

+आयकर अपीलीय अधिकरण “E” न्यायपीठ मुंबई में।

IN THE INCOME TAX APPELLATE TRIBUNAL “E” BENCH, MUMBAI

श्री पी.एम. जगताप, लेखा सदस्य एवं डॉ. एस.टी.एम. पवलन न्यायिक सदस्य के समक्ष ।

BEFORE SHRI P.M. JAGTAP, AM AND Dr. S.T.M. PAVALAN, JM

आयकर अपील सं./I.T.A. No.8076/Mum/2010

(निर्धारण वर्ष / Assessment Year : 2007-2008

आयकर अपील सं./I.T.A. No.4881/Mum/2012

(निर्धारण वर्ष / Assessment Year : 2008-2009

आयकर अपील सं./I.T.A. No.2870/Mum/2013

(निर्धारण वर्ष / Assessment Year : 2009-2010

M/s Sylvester & Company, Sylvester Building, 20, Shahid Bhagat Singh Road, Opp. Custom House, Mumbai – 400 023.	बनाम/ Vs.	A.C.I.T. 12(1), Aayakar Bhavan, Mumbai. 20.
स्थायी लेखा सं./PAN : AAJFS5846F		
(अपीलार्थी / Appellant)	..	(प्रत्यर्थी / Respondent)

Appellant by	Shri Vijay Mehta
Respondent by :	Shri Pitamber Das

सुनवाई की तारीख / **Date of Hearing** : 08-05-2014

घोषणा की तारीख / **Date of Pronouncement** : 04-06-2014

I
आदेश / ORDER

PER P.M. JAGTAP, A.M. :

पी.एम. जगताप, लेखा सदस्य

These three appeals filed by the assessee are directed against three separate orders of the Id. CIT(A) for assessment years 2007-08, 2008-09 and 2009-10 and since some common issues are involved therein, the same have been heard together and are being disposed of by this single consolidated order for the sake of convenience.

2. First, we shall take up the appeal of the assessee for A.Y. 2007-08 being ITA No. 8076/Mum/2010 which is directed against the order of Id. CIT(A) -23, Mumbai dated 3-9-2010.

3. The issue involved ground No. 1 of this appeal relates to the addition made by the A.O. and sustained by the Id.CIT(A) to the extent of Rs. 3,37,373/- being 10% of the total operating expenses incurred by the assessee in cash.

4. The assessee in the present case is partnership firm which is engaged in the business of providing services as clearing and forwarding agent. The return of income for the year under consideration i.e 2007-08 was filed by it on 31-10-2007 declaring total income of Rs. 76,21,285/-. In the P&L account filed along with the said return, expenses of Rs. 85,82,727/- were debited by the assessee under the head "operating expenses" which inter alia included clearing, handling and other expenses of Rs. 33,89,268/- incurred by the assessee. During the course of assessment proceedings, the expenses claimed to be incurred by the assessee on clearing, handling and others were examined by the A.O. and on such examination, he found that the said expenses to the extent of Rs. 33,73,726/- were incurred by the assessee in cash. He also found that the said expenses not supported by third party vouchers were not fully verifiable. In this regard, the contention raised by the assessee before the A.O. was that the said expenses to the extent of Rs. 31,40,115/- were actually reimbursed by the clients and the disallowance on account of un-verifiability could be made only out of the difference between the expenses incurred by the assessee in cash i.e. Rs. 33,73,726/- and the amount reimbursed by the clients i.e. Rs. 31,40,115/-. This stand of the assessee was not found acceptable by the A.O. He noted from the relevant contracts between the assessee firm and its clients that the expenses were recovered by the assessee at flat rates disregarding the actual expenses

incurred and it was thus not a case of reimbursement of actual expenses incurred as claimed by the assessee. He held that the amount of Rs. 31,40,115/- recovered by the assessee from its client was in the nature of service charges and since the expenses claimed by the assessee against the income from service charges were not fully verifiable, he allowed the claim of the assessee for expenses on estimated basis at Rs. 23,43,430/- being 75% of the amount of service charges received by the assessee and made an addition to the total income of the assessee on account of the balance amount of Rs. 10,30,296/- treating the same as profit from the service charges received.

5. The addition of Rs. 10,30,296/- made by the A.O. on account of income estimated from service charges was disputed by the assessee in the appeal filed before the ld. CIT(A). It was brought to the notice of the ld. CIT(A) by the assessee that a similar issue was involved in assessee's own case for the earlier years and the same was decided by the Tribunal in A.Y. 1999-2000, 2002-03, 2003-04 & 2004-05 holding that the disallowance on account of unverifiable element involved in operating expenses could be made only to the extent of 10% of the difference between the amount spent by the assessee and the amount recovered from the client. After considering the submission made by the assessee as well as the relevant material on record, the ld. CIT(A) decided this issue vide para No. 2.3 of his impugned order as under:-

"2.3 I have carefully considered the submissions made for the appellant and the assessment order. I find that the Hon'ble (TAT Mumbai in ITA No. 162/Mum/2003 vide order dated 25/10/2007 had sustained a disallowance made out of similar expenses to the extent of 10%. In ITA No.687/M/06 for A.Y.2002-03, the Tribunal while noting the decisions in respect of A.Y.1999-2000, found that in the previous year relevant to A.Y.2002-03, the assessee the clients on account of expenses in question and keeping in view the position, it was held by the Tribunal that there was no reason to make any disallowance out of such expenses as the same were entirely recovered by the assessee from the clients. The (TAT, in (TA No. 1381 /M/08 and 1753/M/08 for AYs 2003-04 & 2004-05, vide its order dated 20/07/2007 followed its own order in the assessee's own case for AY 2002-03. There would be no ground for making a disallowance if all expenses incurred are recovered from the appellant, since these would be in the nature of reimbursement. However, if

expenses are not incurred and recoveries are made from clients in respect of expenses claimed but not actually incurred, the receivable would be income of the assessee and would not be a reimbursement. The Assessing Officer has given a finding that the clients have paid on a pre agreed rate and not based on actual expenses incurred. Only recovery of actual operational expenses would be treated as reimbursement. In the present case, the total operating expenses of Rs. 31,40,115/- received from the clients has accrued at flat rate as mentioned in the various contracts. No third party receipts, as already agreed by the assessee, exist for these operating expenses. The non verifiable expenses in which are not backed by corroborative proof of actually having been incurred, cannot be treated as reimbursement and accepted as such in toto. I agree with the Assessing Officer that some element of profit would be built in into the said receipts which have been claimed on the basis of unverifiable expenses. The Assessing Officer has treated 75% of such expenses as actually incurred expenses and added 25% of the same as not being in the nature of reimbursements. I find that the I in A.Y. 1999-2000 has upheld disallowances made out of similar expenses to the extent of 10%. Following the same analogy the Assessing Officer is directed to restrict addition to 10% of the unverifiable expenses which are not the nature of reimbursement as discussed above. Since inquiry into the terms on contracts was not made in earlier years, the appellate orders of ITAT in A.Ys. 2002-03 to 2004-05, followed in appeal order of CIT(A) in A.Y. 2006-07 are not applicable. Thus the ground is partly allowed."

6. The ld. CIT(A) thus restricted the disallowance on account of operating expenses to 10% but of total operating expenses incurred by the assessee and not of the difference between the expenses incurred and expenses recovered. Aggrieved by the order of the ld. CIT(A), the assessee has raised this issue in the present appeal for A.Y. 2007-08.

7. We have heard the arguments of both the sides and also perused the relevant material available on record. It is observed that a similar issue was involved in assessee's own case for the earlier years and the same was decided by the Tribunal in A.Y. 1999-2000, 2002-03, 2003-04 & 2004-05 by taking a consistent stand that the disallowance on account of unverifiable element involving operating expenses could be made at 10% of the difference between the expenses incurred by the assessee and the expenses recovered. It is also observed that the said decision of the Tribunal has been followed by the ld. CIT(A) in A.Y. 2006-07, 2007-08, 2008-09 and 2009-10 to restrict the

disallowance on account of unverifiable element involved in operating expenses to 10% of the difference between expenditure incurred and expenditure recovered. In the year under consideration i.e 2007-08, the ld. CIT(A), however, has taken a different view by restricting the disallowance to 10% of the total expenses incurred by the assessee and although he has given some reasons for doing so and the ld. D.R. has strongly relied on such reasons given by the ld. CIT(A), the undisputed position is that the facts involved in the year under consideration are materially similar to the facts involved in the earlier years which have already been decided by the Tribunal. In our opinion, the judicial propriety and discipline required that the decision of the co-ordinate Bench rendered in the earlier years should be followed especially when the facts involved are undisputedly similar. We therefore follow the orders of the Tribunal passed in assessee's own case for the earlier years and direct the A.O. to restrict the disallowance on this issue to 10% of the difference between the expenditure incurred by the assessee and the expenditure recovered. Ground No. 1 of assessee's appeal being ITA No.8076/Mum/2010 for A.Y. 2007-08 is thus partly allowed.

8. The issue involved in Ground No. 2 relates to the disallowance of Rs. 16,34,137/- made by the A.O. and confirmed by the ld. CIT(A) on account of interest expenditure claimed by the assessee.

9. From the perusal of the balance sheet filed by the assessee, it was noticed by the A.O. that the assessee has made an investment of Rs. 1.85 crores in mutual funds and shares. He also found that interest of Rs. 47,01,526/- paid to the partners and interest of Rs. 11,49,034/- paid to other parties was debited by the assessee in the P&L account. Since the assessee was not in the business of trading in shares and mutual funds, the A.O. required the assessee to explain why the interest expenditure attributable to investment made in mutual funds and shares should not be disallowed. In

reply, it was submitted by the assessee that interest @ 12% was paid to the partners on the capital balances as per the terms of the partnership deed and since the same was within the limits specified in section 40(b)(iv) of the Act, the same could not be disallowed. This explanation of the assessee was not found acceptable by the A.O. According to him, the allowability of interest paid to partners was not emanating from section 40(b)(iv) which actually dealt with "amounts not deductible". He held that the allowability of interest expenditure thus was required to be considered u/s 29 to 37 and not u/s 40(b)(iv) of the Act. He noted in this context that there were not interest free funds available with the assessee firm to make investment in shares and mutual funds and thus it was a case of utilization of interest bearing borrowed funds by the assessee for making investment in shares and mutual funds. Accordingly, interest expenditure attributable to the investment made in shares and mutual funds was worked out by the A.O. at Rs. 22,20,015/- being 12% of Rs. 1.85 crores and disallowance to that extent was made by him u/s 36(1)(iii) of the Act. He also made a further disallowance of Rs. 1,58,916/- u/s 14A of the Act which was again inclusive of disallowance made on account of interest.

10. The disallowance made by the A.O. on account of interest expenditure was disputed by the assessee in an appeal filed before the Id. CIT(A) and the submissions made before the A.O. on this issue were reiterated on behalf of the assessee before the Id. CIT(A). It was also contended as an alternative by the assessee that the disallowance worked out by the A.O. on account of interest expenditure by applying flat rate of 12% for the entire year to the value of investment stating standing at the last date of the previous year was not correct as the amount of investment made by the assessee being in the year under consideration and the same was only Rs. 20 lacs during the first half of the said year. The Id. CIT(A) did not find merit in main contention of the assessee but accepting the alternative contention of the assessee, he

sustained partly the disallowance made by the A.O. on account of interest after recording the following observations in para 3.3 of his impugned order:-

“3.3 I have carefully considered the appellant’s submissions and the assessment order. As is evident from the balance sheet that there are no interest free funds with the firm to be invested in non-business activities. However, the assessee has raised funds from partners and other parties and debited huge interest expenditure in its P & L A/c.

The appellant has not been able to show that investments were made out of interest free funds, no nexus between the two has been established. Since the firm has no interest free funds to finance its huge investment in mutual funds the interest paid on borrowal of such funds cannot be said to be incurred for business purposes. The contention that interest expenses to partners is allowed u/s.28(1) r.w.s.40(b)(iv) irrespective of the usage of the capital employed is not tenable. Thus the action of the Assessing Officer is making disallowances of proportionate interest on the funds utilized for investment in mutual funds is confirmed. However, the appellant contended that the investment of Rs. 1,65,00,000 in mutual fund was made only on 18.7.2006 and the Assessing Officer could not have disallowed the interest for the entire period of 12 months. The Assessing Officer is directed to compute the disallowance only for the period from the actual date of investment to the end of the year. Thus the ground is partly allowed.”

11. The Id. Counsel for the assessee submitted that the disallowance on account of interest was wrongly made by the A.O. twice firstly u/s 36(1)(iii) of the Act and secondly u/s 14A of the Act. He contended that since the allegation leveled by the A.O. was about utilization of borrowed funds for making tax free investment, the disallowance on account of interest should have been appropriately made only u/s 14A and not u/s 36(1)(iii) of the Act. He invited our attention to the working of disallowance on account of interest made by the A.O. u/s 14A by applying Rule 8D of the Income Tax Rules, 1962 and pointed out that there is a mistake in the said working inasmuch as the quantum of interest expenditure is wrongly taken by the A.O. as Rs. 11,49,034/- instead of Rs. 58,50,560/-. He submitted that the disallowance u/s 14A by applying Rule 8D actually comes to Rs. 5,99,451/- and although Rule 8D is not applicable to the year under consideration i.e. A.Y. 2007-08, the same can be taken being an appropriate basis to work out the

disallowance on account of interest attributable to the investment made by the assessee, the income of which is exempt from tax. He contended that the disallowance on account of interest made u/s 36(1)(iii) of the Act however is not justified in the facts and circumstances of the case especially when substantial interest expenditure incurred by the assessee is on account of interest paid on partners capital account which has already suffered tax in the hands of the partners.

12. The ld. D.R., on the other hand, submitted that interest bearing borrowed funds were clearly utilized by the assessee for making investment in shares and mutual funds and since the assessee is not dealing in shares and mutual funds, interest expenditure incurred by the assessee was not allowable as business expenditure u/s 36(1)(iii) of the Act as rightly held by the authorities below. He contended that the disallowance made by the A.O. on account of interest expenditure u/s 36(1)(iii) of the Act thus was in accordance with law and the ld. CIT(A) was fully justified in confirming the same. As regards the interest paid by the assessee firm to its partners on their capital account, he contended that although the said interest is governed by the provisions of section 40(b), the allowability of interest first has to be tested u/s 36(1)(iii) of the Act and if the interest is not allowable as per the provisions of section 36(1)(iii), it cannot be allowed u/s 40(b) of the Act. In support of this contention, he relied on the decision of Hon'ble Supreme Court in the case of Munjar Sales Corporation vs. CIT, 68 Taxmann 43.

13. We have considered the rival submissions and also perused the relevant material available on record. We find merit in the contention of the ld. Counsel for the assessee that the provisions of section 36(1)(iii) and u/s 14A of the Act operate on different spheres. If there is a utilization of interest bearing borrowed funds for earning exempt income, the disallowance on

account of interest is governed by section 14A of the Act. On the other hand, if interest bearing borrowed funds are utilized for any other non-business purpose, the disallowance on account of interest is governed by the provisions of section 36(1)(iii) of the Act. There may be a situation where the interest bearing borrowed funds are utilized partly for earning tax free income and partly for other non-business purpose. In such a situation, the disallowance on account of interest may be required to be made u/s 36(1)(iii) and section 14A depending on the facts of each case. The facts involved in the present case, however, are very clear inasmuch as the interest bearing borrowed funds are utilized by the assessee for making investment in shares and mutual funds, the dividend income of which is exempt from tax. The provisions of section 14A of the Act thus are applicable in the present case and not that of section 36(1)(iii) of the Act. We therefore agree with the contention of the ld. Counsel for the assessee that the disallowance on account of interest attributable to the investment made in shares and mutual funds is required to be made u/s 14A of the Act and since the method given in Rule 8D to work out of such investment is quite fair and reasonable and the ld. Counsel for the assessee has also agreed for applying the said Rule although the same is not applicable to the year under consideration i.e A.Y. 2007-08, we direct the A.O. to make a disallowance on account of interest u/s 14A only by applying Rule 8D. As pointed out by the ld. Counsel for the assessee in this regard, there is a mistake committed by the A.O. in computing the disallowance at Rs. 1,58,916/- instead of Rs. 5,99,451/-. The A.O. is accordingly directed to recompute the disallowance u/s 14A read with Rule 8D by taking the correct figure. The disallowance made by the A.O. and confirmed by the ld. CIT(A) on account of interest u/s 36(1)(iii) is accordingly deleted and the disallowance made u/s 14A of the Act is confirmed with a direction to the A.O. to recompute the same by taking the correct figures. Ground No. 2 of the assessee's appeal for A.Y. 2007-08 is thus partly allowed.

14. Now, we shall take up the appeal of the assessee for A.Y. 2008-09 being ITA No. 4881/Mum/2012 which is directed against the order of Id. CIT(A) 23, Mumbai dated 23-5-2012.

15. After considering the rival submission and perusing the relevant material on record, it is observed that the solitary issue involved in this appeal of the assessee relating to the disallowance made on account of interest is similar to the one involved in ground No. 2 of the assessee's appeal for A.Y. 2007-08 which has already been decided by us. As the material facts relevant to this issue as involved in A.Y. 2008-09 are similar to A.Y. 2007-08 and the Id. Representatives of both the sides have also advanced the same arguments, we follow our conclusion drawn in A.Y. 2007-08 and direct the A.O. to make the disallowance on account of interest only u/s 14A read with Rule 8D after recomputing the quantum thereof by taking the correct figure. The appeal of the assessee for A.Y. 2008-09 is thus partly allowed.

16. Now, we shall take up the appeal of the assessee for A.Y. 2009-10 being ITA No.2870/Mum/203 which is directed against the order of Id. CIT(A) 23, Mumbai dated 1-2-2013.

17. After considering the rival submission and perusing the relevant material on record, it is observed that the solitary issue involved in this appeal of the assessee relating to the disallowance made on account of interest is similar to the one involved in ground No. 2 of the assessee's appeal for A.Y. 2007-08 which has already been decided by us. As the material facts relevant to this issue as involved in A.Y. 2009-10 are similar to A.Y. 2007-08 and the Id. Representatives of both the sides have also advanced the same arguments, we follow our conclusion drawn in A.Y. 2007-08 and direct the A.O. to make the disallowance on account of interest only u/s 14A read with Rule 8D after recomputing the quantum thereof by taking the correct figure. The appeal of the assessee for A.Y. 2009-10 is thus partly allowed.

18. In the result, all the three appeals of the assessee are partly allowed.

Order pronounced in the open court on 4th June, 2014.

आदेश की घोषणा खुले न्यायालय में दिनांक: 04-06-2014 को की गई ।

Sd/-
(Dr. S.T.M. PAVALAN)
न्यायिक सदस्य JUDICIAL MEMBER

sd/-
(P.M. JAGTAP)
लेखा सदस्य / ACCOUNTANT MEMBER

मुंबई Mumbai; दिनांक Dated 04-06-2014

I

व.नि.स./ RK , Sr. PS

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

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त(अपील) / The CIT(A)—6 Mumbai.
4. आयकर आयुक्त / CIT -2 Mumbai
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai E Bench
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार (Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai