

IN THE INCOME TAX APPELLATE TRIBUNAL  
AHMEDABAD BENCH

**Before: Shri Anil Chaturvedi, Accountant Member  
and Shri S. S. Godara, Judicial Member**

**ITA No. 831/Ahd/2012  
Assessment Year 2001-2002**

ACIT, Navsari Circle, Navsari (Appellant)	Vs	Shri Jugalkishore K. Agrawal, 29, Maitri Raw House, B/H Surjan Society, Atwalines, Surat. PAN: ABAPA6861E (Respondent)
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**Revenue by: Shri Dinesh, Sr. D.R.  
Assessee by: None**

Date of hearing : 12-10-2015  
Date of pronouncement : 21-10-2015

**आदेश/ORDER**

**PER : S. S. GODARA, JUDICIAL MEMBER:-**

This Revenue appeal for A.Y. 2001-02, arises from order of the CIT(A), Valsad dated 13-01-2012 in appeal no. CIT(A)-

VLS/400/09-10, in proceedings under section 143(3) of the Income Tax Act, 1961; in short %be Act+.

2. The Revenue's sole substantive ground challenges the lower appellate order deleting disallowance of interest expenditure of Rs. 10,38,237/- made by the Assessing Officer in order dated 24-12-2009. The case file indicates that this is second round of litigation between the parties on the very issue before the tribunal. Case called twice. None appears at assessee's behest. The Revenue places on record the hearing notice dated 26<sup>th</sup> August, 2015 containing assessee's signature having received the same on 11-09-2015. We accordingly proceed ex-parte against the assessee.

3. The assessee individual filed his return on 31-07-2001 stating income of Rs. 13,28,020/- from salary and other sources. The Assessing Officer completed a regular assessment on 29-03-2004 disallowing impugned interest expenditure claimed against fixed deposits income of Rs. 22,50,000/- held with Oriental Bank of Commerce, Surat declared under the head other sources. The CIT(A) reversed the Assessing Officer's action. The Revenue filed ITA 550/Ahd/2005 before the tribunal. A co-ordinate bench in its order dated 11-09-2008 remitted the issue back to the assessing authority.

4. The Assessing Officer took up consequential proceedings. He was inter alia of the view that the assessee's interest claim of Rs.

10,38,237/- in question i.e. Rs. 5,15,245/- paid to the bank on current a/c. No. 91890 and Rs. 5,22,986/- pertaining to Shri Shyam K. Agrawal @ 10.5% on unsecured loans of Rs. 90 lacs did not have any nexus with the above stated interest income declared under the head other sources u/s. 57 of the Act. He accordingly disallowed the same in consequential order passed on 24-12-2009.

5. The assessee preferred an appeal. The CIT(A)'s order relevant to the issue in hand reads as under:-

**“4. GROUNDS OF APPEAL:-** The appellant raised as many as three grounds of appeal, however, the effective ground of appeal are narrated below :-

(1) The LAO grossly erred in disallowing interest expenses of Rs. 38,231/- even though the same is fully allowable u/s. 57(iii) of the Act.

(2) The LAO erred in levying interest u/s. 234D of the Act, retrospectively, that is for a period when the said section was not even in the statute.

**5. GROUND No. 1 :-** The contention raised in Ground No. 1 is that the LAO grossly erred in disallowing interest expenses of Rs. 10,38,231/- even though the same is fully allowable u/s.57(iii) of the Act.

**5.1 OBSERVATION OF THE AO :-** During the course of assessment proceedings the AO observed that the assessee is having his own capital of Rs. 4,08,20,480/-. Out of the said capital, the major investment of Rs. 2 Crores has been invested in FDR of OBC, Surat and Rs. 1.86 Crores being capital with Alfa Plastomers P. Ltd. The assessee shown salary income from the company with whom the capital investment is made and interest income on FDR with OBC, Surat. However, the assessee not shown any interest income or charged interest on the loans given as mentioned on Page No.2 of the assessment

order. The assessee claimed interest expenses of Rs. 5,22,986/- being interest paid on the unsecured loans. However, he has not charged interest from the parties to whom huge amount was given as interest-free loan. As per section 36(i)(iii) of the Act, the assessee has not fulfilled the conditions that " the money borrowed must have been used for the purpose of business". Therefore, it is crystal clear that the deduction in respect of interest expenses can be given only if the amount borrowed is utilized for the business or profession. In the instant case, the assessee is nowhere engaged in the business or profession and no income is shown under the head income from business or profession. During the course of assessment proceedings, the assessee failed to prove the nexus of interest income earned and interest expenses. Therefore, considering the entirety facts and circumstances of case and various judicial pronouncements, the AO disallowed interest expenses of Rs. 10,38,237/- and added to the total income of the assessee.

**5.2 SUBMISSION OF THE A.R. :-** During the course of assessment proceedings, the AR of the appellant submitted the following along with the extract of the balance sheet as on 31.03.2001 as under :-

LIABILITIES	Amount in Rs.	ASSETS	Amount in Rs.
Capital Account : Proprietor's Capital]	4,08,20,480	Fixed Assets Computer Accessories	& 9,100
Unsecured Loan		Furniture & Fixtures	2,25,341
		Gold Jewellery	& 18,000
		Ornaments	
Kiran J. Agarwal	9,50,000	Navin Vikash Pvt.	7,42,500

		Ltd. (Shop)	
Sohini J. Agarwal	40,00,000	Silver & Utensils	16,000
Saloni J. Agarwal	22,90,800	Flat (Vapi)	1,02,410
Total Interest free Fund	4,80,61,281	Valuable Articles	40,700
SHuam Aqarwal (Interest Loan) bearing	K. 95,22,986	Business Investment	
		Alpha Plastomers Pvt. Ltd.	1,85,80,867
		Alpha Packaging Ltd.	23,73,081
Alpha Polyfilms	5,750	Alpha Industrial Park(AOP)	89,26,269
		Share various companies	of 5,05,708
		Share Application	10,000
		Money	,
		Kishan Vikas Patra	5,000
		Current Assets,	
		Loans & Advances :	
		Cash & Bank	

		<i>Balance</i>	
		<i>Cash</i>	35,004
		<i>ICICIBankA/c</i>	53,058
		<i>OBC Bank</i>	3,16,9i5
		<i>F.D.R. (O.B.C. Surat)</i>	2,00,00,00
			o
		<i>Salary Receivable</i>	12,500
		<i>Kanhaiyala Agarwal</i>	S. 19,00,000
		<i>Shantidevi Agarwal</i>	K. 18,00,000
		<i>Advance Tax</i>	3,20,000
		<i>P.P.F.</i>	11,49,659
		<i>L.I.C.</i>	4,10,005
		<i>Surat City Gymkhana</i>	25,000
		<i>Telephone Deposit</i>	8,000
		<i>Unit Trust</i>	4,900
	57590017		57590017

*From the above balance sheet, your honour would appreciate that the total interest free funds available with me is Rs. 4,80,61,281/~ in the form of capital and interest free unsecured loans, which, which is far in excess of the interest free advances of Rs. 1,49,99,350/- as alleged in the reasons for reopening reproduced in Para.4.3 herein above.*

*Hence, out rightly, it is submitted that in the vent of interest free funds far exceeding the interest free advances, the very basis of reopening the assessment is erroneous and ab-initio bad-in-law.*

*Your good self may note that I am a promoter shareholder in Alpha Plastomers Pvt. Ltd. and Alpha Packing Ltd. During the year under consideration , I had borrowed Rs. 95 Lacs from Shyam K. Agarwal on interest of 10.5% p.a. and also availed temporary overdraft on bank FD for making investment as seed capital in Alpha Plastomers Pvt. Ltd. being a promoter of the said company since all my other funds were blacked and not liquid. Thus, out of business compulsion, the interest funds were borrowed by me.*

*Your goodself may further note that the amount invested in the name of Alpha Industrial Park is not a loan or advance but it is a business investment in factory land & building at Daman as co-owner and hence, it cannot be termed as interest free advance.*

**Covered matter :-**

(a) *It is also submitted that the issue that no interest is disallowable when interest free funds exceed the interest free advances is directly covered by the decision of the jurisdictional Ahmedabad Bench of the Tribunal in the case of **Torrent Financiers Vs. ACIT (2001) 73 TTJ 624 (Ahd)** wherein, it has been held as follows :-*

*"If the total interest free advances including debit balance of partners of assessee-firm do not exceed the total interest-free funds available with the assessee, no interest is disallowable on account of utilization of fund for non-business purposes ; if it exceeds, proportionate disallowance can be made "*

(b) *The said view has even been consistently followed by the jurisdictional Ahmedabad Bench of the Tribunal even in subsequent judgment i.e. in the case of Navpad Textile Industries Ltd.(ITA No. 2311/Ahd/95 dtd. 30.01.2002) wherein also no disallowance of interest has been made to the extent the assessee had interest-free funds available with it.*

(ii) **Expenditure has been incurred for earning income :-**

*Your goodself may note that I had made business investment in my companies as a promoter in anticipation of earning income from which I had incurred interest expenses only on some of the borrowings.*

*During the year under consideration, there was no immediate realization of income from these investments, however, in the subsequent years i.e. A.Y. 2003-2004, I have earned income from some of these investments which have been offered for tax.*

*However, the erstwhile AO was of the opinion that since the investments have not earned any income in the year under consideration, the interest paid cannot be allowed as expenses.*

*In this regard, I would like to bring to the kind notice of your honour the direct decision of the Hon.ble Supreme Court in the case of CIT v/s. **Rajendra Prasad Moody (1978) 115ITR 519** CSC), wherein, it has been held that section 57(iii) does not require that income must have been earned as a result of the expenditure.*

*Hence, it is most humbly submitted that the erstwhile AO's reasoning for not allowing the interest expenses that the investments have not earned any income is not only erroneous on facts of the case but also in the eyes of the law.*

(iii) **Interest expenses is incurred with the objective of preserving the income earning asset:-**



Over and above, the aforesaid facts, the erstwhile AO was also explained the fact that during the year under consideration, I had a fixed deposit of Rs. 2 Crores with the Oriental Bank of Commerce(OBC), however, in order to make business investment, I did not want premature encashment of the said fixed deposit since the bank interest rates were falling and such withdrawal would have resulted into severe fall into my earnings and therefore, out of commercial expediency and prudence, I instead of prematurely encashing the said P.P. availed loan against the security of the same whereby I preserved higher income earning assets and incurred liability of a much lower extent.

The business prudence and commercial expenditure gets clearly reflected from the fact that by preserving the bank P.P. I have been able to earn net interest income of Rs. 12,11,769/- ( interest income of Rs. 22,50,000/- less interest paid to Shyam K. Agarwal of Rs. 5,22,986/~ and interest paid on bank overdraft of Rs. 5,15,245) and if I had practices the illogical non-prudent and non-commercial approach as adopted by the erstwhile AO. I would not have earned the bank interest income of Rs. 22, 50,000/- and in the said circumstances, the question of disallowance of any interest would not have arisen.

However, by my prudent and commercial approach in fact returned me taxable income of Rs. 12,11,769/-

Thus, even otherwise, interest expense is allowable on the ground that it is incurred with the objective of preserving the income earning asset.

**Judicial pronouncements :-**

Reliance is placed on the following judicial pronouncements directly applicable to the facts of the case.

(a) The Hon.'ble Hyderabad Bench of the Tribunal in the case of **J. D. Italia v. ITO(1986)17 ITD 154 (Hyd)** has held as follows

*" In order to preserve the income earning movable assets, the executor preferred to raise a loan from the bank and to discharge the estate duty liability. Thus, the nexus between the expenditure incurred and the earning of the income has been established.*

*By raising loan on the security of the fixed deposits, the executors were paying only 2% extra interest and preserved the income earning asset.*

*The expenditure incurred by way of interest on loan raised to discharge the estate duty liability is allowable deduction u/s. 5(iii) as there is nexus between the expenditure incurred and the earning of the income.*

*The CIT was not right in directing the ITO to disallow the interest paid to the bank ".*

*(b)The Hon.'ble Hyderabad Bench of the Tribunal once again in a recent judgement in the case of **Ashok Brothers v. ITO (2002) 76 TTJ 427 (Hyd)** has held as follows:-*

*" No part of interest paid by the assesses on its overdraft account could be disallowed on the ground that assessee had made interest-free advances to its sister-concern by issuing cheques from its cash credit account when it has sufficient interest-free funds available to match the interest-free advances".*

*Hence, in view of the aforesaid contentions and the direct judicial pronouncements in support thereof, it is most humbly submitted that no part of the interest expenses should have been disallowed by the erstwhile AO in my case.*

**Rebuttals of the findings of the erstwhile AO :-**

*The observations/findings of the erstwhile AT as contained in his order as regards the facts of the case and the legal position are rebutted herein after.*

*(i) The erstwhile AO has held that the decisions referred to by the assessee are on business expenditure as provided in section 36(i)(iii) whereas, in the assessee's case there is no business activity but income from other sources and hence his case is governed by the provisions of section 57(iii).*

*The aforesaid observation of the erstwhile AO is absolutely erroneous since the judicial pronouncement in the case of **J.D. Italia v. ITO (1986) 17 ITD 154 (Hyd)** as relied upon by me is in respect of section 57(111) and not section 36(i)(iii).*

*However, the erstwhile AO has not discussed the said judgement in his assessment order for the reasons best known to him.*

*Here, reliance is also placed on the following decisions in respect of section 57(iii).*

*(a) The Hon.'ble Karnataka High Court in the case of **Venkateshwara Real Estate & Enterprises (P) Ltd. v. CIT (1985) 151 ITR 729 (Ker)** has held that any expenditure incurred for maintaining the source of income is deductible u/s. 57(iii). The Hon'ble Court has further held that the connection between income and expenditure need not be direct but may even be indirect.*

*(b) The Hon'ble Bombay High Court in the case of **CIT v. N. H. Maharani Shri Vijaykuberba Saheb of Morvi & Ors. (1975) 100 ITR 67 (Bom)** has held that interest paid on borrowed money for purposes of payment of estate duty was allowable as the trustees had no option but to incur the expenditure in order to make the earning of income possible and to preserve the corpus of the trust.*

(ii) *Without prejudice, it is also submitted that the erstwhile AO has erred in holding that I had no business activity since I am a partner in partnership firm and was also a director and promoter in several companies and had even offered Nil business income in my computation of income.*

*It may kindly be noted that it is not absolutely necessary that for treating a person as carrying on business, he should do the business by himself and not through other or an energy like partnership/company.*

(iii) *The erstwhile AO has also held that the amount borrowed has been utilized in the investment of assets exempt from tax and in nonassessable income.*

*The said finding of the erstwhile AO is also incorrect since I have made the investment in partnership firm and in private limited companies from which taxable income in the form of interest, dividend etc. have in fact have been earned though not in the year under consideration but in the subsequent year and thus, it is not a case where the amount of borrowed has been utilized in exempted assets.*

*Thus, the erstwhile AO's argument that the investments have been made in exempted assets also does not hold true.*

(iv) *The AO has placed reliance on the judicial pronouncement in the case of Amna Bai Hajee Issa v. CIT( 1964) 51 ITR 835 (Mad) and H.T. Conville v. CIT (1936) 4 ITR 137 (Lahore), which is absolutely misplaced since both these decisions are in respect of section 36(i)(iii) and not section 57(111).*

*Hence, this stand of the erstwhile AO is in fact self defeating since he himself held that my case is covered by section 57(iii) and not by section 36(i)(iii).*

**DECISION:-** *I have considered the observation of the AO in the assessment order as well as the contention raised by the AR of the appellant in the written submission. The findings of the AO*

*to be high per technical whereby he has admitted to work out the nexus of expenditure claimed by the appellant vis-a-vis the exempt income earned by the appellant. He has dealt with the issue of Sections 56 & 57 and Section 37 of the Act to establish that the appellant under the shelter of investment in a partnership firm and in a company wherefrom the taxable income shall be earned in future. He has discussed about the setting up an industry and set of interest expenses during the period of set up of industry and commencement of business, whereas, the arguments advanced by the AR of the appellant is fully justifiable as the appellant has hit own capital worth Rs. 4,08,20,481/-and the interest-free loans worth Rs.72,40,800/-. Therefore, the appellant has in aggregate interest-free fund available with him stands to 4,80,61,281/-. As against the said interest-free funds, the AO has advanced Rs. 1,49,99,350/- to various parties as an interest-free advance, therefore, it is not justified on the part of the AO to disallow the expenditure of interest claimed by the appellant. This issue is squarely covered by the decision of the Hon'ble Supreme Court in the case of S.A.,Builders 288 ITR 1 (SC). Therefore, the addition made by the AO is **deleted.**"*

6. We have heard the Revenue and gone through the case file. A perusal of the lower appellate findings extracted hereinabove reveals that the CIT(A) has treated the assessee's fixed deposit income of Rs. 22.5 lacs under the head other sources to be exempt. His claim of corresponding interest expenditure made u/s 57(III) qua any other expenditure not being in the nature of capital expenditure laid out or expended wholly and exclusively for the purpose of making or earning such income has been accepted. We have already given details of the same in the preceding paragraphs. The Assessing Officer invoked the impugned disallowance quoting assessee's failure in proving nexus between the impugned interest income vis-à-vis the

interest expenditure. The lower appellate authority follows case law of SA Builders (supra) accepting plea of commercial expediency involved in a case of borrowed funds being advanced to a sister concern without charging interest. The same is nowhere applicable qua the facts of the instant case wherein no nexus between the impugned income and interest is forthcoming. Thus, we accept Revenue's arguments. The Assessing Officer's findings disallowing the impugned interest expenditure of Rs. 10,38,237/- are accordingly restored. The Revenue's sole substantive ground succeeds.

7. This Revenue's appeal is allowed.

Order pronounced in the open court on 21-10-2015

**Sd/-**  
**(ANIL CHATURVEDI)**  
**ACCOUNTANT MEMBER**  
**Ahmedabad : Dated 21/10/2015**  
*ak*

**Sd/-**  
**(S. S. GODARA)**  
**JUDICIAL MEMBER**

आदेश का प्रतिलिपि आदेश / Copy of Order Forwarded to:-

1. Assessee
2. Revenue
3. Concerned CIT
4. CIT (A)
5. DR, ITAT, Ahmedabad
6. Guard file.

By order/आदेश से,

उप/सहायक पंजीकार  
आयकर अपील आधिकरण,  
अहमदाबाद