

IN THE INCOME TAX APPELLATE TRIBUNAL "G" BENCH, MUMBAI
BEFORE SHRI PRASHANT MAHARISHI, AM
AND
SHRI PAVAN KUMAR GADALE, JM

ITA No. 2587/Mum/2019
(Assessment Year 2015-16)

Wanbury Limited 10 th Floor, Sector 30A, BSEL Tech Park B wing Opp Vashi Rly Station Vashi, Mumbai-400075	Vs.	The Dy. Commissioner of Income Tax, Circle 15(3)(1), R.No. 451 Aayakar Bhavan New Marine Lines, Mumbai-400 020
(Appellant)		(Respondent)
PAN No. AABCP5939P		

Assessee by	:	Shri Madhur Agrawal, advocate, AR
Revenue by	:	Shri Hoshang B. Irani, DR

Date of hearing:	23.03.2022
Date of pronouncement :	25.04.2022

ORDER

PER PRASHANT MAHARISHI, AM:

01. This appeal is filed by the assessee against the order passed by learned Commissioner of Income Tax (Appeals)-24, [the learned CIT (A)], Mumbai dated 07.02.2019 for AY 2015-16 raising following grounds of appeal.

"1. Disallowance under Section 36(1)(iii) of the Act.

1.1. On the facts and circumstances of the case, the Ld. CIT(A) has erred in disallowing interest expense under section 36(1)(iii) of the Act amounting to Rs. 2,39,97,017 without appreciating the fact that the Appellant has incurred interest expense for the purpose of business and accordingly, the same ought

to be allowed as deduction while computing income from business and profession.

1.2. Without prejudice to Ground No. 1.1 above and on the facts and circumstances of the case, the Ld. CIT(A) has erred in disallowing interest expense under section 36(1)(iii) of the Act without appreciating the fact that the Appellant had given advances to four unrelated parties (outstanding as on April 1, 2014) out of own funds and internal accruals of previous years and accordingly, disallowance ought to be restricted to the amount advanced during the year under consideration.

1.3. Without prejudice to Ground No. 1.1 & 1.2 above and on the facts and circumstances of the case, the Ld. CIT(A) has disregarded the fact that the Appellant has given advances to three parties and charged interest at a rate of 6.11% and accordingly no disallowance under section 36(1)(iii) is warranted on advances given to these three parties.

1.4. Without prejudice to Ground No. 1.1, 1.2 & 1.3 above and on the facts and circumstances of the case, the Ld. CIT(A) has disregarded the fact that the Appellant has given advances to three parties and charged interest at a rate of 6.11% and thereby erred in not restricting the disallowance on amounts advanced during the year to the fourth party by adopting such rate of 6.11%.

1.5. Without prejudice to Ground No. 1.1, 1.2, 1.3 & 1.4 above and on the facts and circumstances of the case, the Ld. CIT(A) has erred in computing the disallowance under section 36(1)(iii) by adopting an ad-hoc rate of 12% (assuming prevailing market rate), instead of restricting the quantum of disallowance to average rate of interest on borrowings availed by the Appellant.

1.6. Without prejudice to Ground No. 1.1, 1.2, 1.3, 1.4 & 1.5 above and on the facts and circumstances of the case, the Ld. CIT(A) has erred in not restricting the disallowance of interest under section 36(1)(iii) of the Act on a proportionate basis i.e. in proportion of average loan advanced to four unrelated parties to the average value of total assets for AY 2015-16.

2. Disallowance under Section 14A of the Act

2.1 On the facts and circumstances of the case, the Ld. CIT(A) has erred in upholding disallowance of Rs. 1,92,395 under section 14A of the Act read with Rule 8D of the Income-tax Rules, 1962, without appreciating the fact that no exempt income has been earned by Appellant during the year under consideration."

02. The brief fact of the case shows that assessee is a company engaged in manufacturing of bulk drugs and trading of pharmaceutical products. It filed its return of income on 29.09.2015 at a loss of Rs. 137,37,370/-. The case of the assessee was picked up for scrutiny.

03. Assessment order u/s 143 (3) of the income tax act 1961 was passed on 15 December 2017 wherein the returned income of the assessee was assessed at ₹ 79,877,752/- against loss of Rs 1,37,37,370/- . Learned AO has made following three additions:-
- i. disallowance u/s 36 (1) (iii) of ₹ 7,774,946/-
 - ii. disallowance u/s 14 A of the act ₹ 72,877,022/-
 - iii. disallowance u/s 36 (1) (va) of the act Rs 129,63,154/-
04. Subsequently order u/s 154 of the income tax act was passed on 5/2/2017 wherein the disallowance u/s 14 A was revised to Rs 1,92,395/-
05. on appeal before learned CIT A, disallowance u/s 36 (1) (iii) of the act was enhanced by ₹ 16,222,071/- over and above the disallowance made by the learned assessing officer of ₹ 7,774,946/- thereby confirming the disallowance of ₹ 23,997,017/-. Disallowance u/s 14 A of the act was also confirmed by ₹ 192395/- . Therefore, assessee is in appeal.
06. Ground number 1 is against disallowance u/s 36 (1) (iii) of ₹ 23,997,017/-.
07. During the course of assessment proceedings the learned Assessing Officer noted that assessee has debited financial expenditure of Rs. 17,31,34,000/-. The learned Assessing Officer noted that assessee has given a loan to one company M/s Beyond Pharma Ltd. of Rs. 6, 47, 91,216/- without charging any interest. In absence of any information forthcoming from the assessee, the learned Assessing Officer held that as assessee has paid interest on loan fund and has

given interest free loan therefore, he computed the interest disallowance of Rs. 77,74,946/- @ 12% and disallowed the same under provisions of section 36(i)(iii) of the income tax Act, 1961 (the Act). This addition was challenged before the learned CIT – A. He found that assessee has also advanced loans to various other parties without charging interest or charging interest at lower rate. Therefore he issued notice for enhancement u/s 251 (2) of the act on 31st of December 2018. He tabulated the information as Under:-

serial number	name of the borrower	opening balance	fresh loan	Repaid	closing balance	interest charged	Rate of interest
1	Metallica enterprises private limited	6,42,37,450	Nil	2,12,70,203	4,29,67,247	39,22,936	6.10
2	Anjay shares and securities private limited	12,44,69,957	nil	6,48,22,198	5,96,47,759	76,01,292	6.10
3	Akkadin trading private limited	1,41,78,059	Nil	1,41,78,059	Nil	8,65,844	6.10%
4	Beond Pharma Ltd	3,55,49,066	6,47,91,216	Nil	10,03,40,282	Nil	Nil

Therefore he found that the difference between the rates eight which interest is charged on the prevailing interest rate of 12% the amount of interest chargeable on these companies amounts to Rs 2,39,97,017/-. Assessee submitted a reply on 23/1/2019 stating that loans and advances were given for the purposes of the business, notional income cannot be brought to tax in terms of the provisions of Section 36, loans have been advanced out of internal accruals and own funds and further the disallowance could be restricted to the actual average rate of interest on borrowings for advances given to only beyond Pharma Ltd. The learned CIT – A considered the explanation of the assessee and confirmed the disallowance for following reasons:-



- i. Assessee has not provided with the workings of the above interest received from the three companies and therefore it is apparent that assessee has not charged interest from them for the full year.
 - ii. The loans have not been given for any business purpose
 - iii. As assessee has written of the sum of ₹ 87 lakhs with respect to one of the lending, it has huge risk of advancing money to third parties.
 - iv. Decision relied upon by assessee on decision of Supreme Court in case of SA builders Ltd 158 taxman 74 is not applicable as assessee has failed to show any commercial expediency
 - v. Assessee is borrowing money on which it is being interest at much higher rate as compared to interest received. It is not charging interest on notional income but disallowance of interest expenditure claimed by assessee as deduction.
 - vi. Entire profit and results of the assessee has been eroded in this year of operation because of provision for doubtful advances of ₹ 89.41 crores and assessee has also long-term investment and loans and advances therefore it cannot be said that amount of share capital and reserve are used by assessee for advancing loan. Therefore, assessee does not have interest free funds available.
 - vii. The general market rate of interest on which monies are lent is 12%
08. The learned Authorized Representative, Mr. Madhur Agarwal, Advocate, took us to the assessment order as well as the order

of the learned CIT (A). He submitted that according to the annual accounts of the assessee, the loan of the three different parties as well as the loan considered by the learned Assessing Officer is far less than the share capital and reserves and surplus of the assessee. He submitted that these are interest free funds available with the assessee at the beginning of the year. He also submitted that the loans are advances given to all these 4 parties at the time of opening balance is far less than the amount of interest free share capital and free reserve available with the assessee. He therefore, submitted that presumption would be available in favour of the assessee that no interest bearing funds are used for advances to these parties. For this proposition, he referred to audited annual accounts of assessee wherein it has share capital of ₹1996.93 lakhs and reserve and surplus of 8912.85 lakhs totaling to ₹ 10,909.78 lakhs as on 31st of March 2014. He therefore submitted that if opening balance of which are listed by the learned and CIT – A is considered it comes to only ₹ 23.84 crores, which is far less than the amount of interest free funds available with the assessee. He further submitted that assessee has only given a loan of ₹ 64,791,216 to beyond Pharma Ltd during the year which is also financed by the payment of loan from three other parties listed in table given by the learned CIT – A. He submitted that recovery from all these three parties amounts to ₹ 100,270,466/- whereas the loan given to beyond Pharma Ltd is only ₹ 64,791,216/- therefore, the assessee has interest free funds available with the assessee more than the amount of lower interest-bearing funds advanced to these parties. He therefore, submitted that the loan and advances considered by the learned Assessing Officer and learned CIT (A) amounts to Rs. 23.84 crores where as the share capital and reserve and surplus available with the

assessee are to the tune of Rs.109 crores, therefore, no disallowance on account of the interest arises. He further submitted that Rs.6,47,91,216/- is a fresh loan given by the assessee to one of the parties.

09. He submitted that at the end of the year, the reserves and surplus of the assessee has diminished to the (-) Rs.18,821/- lakhs only because of the reason that Rs.152 crores are provided for diminution in value of investment. Same is merely an accounting entry and no cash outflow can be attributed to such accounting entries and therefore the learned CIT – A has wrongly stated that assessee does not have interest free funds available with it. In view of this, he submitted that the disallowance made by the learned Assessing Officer and enhanced by the learned CIT (A) is not sustainable.
010. The learned departmental representative vehemently supported all the reasons given by the learned CIT – A for confirming the disallowance as well as for enhancement of such disallowance. It was submitted that assessee does not have interest refund is available with it and has failed to show that there is any business exigency for allowing interest free funds or lower interest charging funds to these companies. It was further stated that the assessee is paying huge interest and therefore the disallowance has correctly been made.
011. We have carefully considered rival contention and perused the orders of the lower authorities. We find that as on 31/3/2014 assessee has advanced loan to four different parties amounting to ₹ 23,84,34,532/-. This is the opening balance of loans and advances outstanding in the account of these parties as advances. No doubt, the assessee has charged interest at the rate of 6.10% on these advances. However, we find that as on

31st of March 2014, assessee has non-interest-bearing funds available with it of Rs. 10,909.78 lakhs, which is far in excess of the loan advanced of ₹ 23.84 crores. Therefore, the presumption would be available in the favour of the assessee that assessee has advanced these interest free funds or lower interest bearing funds to these parties out of the interest free funds available with them.

012. Further, during the year assessee has given a fresh loan of ₹ 64,791,216 to beyond Pharma Ltd. As on 31st of March 2015, the fund position of the assessee has changed and share capital is amounting to ₹ 1996.93 lakhs whereas the reserve and surplus has turned negative to ₹ 18,821.69 lakhs. This has resulted because of the exceptional items written off in the profit and loss account as per note number 30 of ₹ 24,176.32 lakhs. Out of that ₹, 8941.48 Lacs are provision for doubtful debts and ₹ 15,234.84 lakhs are because of provision for diminution in value of investment. We find that accounting entry of ₹ 15,234.84 lakhs of writing of investment does not involve any cash outflow. Further the assessee has recovered a sum of ₹ 100,270,460/- out of loans and advances given to the first 3 parties which is also higher than the amount of fresh loan advanced to beyond Pharma of ₹ 64,791,216/-. In view of this we do not find that any interest bearing funds have been used for advancing loan is to these parties when enough in non-interest-bearing funds are available with the assessee for advancing non-interest-bearing or lower interest-bearing funds to these parties. The presumption is always available in favour of the assessee that non-interest-bearing funds have been used for advancing to the parties, unless otherwise proved. In view of this the addition confirmed by the learned CIT – A of Rs. 2, 39,97,017/- u/s 36 (1) (iii) of the act deserves to be deleted.

Hence deleted. Accordingly, ground number 1 of the appeal along with sub grounds is allowed.

013. Ground number 2 is with respect to the disallowance u/s 14 A of the act of ₹ 192395/-. As during the year learned AO noted that assessee has shown usual investment and therefore assessee was asked to show what is the amount of disallowance u/s 14 A read with rule 8D. The assessee submitted that assessee has not received any exempt income and further no expenditure has been incurred to in on any exempt income therefore there cannot be any disallowance u/s 14 A of the act. However without prejudice the assessee submitted the working of such disallowance amounting to ₹ 192,395/- . The learned assessing officer ultimately after passing the order u/s 154 of the act retained this disallowance. The learned CIT – A also confirmed the same.
014. On the issue of disallowance under section 14A of the Act, learned AR submitted that assessee has not earned any exempt income and further has categorically submitted that it has not incurred any expenditure for earning the exempt income. He further stated that there is no satisfaction recorded by the learned Assessing Officer and hence, disallowance of Rs. 1,92,539/- confirmed by the learned CIT(A) deserves to be deleted.
015. Learned departmental representative vehemently supported the order of the learned CIT – A and stated that when assessee itself has submitted the working of the disallowance which has been confirmed by the lower authorities now there cannot be any grievance.
016. We have carefully considered rival contention and perused the orders of the lower authorities. We find that during the year,

the assessee has not earned any exempt income and further assessee denied that it has incurred any expenditure. Now therefore it is mandatory on part of the learned assessing officer to record a satisfaction that the claim of the assessee is not correct. Such is the mandate of the provisions of Section 14 A (2) of the act. We find that the learned assessing officer has merely on the basis of the investment shown in the annual accounts of the assessee has invoked the provisions of Section 14 a read with rule 8D and issued notice to the assessee. When assessee has categorically replied that it has not incurred any expenditure during the year the learned assessing officer is duty-bound to record a satisfaction that why the explanation furnished by the assessee is incorrect. Such satisfaction also has to be based on accounts of the assessee. If assessing officer merely says that as the investment decision are very complex the assessee should have incurred certain expenditure cannot satisfy the requirement of Section 14 A (2) of the act. This shows that there is no reference to the accounts of the assessee. Accordingly, we find that assessing officer has failed to record any satisfaction prior to invoking of the provisions of rule 8D of income tax rules 1962. Accordingly ground number 2 of the appeal of the assessee is allowed and disallowance made by the learned assessing officer u/s 14 A of the act of ₹ 192,395/- confirmed by the learned CIT – A deserves to be deleted in view of absence of proper satisfaction recorded by the learned AO.

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

Order pronounced in the open court on 25.04.2022.

Sd/-
(PAVAN KUMAR GADALE)
(JUDICIAL MEMBER)

Sd/-
(PRASHANT MAHARISHI)
(ACCOUNTANT MEMBER)



Mumbai, Dated: 25. 04.2022

Sudip Sarkar, Sr.PS

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent.
3. The CIT(A)
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

BY ORDER,

True Copy//

Sr. Private Secretary/ Asst. Registrar
Income Tax Appellate Tribunal, Mumbai