of investments at Rs.4,88,721/- and made disallowance for the same which came to be affirmed in the first appeal.

10. The ld. AR submitted that the disallowance made in this regard is excessive. He submitted that the disallowance may be made on the reasonable basis, may be, at Rs.1,000/- per entry. He filed a copy of dividend account showing number of entries. In my considered opinion, this type of *ad hocism* is impermissible in view of the clear mandate of Rule 8D(2)(iii). As the assessment year under consideration is a period after the

insertion of Rule 8D, I hold that the disallowance at 0.5%, being the prescription of the rule, as made and sustained in the first appeal is in order. To sum up, disallowance u/s.14A of the Act is sustained at Rs.4,88,721/- and the assessee gets relief of Rs.2,73,505/-.

11. The other ground raised by the assessee is against the confirmation of disallowance of foreign tour expenses amounting to Rs.2,10,987/-.

12. The facts apropos this issue are that the AO made addition of Rs.2,10,987/- on the ground that the assessee failed to produce any submission on the performance of foreign tour and how it was related to business. The ld. CIT(A) sustained the addition. The assessee is aggrieved by the confirmation of such disallowance.

13. I have heard both the sides and gone through the relevant material on record. A copy of the assessee's Profit and loss account has been placed at page 20 of the paper book. It can be seen that the assessee made export sales of Rs.2.81 crore as against domestic sales amounting to Rs.40.55 lakh. The ld.

CIT(A) has recorded the assessee's submission made before him on page 16 of the impugned order, vide which it was stated that foreign tour was undertaken to USA where the assessee has got its customers. Not only that, the assessee also filed copies of bills and vouchers before the AO during the course of assessment proceedings. This shows that the assessee genuinely undertook foreign visit to USA. Since his major sales are to foreign countries including USA, there can be no reason to disallow the foreign travel expenses incurred in this regard. I, therefore, order to delete the addition.

14. Ground no.4 was not pressed by the ld. AR. The same is, therefore, dismissed.

15. In the result, the appeal is partly allowed.

Order pronounced in the Open Court on 14th May, 2019.

Sd/-
(R.S.SYAL)
उपाध्यक्ष/ VICE PRESIDENT

पुणे Pune; दिनांक Dated : 14th May, 2019
सतीश

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

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. आयकर आयुक्त(अपील) /
   The CIT (Appeals)-3, Pune
4. The Pr. CIT-2, Pune
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे "**SMC**" /
   DR 'SMC', ITAT, Pune;
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

// True Copy // Senior Private Secretary
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune

		Date	
1.	Draft dictated on	13-05-2019	Sr.PS
2.	Draft placed before author	13-05-2019	Sr.PS
3.	Draft proposed & placed before the second member		JM
4.	Draft discussed/approved by Second Member.		JM
5.	Approved Draft comes to the Sr.PS/PS		Sr.PS
6.	Kept for pronouncement on		Sr.PS
7.	Date of uploading order		Sr.PS
8.	File sent to the Bench Clerk		Sr.PS
9.	Date on which file goes to the Head Clerk		
10.	Date on which file goes to the A.R.		
11.	Date of dispatch of Order.		

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