IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "SMC" MUMBAI

BEFORE SHRI OM PRAKASH KANT (ACCOUNTANT MEMBER) AND
SHRI SANDEEP SINGH KARHAIL (JUDICIAL MEMBER)

ITA No. 252/MUM/2021
Assessment Year: 2016-17

M/s General Aerodynamics Pvt. Ltd., Ali Chambers, Tamarind Lane, Fort, Mumbai-400023.	**Vs.**	Income Tax Officer-2(1)(2), Room No. 543, Aayakar Bhavan, M.K. Road, Churchgate-400021.
PAN No. AABCG 4629 H **Appellant**		**Respondent**

Assessee by	:	Mr. Hitesh Jain, AR
Revenue by	:	Mrs. Smita Nair, DR
Date of Hearing	:	21/06/2022
Date of pronouncement	:	05/07/2022

ORDER

PER OM PRAKASH KANT, AM

This appeal by the assessee is directed against order dated 04/02/2020 passed by the Ld. Commissioner of Income-tax(Appeals)-4, Mumbai [in short 'the Ld. CIT(A)'] for assessment year 2016-17, raising following grounds:

1. *The Learned Commissioner of Income Tax (Appeals) ("Ld. CIT (A)") has erred in confirming the disallowance of interest expense*

of Rs 25,38,825/- u/s 36(1) iii) of the Act, on the assumption that the borrowed funds have been utilized for non-business purpose of the appellant. On the basis of the circumstances and facts of the case, this addition ought to be deleted.

2. *Without prejudice to ground no 1, the Ld. CIT (A) erred in confirming the disallowance u/s 36(1) (iii) at ₹25,38,825/- instead of ₹9,74,983/- being proportionate disallowance of interest expenditure pertaining to borrowed funds used for non-business purpose) On the basis of the circumstances and facts of the case, addition, if any, ought to be restricted to ₹9,74,983/-*
3. *Without prejudice to ground 1 and 2 above, the Ld. CIT(A) has erred in confirming action of the 'AO in not allowing capitalization of interest disallowed u/s 36(1)(iii) along with the value of investments. On the basis of the circumstances and facts of the case, interest disallowed, ought to be allowed to be capitalized.*

2. At the outset, we may like to mention that Registry has pointed out delay of 339 days in filing the appeal. As per Form No. 36 i.e. the form prescribed for filing the appeal, the order of the Ld. CIT(A) was served upon the assessee on 04/02/2020 and therefore appeal before the ITAT was due within 60 days i.e. 5/03/2020, whereas the appeal has been filed on 09/03/2021. We find that in view of the

order dated 10/01/2022 of the Hon'ble Supreme Court in Miscellaneous Application No. 21 of 2022 in *suo moto* writ petition (C) No. 3 of 2020, wherein it is directed that period from 15/03/2020 till 28/02/2022 shall stand excluded for the purpose of limitation as may be prescribed under any general or special laws in respect of all judicial or quasi judicial proceedings, the appeal filed by the assessee is within extended limitation period. Accordingly, the appeal is admitted for adjudication.

3. Briefly stated, facts of the case are that the assessee was engaged in the business of providing loans to corporate and bill discounting activity. For the year under consideration, the assessee filed return of income on 15/10/2016, declaring total income at Nil. The Ld. Assessing Officer scrutinized the return of income and in the assessment order dated 14/12/2018, passed under section 143(3) of the Income-Tax Act, 1961 (in short 'the Act'), out of the claim of

the interest expenditure of ₹55,53,061/-, he restricted claim of interest expenditure to ₹30,14,226/-and disallowed balance amount of ₹25,38,825/-. The Ld. CIT(A) also upheld the disallowance. Aggrieved, the assessee is an appeal before the Tribunal, raising the grounds as reproduced above.

4. Before us the Ld. counsel of the assessee filed a paperbook containing pages 1 to 49 and also filed copy of the decisions relied upon.

5. The ground No. 1 of the appeal relates to entire disallowance of ₹25,38,825/-, which the Assessing Officer held as related to investments and not for the purpose of the business.

5.1 The facts qua the issue in dispute are that assessee was engaged in business of giving loans to corporate. The assessee borrowed money and during the year under consideration incurred interest of ₹55,53,061/-. The assessee further given advances out of the money borrowed and during the year under consideration earned interest income ₹46,73,102/-. The Assessing Officer observed that assessee had a opening investment of ₹1,30,00,000/- in debt oriented mutual fund and made a further investment of ₹40,00,000/- during the year under consideration and thus made total investment in debt oriented mutual fund as on 31/03/2016 at ₹1,70,00,000/-. The Ld. Assessing Officer held that interest corresponding to money invested in debt mutual fund, being for non-business purposes, is not allowable and accordingly, he allowed out of the interest incurred, interest of ₹30,14,226/- for the fund utilized for business purposes (i.e. advancing loans) and made proportionate disallowance of interest amounting to ₹ 25,38,825/- for fund invested for non-business purposes. The said working of interest for business purpose made by the Assessing Officer is reproduced as under:

$$= \frac{\text{amount of fund used for business purpose}}{\text{amount of fund borrowed}} \quad \mathbf{X} \quad \text{gross interest debited in profit and loss account}$$

= (2,80,40,460/5,16,58,492) **X** 55,53,061

=₹30,14,226/-

6. The Ld. Assessing Officer held that money was diverted for non-business purposes. In absence of link of said investment from own capital he, also rejected the contention of the assessee that investment in debt mutual funds was out of own capital. He relied on the decisions of the Hon'ble Madras High Court. The relevant finding of the Ld. Assessing Officer is reproduced as under:

> *"In this case, the facts are sufficiently clear to warrant the finding that there has been a diversion. The deduction u/s.36(1)(iii) is an allowable expenditure as long as the amounts borrowed were used for the purpose assessee's business. Further, the capital borrowed should not only be invested in assessee's Own business but also that the amounts borrowed continues to remain in the business. It is further seen from the details submitted that assessee has not provided one to one nexus on the funds borrowed and funds utilized. Analysis of balance sheet clearly indicates the assessee kept entire funds available as a common pool of funds and in absence of any separate accounting entries in the books for funds*

borrowed and funds utilized the only conclusion is funds are utilized from common pool of funds. Hence proportionate interest is required to be disallowed in accordance with section 36(1)(iii).

*In this regard, reliance is placed on the decision of **Madras High Court (2011 TIL 687-HC-MAD-IT) CIT Vs R Mohan** where in it was held that the assessee is not entitled to claim interest expenditure on the borrowed funds which were diverted to non business objects. Further reliance is placed on **CIT Vs M.S. Venkateswaran (Mad) 222 ITR 163 K. Somasundaram & Brothers Vs CIT (Mad) 238 ITR 939** where in it was held that When Department established the fact of diversion of borrowed funds for non-business purposes, the presumption that assessee had sufficient capital and the diversion is out of such funds cannot exist - Disallowance justified."*

6.1 The Ld. CIT(A) upheld the disallowance observing as under :

"4.2 I have carefully gone through the assessment order as well as submission of the appellant. The appellant is engaged in the business of giving loans. The sources of funds available with the appellant as per the balance sheet is share capital of 22.95 lacs and reserve and surplus of 213.77 lacs. As against this the appellant has a long term borrowings of R5.16 crore. Thus the borrowed fund of the appellant is more than 30 times that of its own funds. In this situation it is incorrect on the part of the appellant to say that investment in mutual fund amounting to R1,70,00,000 has been made by using its own non interest being fund. From the facts of the case it is clear that the appellant has hardly any

own funds to its credit and it is managing its entire business activities as well as its investment and asset from borrowed funds only. It has been held by the Hon'ble Supreme Court in the case of S A Builders Ltd. 158 taxman 74 that the allowability of interest on borrowed loan will depend on facts of a particular case. In this case, the AO himself has stated in the assessment order that only proportionate disallowance of interest expenditure is required to be done. It is also seen that in the assessment order the AO has taken an adverse view only on the proportion of interest which he had thought to be relatable to activities such as loans and advances and investment in mutual funds. It is further seen that out of total interest expenditure of ₹55,53,061/- he has disallowed an amount of ₹25,38,825/- However, as mentioned earlier, the appellant is in the business of giving loans and therefore, the activity of loans and advances cannot be described as being not related to the business of the appellant.

4.3 Thus the only issue to be decided now is whether investment in mutual funds amounting to ₹70 lacs can be said to be for the purposes of business or as a measure of commercial expediency. The appellant is not an investment company and therefore investing ₹1.70 lacs in mutual funds from borrowed fund does not make the case for either the purposes of business or commercial expediency. Considering the fact that the AO has himself given substantial relief to the appellant by not disallowing the entire amount of interest paid, I see no reason to interfere with the order of the AO. The grounds of appeal no. 1,2 and 3 are accordingly dismissed and the addition of ₹25,38,825/- is confirmed."

7. The assessee before us contended that since the fund of ₹1,28,22,497/- was lying idle in current account as on 31/03/2015, no interest would be earned and therefore the assessee decided to invest the said ideal fund in mutual funds and therefore according to the assessee said investment was for the purpose of the business only. The Ld. counsel further submitted that the assessee only need to prove that funds have been borrowed for the purpose of the business or profession and not actual deployment.

7.1 The Ld. counsel submitted that decisions relied upon by the Assessing Officer are distinguishable as in those cases borrowed funds were advanced to/utilized by the assessee for relative party whereas in the case of the assessee, funds have been retained by the assessee in its own name and has been temporarily invested into mutual funds, instead of keeping it into current account, which does not give any income.

7.2 Without prejudice to the above, in ground No. 2 the assessee has requested for restricting the disallowance to ₹9,74,983/-. The Ld. counsel drawn our attention to position of availability of own fund. The said chart reproduced in para 9 of his written submission is extracted as under :

Particulars	As on 31.03.2015	As on 31.03.2014
Share Capital	2,95,000/-	2,95,000/-
Reserves and Surplus	76,35,020/-	71,09,848/-
Total Investment in Mutual Fund	79,30,020/-	74,04,848/-

7.3 He further submitted that Ld. CIT(A) in assessment year 2015-16 has held that firstly, own funds of the assessee need to be adjusted against investment and excess investment over own funds, can only be liable to disallowance under section 36(1)(iii) of the Act. He submitted that Ld. CIT(A) in assessment year 2015-16 has quantified ₹55,95,152/- out of ₹1,30,00,000/- investment, interest on which was held to be liable for disallowance. The Ld. counsel submitted that following the finding of the Ld. CIT(A) in assessment year 2015-16, in the case of the assessee disallowance of ₹9,74,983/- could only be made. The relevant submission of the Ld. counsel are reproduced as under:

> *"15. During the year under consideration, the appellant has made an further investment in mutual funds of Rs. 40,00,000/- and its shareholders funds during the A.Y 2015-16 has been increased by Rs. 5,25,172/- (i.e. Rs. 79.30,020/- as on 31.03.2015 minus Rs. 74,04,848/- as on 31.03.2014) and therefore, the amount on which interest disallowance to be made, ought to be computed as under:*
>
> > *a) On Rs. 55,95,152/- as quantified by Hon'ble CIT(A) in order for AY 2015-16 plus*
> >
> > *b) On Rs. 34,74,828/- (being Rs. 40,00,000/- additional investment minus Rs. 5,25,172/- being the increase in internal accruals in A.Y 2015-16)*
>
> *16. Based on the above, the amount of proportionate disallowance to be made comes to Rs.9,74,983/- (ie investment out of borrowed funds of Rs. 90,69,980/- divided by total borrowed funds of Rs. 5,16,58,492 multiplied by interest paid of Rs. 55,53,061/-).*
>
> *17. In view of above, we request your Honour to restrict the disallowance to Rs. 9,74,983/ as against Rs. 25,38,825 made by the Assessing Officer."*

7.4 Further, without prejudice to ground No.1 and 2, the Ld. counsel further submitted that while allowing the proportionate interest for fund utilized for business purpose, the Assessing Officer has not considered amount of ₹51,00,000/- advanced to M/s Elder Healthcare Ltd., which was grouped as doubtful debt and further ignored amount of ₹75,83,341/- which was lying in the bank account. The Ld. counsel drawn over attention to audited financial statement available on page 14 of the paperbook. The Ld. counsel submitted that accordingly the funds utilised for business purpose works out to ₹4,07,23,801/- instead of ₹2,80,40,460/- taken by the Assessing Officer for computation of interest allowable to the assessee. The Ld. counsel submitted revised working of interest allowable to the assessee as under:

$$= \frac{\text{amount of fund used for business purpose}}{\text{amount of fund borrowed}} \; \mathbf{X} \; \text{gross interest debited in profit and loss account}$$

$$= (4{,}07{,}23{,}801/5{,}16{,}58{,}492) \quad \mathbf{X} \quad 55{,}53{,}061$$

=₹43,77,630/-

7.5 The Ld. counsel accordingly submitted that in that case disallowance would be restricted to ₹11,75,431 /- (₹55,53,061 – ₹43,77,630/-)

7.6 Without prejudice to ground one and two of the appeal, supporting the ground No. three, the Ld. counsel submitted that proportionate disallowance under section 36(1)(iii) should be allowed to capitalize along with the value of the investment. In support, he relied on the decision of the Hon'ble Madras High Court in the case of **Trishul Investment 305 ITR 434** and decision of the Tribunal Mumbai bench in the case of **DCIT vs. Sh Fritz D Silva in ITA No. 236/Mum/2010**.

8. The Ld. DR on the other hand relied on finding of lower authorities and submitted that assessee has failed to justify as the proportionate interest disallowed is related to the business activity

of advancing loan and therefore disallowance has been made in accordance with law.

9. We have heard rival submission of the parties and perused the relevant material on record.

9.1 As far as ground No. 1 of the appeal of the assessee is concerned i.e. the investment made in debt mutual fund was part of business activity because funds being ideal for invested for earning income, the argument of the Ld. counsel does not in any manner establish that investment in mutual fund is part of the business activity of the assessee. The assessee has clearly admitted that it was engaged in advancing loan to corporate and bill discounting. In the profit loss account, the assessee has shown interest income from advancing loan only and this activity of investment in mutual fund is not the business activity irrespective of the fact that ideal funds have been invested. The funds have not been invested due to business or commercial expediency, and same have been invested for earning income on ideal funds. Therefore, interest corresponding to borrowed money utilized in said investment is disallowed. The ground No. 1 of the appeal of the assessee accordingly is dismissed.

9.2 As far as ground No. 2 of the appeal is concerned, the assessee failed before the lower authorities to justify as how the own funds were deployed in investment in debt mutual fund and in absence of which the claim of utilisation of own capital and reserves surplus towards investment in debt mutual fund of ₹1.30 crores cannot be accepted. The ground No. 2 of the appeal of the assessee is accordingly dismissed.

9.3 The alternative plea made in ground No. 2 of the assessee, is however, convincing. While taking calculation of the funds utilised for business purpose, the Ld. Assessing Officer was required to consider the claim of the assessee of ₹51 lakh representing under the doubtful debt and ₹75,83,341/- lying in bank account. The amount of interest allowable was required to be considered after including above two amounts. Accordingly, we accept this contention of the assessee. We set aside the order of the Ld. CIT(A) on the issue in dispute and restore the matter to the file of the Ld. AO for re-computation of the amount of the interest allowable in terms of section 36(1)(iii) in view of the plea of including the amount of ₹ 51 lakh representing doubtful debt and ₹75,83,341/- representing as amount lying in bank account for funds utilized for business purposes. It is needless to mention that the assessee shall be afforded adequate opportunity of being heard. In the result, the ground No. 2 of the appeal is partly allowed for statistical purposes.

9.4 The ground no. 3 being raised as alternative remedy. The assessee is seeking capitalization of the amount of interest disallowed under section 36(1)(iii) of the Act. Here the assessee is claiming that if interest corresponding to investment in mutual funds is not allowed as revenue expenditure, then same should be treated as cost of acquisition of the said mutual fund. We are of the opinion that the issue of claim of the interest amount as cost of acquisition will arise at the time of the sale of the said mutual funds and therefore issue is premature at this stage, therefore, we are not adjudicating upon the said issue. The ground No. 3 of the appeal is accordingly dismissed.

10. In the result, the appeal of the assessee is allowed partly for statistical purposes.

Order pronounced in the Court on 05/07/2022.

Sd/-	Sd/-
(SANDEEP SINGH KARHAIL) **JUDICIAL MEMBER**	**(OM PRAKASH KANT)** **ACCOUNTANT MEMBER**

Mumbai;
Dated: 05/07/2022
Rahul Sharma, Sr. P.S.

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)
ITAT, Mumbai