IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.1165 OF 2013

The Commissioner of
Income Tax, Mumbai .. Appellant.
Vs.
M/s. Everest Kento Cylinders Ltd. .. Respondent.

Mr. A.R. Malhotra for the Appellant.
Mr. Percy Pardiwalla, Sr. Counsel along with Mr.Atul Jasani for the Respondent.

CORAM : S.C. DHARMADHIKARI &
A.K. MENON , JJ.

RESERVED ON : 24TH APRIL, 2015

PRONOUNCED ON : 8TH MAY, 2015

ORAL JUDGMENT (PER A.K. MENON, J.)

1. The revenue has filed the present appeal proposing the following three questions as substantial questions of law :

> "(1) Whether on the facts and in the circumstances of the case and in law, order passed bearing ITA No.542/Mum/2012 dated 23.11.2012 (A.Y. 2007-08) by ignoring the Income Tax (fifth amendment) Rules 8D for disallowing of the interest u/s 14A of the I.T.Act 1961 was perverse ?
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> (2) Whether on the facts and circumstance of the

case and in law the ITAT Mumbai Bench "K" Mumbai was justified in restricting the disallowance u/s 14A of the I.T. Act 1961 to Rs.1,00,000/-. When the Assessee Company itself had made disallowance of Rs.4,47,649/- ?

(3) Whether on the facts and in the circumstances of the case and in law the Hon'ble ITAT "K" Bench Mumbai was right in deleting the addition of Rs.28,50,353/- on account of TP adjustment on guarantee commission ?"

2. The facts in brief are as follows : The Assessee was engaged in making High Pressure Gas Cylinder services and compressed natural gas cylinder. The assessee had subsidiary company at Dubai. The assessee company filed an E-return on 31.10.2007 declaring total income of Rs.71,90,77,156/- under the Income Tax Act, 1961 (for short "I.T.Act") and showing book profit of Rs.70,18,79,265/- under section 115JB of the I.T.Act. The return was processed under section 143 (1) on 3.12.2008. The case of the assessee was selected for scrutiny and notice under section 143(2) dated 10.9.2008 was served on the assessee along with a questionaire. Subsequently the case was transferred to the DCIT with effect from 1.9.2010. The assessee was heard. After verifying the accounts of the assessee company a draft assessment order was prepared and served on 30.12.2010. The assessee was made

aware that the objections to the draft assessment order were to be filed within 30 days from the date of service, before Dispute Resolution Panel (DRP) failing which the draft assessment order would be finalised.

3. The assessee did not file objections before DRP. Instead it filed a letter dated 7.1.2011 stating that they will file an appeal before the Commissioner of Income Tax (Appeals). The assessee had received dividend of Rs.31,91,330/- and claimed exemption under section 10(33) of the I.T.Act. The assessee was informed that as per Rule 8D of the Income Tax Rule, 2008, the total interest under section 14A was disallowable. The amount of interest paid on Wealth Tax amounting to Rs.8,313/- was disallowed. The depreciation claim by the assessee on account of foreign exchange variations loss was Rs.22,71,802/-. The assessing officer disallowed this amount of foreign exchange loss. With specific reference to investments the assessee contended it made investments out of surplus funds available during financial year 2005-06 from an initial public offering. As far as transfer pricing adjustment was concerned when the Transfer Pricing Officer (TPO) passed an order under section 26A dated 28.10.2000 wherein he concluded the amount of guarantee commission received by the assessee from Associated Enterprise

was downscaled on Arm's length price by an amount of Rs.28,50,353/-. The total income was thus assessed at Rs.28,50,353/- after adjustments and penalty proceedings under section 271(1)(c) were initiated.

4. The TPO in his order dated 28.10.2010 observed that during financial year 2006-07 the Associated Enterprise had taken loan of Rs.86.88 crores that is USD 20,000,000 from ICICI bank and one of the clause of term loan was to provide a corporate guarantee by the assessee. In this behalf the assessee provided a Corporate Guarantee/guaranteeing repayment of borrowings made by the Associated Enterprise at Dubai for purchase of assets and inventories and for working capital and as a term loan. The Assesee had charged guarantee commission @ 0.5%. The TPO found that the guarantee fee charged was at a lower rate and proceeded to compare guarantee costs. The provision of guarantee was found to be an international transaction as defined under section 92B of the Act and it was found that the transaction would have a bearing on the profits, income, losses or assets of the assessee. It was observed that overall risk exposure of the assessee company becomes higher by virtue of the amount of guarantee and company becomes more leveraged including by virtue of its debit equity ratio which would

ultimately effect the cost of borrowing. The Dubai subsidiary was newly formed, was unknown had a low credit rating and as such the TPO concluded that if the guarantee had not been provided, ICICI Bank would not have lent and advanced monies to the AE. Relying upon the principles of computing guarantee fees in a case of General Electronic Capital Canada Inc. Vs. Her Majesty, The Queen, the difference between the bank rate and PLR rate it showed a return for bearing risk followed by other banks during relevant year was 6%, while the average PLR rate was 11.35%. This shows that the return for bearing the risk was around 5.35%. It was also found in another case taken up for comparison that a public company with limited liability in which 51% stake was held by Dutch State, FMO (Nederlands Financierings Maatschappij Voor Ontwikkelingslanden N.V) had charged 2.5% for furnishing guarantee in the case of RABO India Finance Pvt. Ltd., despite the fact that FMO and RABO were not related entities. The TPO came to the conclusion that the banks and companies are charging atleast 3% for providing guarantees and therefore, the bench mark arms length price for the guarantee given by the Assessee to ICICI for the benefit of the AE at 3% of the amount of guarantee. In this manner he arrived at an amount of Rs.34,99,003/- as guarantee commission and made adjustment of Rs.28,50,353/- since the amount of Rs.6,48,650/- (equivalent to 0.5%)

had already been provided for.

5. In appeal before the CIT (Appeals) the Commissioner found that in view of the decision of this Court in Godrej and Boyce Manufacturing Co. Ltd. the Assessing Officer was duty bound to work disallowance in terms of section 14A of the reasonable basis and found that the conclusion of Assessing Officer and making disallowance of Rs.20,27,896/- was reasonably correct and therefore, this ground of assessee was dismissed and the order of the Assessing Offcer was upheld. On the second issue, namely, making of addition of Rs.28,50,353/- under section 92CA the Commissioner (Appeals) after detail consideration of the order of the TPO came to the conclusion that bank rate and guarantee of the relevant period was 6% whereas PLR was 10.5% which shows that the return for bearing received was 4.5%. He therefore found that return of 3% arrived at by TOP is justified and the challenge on this ground of the appellant was also rejected.

6. Against the dismissal of the appeal, the assessee approached the Income Tax Appellate Tribunal questioning rejection of the grounds (i) the disallowance of Rs.20,27,896/- under section 14A of the Act and (ii) the order computing arms length price and making

adjustment of Rs.28,50,353/-. The Tribunal after hearing parties partly allowed the appeal on ground no.1 and estimated sum of Rs.1 lac for the purpose of disallowance under section 14A. As far as second ground is concerned, the adjustment of Rs.28,50,253/- was deleted. Aggrieved by this order the revenue is in appeal before us.

7. Mr.Malhotra, learned counsel for the Appellant supported the order of the Assessing Officer on both counts. He submitted that referring to paragraph 4 of the order that the assessee itself had stated that disallowance of Rs.4,47,649/- could be made under section 14A. He further took us through the various computations of bank guarantee commission including the order of TPO in paragraph 5.2 which set out the manner in which transaction was entered into. According to him but for the corporate guarantee, the Associated Enterprise would not have been granted the loan at all. In this view of the matter, he further invited our attention to the order of TPO and the fact that inquiry had been made by TPO with HSBC Ltd, Mumbai which was charging a rate between 0.15% to 3%. The Allahabad Bank was charging rate of 0.75% to per quarter to 3% per annum and foreign companies such as Dutch State, FMO has charged 2.5% in case of Rabo India Finance Pvt. Ltd. Furthermore, he submitted that EXIM Bank of USA has provided guarantee to Boeing Company of USA against the Hire

Purchase Agreement for purchase of aircrafts by Jet Airways India. The EXIM bank has charged a commission of 3% plus commitment charges from Jet Airways as consideration for guarantee. Accordingly, he justified the bench mark in a arm's length price for the bank guarantee at 3% of the amount of guarantee. In this manner Mr.Malhotra sought to justify arm's length price of Rs.34,99,003/- and therefore the adjustment to the extent of Rs.28,50,353/-. As far as the order of the Tribunal issuing disallowance under section 14A of Rs.1 lac is concerned, he stated that the sum is arbitrary and unsustainable specially in view of the fact that the adjustment to the extent of Rs.4,47,649/- was offered before the Assessing Officer by the Assessee itself. He therefore submitted that three questions of law are substantial questions of law and therefore ought to considered and the appeal be admitted.

8. Mr.Pardiwalla appearing on behalf of the assessee pointed out that the first issue of disallowing interest under section 14A of the I.T. Act, the order of the tribunal was prefectly justified and the disallowance of Rs.1 lakh is also justified in view of the fact that the adjustment to the extent of Rs.4,47,649/- that was offered before the Assessing Officer was not based on the original return at all. He pointed out that the original return did not contain any such concession

and adhoc figure was something that the assessee submitted during the course of assessment. The admission was thus not a part of the return filed and which was before the Assessing Officer and the Assessee could not be bound by it. He therefore submitted that the qualification made by the Tribunal was appropriate considering the facts of the case. He further submitted that a sum of Rs.11.09 crores which was invested was sourced from funds raised by way of Initial public offering (IPO) to extent of Rs.90 crores. It was found to have been made out of funds raised by IPO and order of the Commissioner of Income Tax (Appeal) has been confirmed by the tribunal. He submitted that investment was made from the surplus funds and nothing was brought on record to show otherwise. The tribunal observed that after having considered fund flow statement there was no scope of supporting the views of the Commissioner of Income Tax and the Assessing Officer that the assesee has made investment out of interest bearing funds. Therefore, considering the fact that the interest bearing funds were not used and providing for some administrative costs, a fair assessment of Rs.1 lac is arrived at for the purpose of disallowance under section 14.

9. Mr.Pardiwalla then assailed the TPO findings by making reference to the order of the Tribunal. He pointed out in paragraph

14(b) that the Associated Enterpise could have borrowed money as per prevailing rate in AE countries which were around 5.5 % per annum and during the said period AE had borrowed at the rate LIBOR + 0.83% for term loan for working capital purpose. Thus, if it could have borrowed at the said rate, the prevailing LIBOR rates were ranging from 5.3% and effective rate of borrowing was @ 6.13% for term loan and 5.8% for working capital loan, which was in line with normal rates prevailing in AE country. Mr.Pardiwalla further submitted that AE had obtained loan from its bankers on first charge towards the fixed asset and further hypothecation of inventory and book debts. AE has a gross fixed asset base valued at about USD 13 million and had inventory valued at USD 7.6 million, book debts of USD 5.4 million and cash and a bank balance of USD 1.8 million. He pointed out that against a loan outstanding of USD 10 million as of 31.3.2007, assets available were to the tune of USD 27.4 million. Accordingly there was no question the Associated Enterprise not being able to obtain a loan without this corporate guarantee issued by the Assessee.

10. Having considered submissions of Mr.Malhotra for the revenue and Mr.Pardiwalla for the assessee, we are of the view that the order of the Tribunal as regards disallowance under section 14A and restricting the same to Rs.1 lac was justified in view of the material

before the Tribunal. Furthermore, having considered the fact that a sum of Rs.4,47,649/- was not conceded in the return but was adhoc acceptance during the course of assessment, the assessee could not be bound by it. The Tribunal as the second fact finding authority had gone into factual aspects in great detail and therefore having interpreted the law as it stood on the relevant date the order passed cannot be faulted. In the matter of guarantee commission, the adjustment made by the TPO were based on instances restricted to the commercial banks providing guarantees and did not contemplate the issue of a Corporate Guarantee. No doubt these are contracts of guarantee, however, when they are Commercial banks that issue bank guarantees which are treated as the blood of commerce being easily encashable in the event of default, and if the bank guarantee had to be obtained from Commercial Banks, the higher commission could have been justified. In the present case, it is assessee company that is issuing Corporate Guarantee to the effect that if the subsidiary AE does not repay loan availed of it from ICICI, then in such event, the assessee would make good the amount and repay the loan. The considerations which applied for issuance of a Corporate guarantee are distinct and separate from that of bank guarantee and accordingly we are of the view that commission charged cannot be called in question, in the manner TPO has done. In our view the comparison is not as

between like transactions but the comparisons are between guarantees issued by the commercial banks as against a Corporate Guarantee issued by holding company for the benefit of its AE, a subsidiary company. In view of the above discussion we are of the view that the appeal does not raise any substantial question of law and it is dismissed. There will be no order as to costs.

(A.K. MENON,J.) **(S.C. DHARMADHIKARI,J.)**