

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES “ I ”, MUMBAI**

**BEFORE SHRI RAJENDRA SINGH, ACCOUNTANT MEMBER AND
SHRI VIJAY PAL RAO, JUDICIAL MEMBER**

ITA No. : 6711/Mum/2011
Assessment Year : 2008-09

DCIT, Range 9(2), Aayakar Bhavan, R. No.218, 2 nd floor, M.K. Road, Mumbai-400 020	Vs.	M/s. India Advantage Securities Ltd. 4 th floor, Om Plaza, Vasanji Lalji Road, Kandivali (W), Mumbai-400 067 PAN NO: AADCP 5317 M
(Appellant)		(Respondent)

Appellant by : Shri K. C. Kutty
Respondent by : Shri Dharmesh Shah

Date of hearing : 05.09.2012
Date of Pronouncement : 14.09.2012

ORDER

Per Rajendra Singh, A.M. :

This appeal by the Revenue is directed against the order dated 25.07.2011 of CIT(A), Mumbai for the A.Y. 2008-09. The only dispute raised by the Revenue in this appeal is regarding the disallowance of expenses in relation to the exempt income u/s.14A of the I.T. Act.

2. The facts in brief are that the A.O. during the assessment proceedings noted that the assessee had received dividend income of

Rs.1,40,859/- which was exempt from tax. The assessee had however, not made any disallowance of expenses relating to exempt income. The A.O., therefore, computed the disallowance u/s.14A as per Rule 8D which come to Rs.48,73,483/- consisting of interest expenditure of Rs.39,00,174/- and other expenses of Rs.9,73,309/-. The A.O. thus disallowed a sum of Rs.48,73,483/- and added to the total income.

3. The assessee disputed the decision of the A.O. and submitted before the Ld. CIT(A) that the disallowance u/s.14A could be made only if the A.O. was satisfied that the assessee had incurred any expenditure in relation to the exempt income. It was pointed out that the interest expenditure had been claimed by the assessee as deduction u/s.36(1)(iii). It was also submitted that the shares had been shown as stock-in-trade in the books of accounts and, therefore, such stock-in-trade could not be taken into account while computing the disallowance under Rule 8D. The CIT(A) was satisfied by the explanation given and agreed that the disallowance under Rule 8D could be made only with respect to investment and not in stock-in-trade. It was noted by him that the investments made by the assessee were only to the tune of Rs.50,000/-. The A.O. had however, adopted the figure of stock inventory appearing at schedule-6 amounting to Rs.25,81,52,042/- which was trading stock and which had to be excluded. The Ld.CIT(A) accordingly excluded the stock-in-trade from the purview of computation of disallowance of

expenses under Rule 8D. He accordingly computed the disallowance both direct expenses and indirect expenses at Rs.47,247/- and disallowance was upheld only to that extent and the balance addition made by the A.O. was deleted. Aggrieved by the said decision, the Revenue is in appeal before the Tribunal.

4. Before us, the ld. DR appearing for the Revenue assailed the order of the Ld.CIT(A). It was submitted that the provisions of section 14A were applicable even in relation to the dividend income received from the trading in shares as held by the Special Bench of the Tribunal in the case of ITO vs. M/s. Daga Capital Management P. Ltd. (117 ITD 169). He also referred to the latest decision of the Tribunal dated 08.08.2012 in ITA No.5904 & 6022/Mum/2000 in the case of M/s. American Express Bank Limited. The ld. AR for the assessee, on the other hand, submitted that issue was covered in favour of the assessee by the latest judgment of the Hon'ble High Court of Karnataka in the case of CCL Ltd. Vs. JCIT (250 CTR 291) in which it has been held that no disallowance could be made u/s.14A in respect of dividend income received from the shares held as trading stock. It was pointed out that following the said judgment, the Mumbai Bench of the Tribunal in the case of Ganjam Treading Co. P. Ltd. in the order dated 20.07.2012 in ITA No.3724/Mum/2005 have held that the decision of the Special Bench of the Tribunal in the case of M/s. Daga Capital Management P. Ltd.

(supra) was not applicable in the case of dividend received from trading shares. The ld. AR for the assessee also relied on the decision of the Tribunal in the case of Yatish Trading Co. (P) Ltd. vs. ACIT (129 ITD 237) and the decision in the case of Prakash K. Shah & Securities P. Ltd. vs. ACIT in ITA No.3339/Mum/2010.

5. We have perused the records and considered the rival contentions carefully. The dispute is regarding the disallowance of expenses u/s.14A in relation to the exempt dividend income received from shares held on trading account. The A.O. disallowed the expenses holding that the provisions of section 14A were applicable even in relation to the dividend received from the trading shares. The Ld.CIT(A) has however held that the provisions of section 14A will not apply to the shares held on trading account. The Revenue has placed reliance on the decision of Mumbai Bench of the Tribunal in the case of M/s. American Express Bank Limited (supra) in which the Tribunal has held that the expenditure u/s.14A has to be disallowed even in respect of dividend income received from trading shares. The Tribunal followed the decision of the Special Bench of the Tribunal in the case of ITO vs. Daga Capital Management Pvt. Ltd. (supra). The assessee in that case had relied on the judgment of Hon'ble High Court of Kerala in the case of CIT vs. Smt. Leena Ramachandran (339 ITR 296) to argue that the disallowance could not be made in relation to the dividend received from trading shares. The

Tribunal had however, distinguished the said judgment of Hon'ble High Court of Kerala on the ground that in that case the acquisition of shares with the borrowed funds was for the purpose of controlling the company. Therefore, even though the purpose for acquiring the shares was business, the High Court had upheld the disallowance u/s.14A of the I.T. Act. The Tribunal also noted that the High Court in that case had only observed that the interest paid on borrowed funds utilised for acquiring shares could be allowed as deduction u/s.36(1)(iii) only if shares were held as stock-in-trade. These observations were only obiter dicta and not the ratio decidendi of the judgment. The ratio decidendi of the judgment was disallowance of interest u/s.14A which had been upheld by the Tribunal. The Tribunal, therefore, did not accept the arguments based on the judgment of Hon'ble High Court of Kerala in the case of Smt. Leena Ramachandran (supra) which was not directly on the issue of disallowance of expenses in relation to the dividend income received from trading in shares.

6. However, the Hon'ble High Court of Karnataka have recently considered the disallowance of expenses incurred on borrowings made for purchase of trading shares u/s.14A of the I.T. Act in case of CCL Ltd. vs. JCIT (supra). The assessee in that case was distributor of state lotteries and a dealer in shares and securities. The assessee had taken loans for the purchase of certain shares and it had incurred expenditure for broking the loans which had

been disallowed under Rule 8D by the A.O. and confirmed by the Ld.CIT(A). The Tribunal agreed with the authorities below that the expenditure relatable to earning of dividend income though incidental to the trading in shares was also to be disallowed u/s.14A of the I.T. Act. The Tribunal however, had observed that the entire broking commission was not relatable to earning of dividend income as the loan had been utilised for the purchase of shares and the profit shown from the sale of shares had been offered as business income. The Tribunal, therefore, directed the A.O. to bifurcate the expenditure proportionately. The order of the Tribunal was however, not upheld by the Tribunal. The High Court noted that 63% of shares which were purchased were sold and income derived was offered to tax as business income. The remaining 30% of shares which remained unsold had reverted to dividend income for which the assessee had not incurred any expenditure at all. The High Court also observed that the assessee had not retained the shares with the intention of earning dividend income which was incidental due to his sale of shares which remained unsold by the assessee. The High Court, therefore, did not uphold the order of the Tribunal disallowing the expenditure in relation to the dividend from shares. Thus there being a direct judgment of a Hon'ble High Court on this issue, the same has to be followed in preference to the decision of the Special Bench of the Tribunal in the case of M/s. Daga Capital Management P. Ltd. (supra).

In fact, we note that the Tribunal in the case of Ganjam Trading Co. Ltd. (supra) has already considered this situation and held that in view of the judgment of Hon'ble High Court of Karnataka in the case of CCL Ltd. Vs. JCIT (supra) the disallowance of interest in relation to the dividend received from trading shares cannot be made. We, therefore, see no infirmity in the order of the Ld. CIT(A) in deleting the disallowance u/s.14A computed by the A.O. in relation to the stock-in-trade. The order of the Ld.CIT(A) is accordingly upheld.

7. In the result, the appeal filed by the Revenue is dismissed.

Order pronounced on this 14th day of September, 2012.

Sd/-

**(VIJAY PAL RAO)
JUDICIAL MEMBER**

Sd/-

**(RAJENDRA SINGH)
ACCOUNTANT MEMBER**

MUMBAI, Dt: 14.09.2012

Copy forwarded to :

1. The Appellant,
2. The Respondent,
3. The C.I.T.
4. CIT (A)
5. The DR, - Bench, ITAT, Mumbai

//True Copy//

BY ORDER

ASSISTANT REGISTRAR
ITAT, Mumbai Benches, Mumbai

Roshani

IN THE INCOME TAX APPELLATE TRIBUNAL, MUMBAI BENCH "D", MUMBAI

**BEFORE SHRI D. MANMOHAN, (VICE PRESIDENT) AND
SHRI RAJENDRA SINGH, ACCOUNTANT MEMBER**

ITA No.3724/Mum/2005

Assessment Year : 2001-02

ITA No.932/Mum/2006

Assessment Year : 2002-03

ITA No.1384/Mum/2007

Assessment Year : 2003-04

Ganjam Trading Co. Pvt. Ltd. 135, Dr. Continental Building Dr. Annie Besant Road, Worli Mumbai-400 018. PAN No. AAACG 3975 H	Vs.	Dy. Commissioner of Income tax , Circle- 6(3) Aayakar Bhavan Mumbai-400 020.
(Appellant)		(Respondent)

ITA No.2879/Mum/2007

Assessment Year : 2003-04

Asstt. Commissioner of Income tax , Circle- 6(3) 5 th Floor,Aayakar Bhavan M.K. Road Mumbai-400 020.	Vs.	Ganjam Trading Co. Pvt. Ltd. 135, Dr. Continental Building Dr. Annie Besant Road, Worli Mumbai-400 018. PAN No. AAACG 3975 H
(Appellant)		(Respondent)

Assessee by : Shri Firoze Andhyarjuna &
Shri B.S. Sharma
Revenue by : Shri Satbir Singh

Date of hearing	:	28.6.2012
Date of Pronouncement	:	20.07.2012

ORDER

PER RAJENDRA SINGH, AM:

These appeals by the assessee and the cross appeal by the Revenue, are directed against different orders dated 28th January 2005 and 8th November 2005 and 7th December 2006, of CIT(A), Mumbai, for assessment

years 2001-02 to 2003-04. The Revenue is in appeal only in assessment year 2003-04. As the dispute raised in these appeals are mostly common and connected, these appeals are being disposed off by single consolidated order for the sake of convenience.

2. Facts in brief are that the assessee, who was in the business of trading and investment in goods, securities, etc., had declared income from interest, dividend and profit / loss from trading of shares. In the years under consideration, the assessee had declared huge losses from trading in shares which were treated by the Assessing Officer as speculation loss under the provisions of Explanation to section 73 of the Act. These losses were, therefore, not adjusted by the Assessing Officer against other income declared by the assessee. The assessee had also paid huge interest on borrowings. The Assessing Officer disallowed the interest relating to the investment made in shares under section 14A of the Income Tax Act, 1961 (for short "*the Act*") and also disallowed interest on borrowings under section 36(1)(iii) of the Act holding that borrowings to that extent had not been utilised for the purpose of business. The disputes raised in these appeals, therefore, relate to treatment of losses from trading of shares as speculation loss, disallowance of interest under section 36(1)(iii) and disallowance of interest under section 14A of the Act.

3. We first take up the issue relating to treatment of losses from trading in shares as speculation loss under the provisions of Explanation to section 73. The assessee, in all the years, had declared losses from trading in shares which was Rs.15,30,05,394 in the assessment year 2001-02; Rs.1,09,67,140 in assessment year 2002-03 and Rs.49,25,300 in assessment year 2003-04 which had been treated by AO as speculation loss under provisions of Explanation to section 73. The Assessing Officer had also disallowed interest on borrowings used for trading in shares and treated the same as speculation loss. The interest disallowed in relation to trading in shares were Rs.3,79,87,928 in assessment year 2001-02; Rs.3,99,66,788 in assessment year 2002-03 and Rs.3,83,21,891 in assessment year 2003-04. The CIT(A) has confirmed the order of the Assessing Officer treating the trading loss as speculation loss and has also confirmed the disallowance of

interest in relation to trading in shares and treating the same as part of speculation loss. The assessee, in assessment year 2003-04, had argued that loss was on account of valuation of shares and there were no purchases and sales and, therefore, provisions of section 73, could not be applied. The CIT(A) has, however, not accepted the arguments following the decision of Calcutta Bench of the Tribunal in *Paharpur Cooling Towers Ltd. v/s DCIT*, [2003] 85 ITD 745 (Cal.) in which it has been held that the provisions of Explanation to section 73, would apply even if there were no purchases and sales during the year. The argument raised by the assessee that for application of provisions of Explanation to section 73, there should be at least two businesses as the Explanation applies when a part of the business of the assessee consists of purchase and sale of shares has also not been accepted by the CIT(A). Aggrieved by the decision of the CIT(A), the assessee is in further appeal before the Tribunal in all the years.

3.1 Before us, the learned Counsel for the assessee reiterated the submissions made before the authorities below that the provisions of Explanation to section 73, were applicable only when there were at least two businesses and the assessee having only one business, the provisions could not be applied. It was also submitted that trading loss in shares also included loss attributable to the valuation of closing stock which will not be covered by the provisions of said Explanation. It was further pointed out that the provisions of Explanation to section 73, were applicable only in case of purchase and sale of shares from group companies by the business houses with a view to create loss as had been recommended by Wanchoo Committee. In this case, the loss had not arisen from purchase and sale of shares of group companies and, therefore, provisions could not be applied. The learned Counsel for the assessee also submitted that the assessee had also received substantial income from interest. It was pointed out that the assessee was registered as a Non Banking Finance Company (NBFC). It was pointed out that the provisions of Explanation to section 73, were not applicable to companies, the principal business of which is the business of banking or granting of loans and advances. It has, accordingly, been argued that the provisions of Explanation to section 73, cannot be applied in the

case of assessee and the loss from trading in shares should be treated as normal business loss.

3.2 Learned Departmental Representative, on the other hand, strongly supported the orders of the authorities below. It was submitted that the provisions of Explanation to section 73, were applicable even when the assessee had only one business i.e., trading in shares as "part" also include whole", as held by the Hon'ble Calcutta High Court in CIT v/s Arvind Investments Ltd., [1991] 192 ITR 365 (Cal.). It was also submitted that loss attributable to valuation of closing stock while computing the loss from trading in shares has also to be considered as part of speculation loss as the Explanation only deems the business of purchase and sale of shares in certain circumstances as speculation business and, therefore, profit / loss from a business has to be computed as per the accepted method of accounting which includes valuation of closing stock. Learned Departmental Representative further submitted that the principal business of the assessee was trading and investment in shares and not the granting of loans and advances and, therefore, the provisions of Explanation to section 73, were applicable in the case of assessee.

3.3 We have perused the records and considered the rival contentions of the parties. The dispute is regarding treatment of loss arising from sale and purchase of shares by the assessee as speculation loss under the provisions of Explanation to section 73. As per the said Explanation, in case any part of the business of the company consists of purchase and sale of shares of other companies, such company shall be deemed to be carrying on a speculation business to the extent to which the business consists of purchase and sale of shares. The Explanation, however, exempts the companies the gross total income of which consists mainly of income which is chargeable under the head "*interest on securities*", "*income from house property*", "*capital gains*", and "*income from other sources*", or the company the principal business of which is the business of banking or granting of loans and advances. It may be pointed out here that the assessee had huge transactions in share trading which is clear from the fact that in assessment year 2001-02, the trading loss was Rs.15.30 crores and the closing stock was more than Rs.25 crores.

It is a settled legal position that loss is nothing but negative profit. Though the assessee had also received interest income but the gross total income mainly consisted of income from trading in shares. Further, it may be pointed out that the assessee is mainly a trading and investment company. In fact, in the submissions made before the CIT(A), the assessee itself submitted that the assessee was a trading and investment company having its main business of making investment in equities and trading in shares as recorded by CIT(A) at page-3 of the appellate order for assessment year 2002-03. Therefore, the arguments of the learned Counsel for the assessee that principal business of the assessee was granting loans and advances cannot be accepted.

3.4 Further, the provisions of Explanation to section 73, are not applicable only to purchase and sale of shares from group companies as it is clear from the provisions that it applies to purchase and sale of shares of any company. This view is also supported by Ahmedabad Special Bench of the Tribunal in AMP Spg. and Wvg. Mills (P) Ltd. v/s ITO, [2006] 100 ITD 142 (Ahd.). The Explanation will also apply when there is only one business of trading in shares as held by the Hon'ble Calcutta High Court in case of Arvind Investments Ltd.(supra). We also do not find any substance in the argument of the learned Counsel for the assessee that the provisions of Explanation to section 73, will apply only to the loss arising from sale and purchase of shares and not from valuation of closing stock. The Explanation to section 73, only deems the business of purchase and sale of shares as speculation business and, therefore, the profit from such speculation business has to be computed as per the accepted accounting principles which includes valuation of shares as per method followed by the assessee in the closing stock. Therefore, any loss arising from diminution in the value of shares in closing stock will be part of trading loss. Further, it is not necessary that for application of provisions of Explanation to section 73, there should necessarily be purchases and/or sales during the year. The provisions will also apply even if there are no purchases or sales during the year. This view is supported by the judgment of Hon'ble Jurisdictional High Court in Prasad Agents (P.) Ltd. v/s ITO, [2011] 333 ITR 275 (Bom.). Therefore, considering

the facts and circumstances of the case, we see no infirmity in the conclusion drawn by the authorities below that provisions of Explanation to section 73, are applicable in the case of assessee and the loss from trading in shares has to be treated as speculation loss. The authorities are also justified in allocating interest expenses towards the loss arising from trading of shares as while computing the profit or loss from trading of shares all expenses have to be considered. In the present case, allocation of interest expenditure to trading shares had been made on the basis of computation given by the assessee itself. Therefore, there is no dispute about quantum of interest allocated to trading of shares. We, therefore, confirm the order of the learned CIT(A) in treating the trading loss as speculation loss and also in disallowing the interest and treating the same as part of speculation loss in all the years under consideration.

4. The second dispute which is relevant only to assessment year 2001-02, is regarding disallowance of interest under section 14A of the Act. The Assessing Officer, during the assessment proceedings, noted that the assessee had received dividend income of Rs.75,45,066, which were exempt from tax. The investment made by the assessee in the equity shares amounted to Rs.8,37,25,902. The Assessing Officer also noted that the assessee had made huge borrowings on which interest had been claimed to the tune of Rs.12,68,21,302. The Assessing Officer further noted that own funds of the assessee were negative to the tune of Rs.20,57,46,495, because of losses incurred. The assessee had secured loan of Rs.27 crores and unsecured loan of Rs.103.19 crores. He, therefore, concluded that investment in shares had been made from borrowed funds. He computed the interest attributable to investment in shares @ 15% per annum and, thus, computed the interest @ Rs.66,78,163, and asked the assessee to explain as to why the same should not be disallowed. The assessee submitted that opening balance of investment in shares during the year was 1,83,58,300, and the shares acquired during the year were to the tune of Rs.6,91,18,002. The assessee had also the closing stock of shares of Rs.26.64 crores which were part of trading stock. It was pointed out that investment in trading stock were also meant for earning profit by way of capital gain and trading

profit. The earning of dividend was only incidental to holding of investments. It was, accordingly, urged that the entire interest paid was allowable as deduction under section 36(1)(iii). The assessee also placed reliance on the judgment of Hon'ble Supreme Court in Rajasthan State Warehousing Corporation v/s CIT, [2000] 242 ITR 450 (SC), in which it was held that when the assessee had one composite business part of which had taxable income and part of which generated non-taxable income, the entire expenditure has to be allowed. The Assessing Officer, however, did not accept the contentions raised. It was observed by him that the judgment was not applicable in view of the provisions of section 14A inserted with retrospective effect. He, accordingly, disallowed the interest under section 14A as proposed earlier. In appeal, the learned CIT(A) confirmed the order of the Assessing Officer, aggrieved by which the assessee is in further appeal before the Tribunal.

4.1 Before us, the learned Counsel for the assessee argued that the dividend income was only incidental to the business income and, therefore, the assessee had not incurred any expenditure for earning of dividend income and accordingly, no expenditure should be disallowed. Reliance for the said proposition was placed on the judgment dated 28th February 2012 of Hon'ble Karnataka High Court in the case of CCI Ltd. v/s JCIT. Alternatively, it was also submitted that the disallowance made was high. The learned Counsel for the assessee referred to some Tribunal decisions to point out that, in many cases, the Tribunal had restricted the disallowance to 2% of dividend income. It was also submitted that there were many shares which had not yielded any income during the year and, therefore, no disallowance could be made in respect of such investment.

4.2 The learned Departmental Representative, on the other hand, supported the orders of the authorities below. It was argued that in view of the judgment of Hon'ble Jurisdictional High Court in Godrej & Boyce Mfg. Co. Ltd. v/s DCIT, (2010), 328 ITR 081 (Bom.), both direct and indirect expenses have to be considered for disallowance. It was also submitted that in some cases as pointed out by the learned Counsel for the assessee, expenditure had been restricted by the Tribunal to 2% of the dividend

income but in those cases, there was no direct expenditure and only establishment expenses had been disallowed. In the present case, there was direct expenditure on account of interest which had to be disallowed. It was further submitted that interest had to be disallowed in respect of those shares also in relation to which no dividend had been received during the year as dividend even if received was not taxable. It was accordingly argued that disallowance of interest was justified.

4.3 We have perused the records and considered the rival contentions carefully. The dispute is regarding disallowance of interest expenditure in relation to dividend income which was exempt from tax, under section 14A of the Act in assessment year 2001-02. The assessee had made investment in equity shares of companies from which dividend of Rs.75,45,066/- had been received which was exempt from tax. The assessee had made huge borrowings on which interest of Rs.12,68,21,302/- had been paid. The assessee company had equity capital of Rs.1.04 crores and in P&L Account, there was debit balance of Rs.21.61 crores shown on asset side of the balance sheet for the assessment year 2001-02. Therefore, net capital of company was negative to the tune of Rs.20.57 crores. There were no reserves nor any other interest free funds available has been brought to our notice in assessment year 2001-02. The conclusion of the AO that the borrowed funds had been utilized for investment in shares is, therefore, reasonable and proper and since the dividend income from the investment was not taxable, disallowance of interest in relation to such investment is required to be made under section 14A of the Income tax Act. The Id. AR for the assessee has argued that in many cases the Tribunal has upheld the disallowance only at the rate of 2% of the dividend income. These cases are different in which only indirect expenses such as establishment expenses have been disallowed on estimate. In case, there are direct expenses in the form of interest incurred for making investment from which dividend has been received, such expenses have to be disallowed on actual basis.

4.4 However, we find substance in the alternate contention of the Id. AR that dividend had also arisen from trading shares and in respect of such

shares which were meant for trading, dividend was only incidental and purchases had not been made for earning dividend income but for trading profit and therefore, in relation to such dividend, no disallowance should be made. Reliance has been placed on the judgment of Hon'ble High Court of Karnataka in the case of CCI Ltd. vs. JCIT (supra). In that case, the Hon'ble High Court held that the assessee had retained shares not with the intention of earning dividend income and that dividend income was incidental to the business income of sale of shares. Therefore, disallowance of expenses in relation to such dividend income was not upheld. The Id. DR has referred to the judgment of Hon'ble Jurisdictional High Court in the case of Godrej & Boyce Mfg. Co. Ltd. vs. DCIT (328 ITR 081) to argue that in terms of the said judgment, both direct and indirect expenses have to be considered for disallowance under section 14A. We have perused the said judgment and find that the issue regarding disallowance of interest expenses in relation to dividend income received from trading shares was not before the Hon'ble High Court. Such issue had been raised before the Special Bench of the Tribunal in the case of Daga Capital & Management P. Ltd. (119 TTJ 289) and the Special Bench held that disallowance of expenses even in relation to dividend income from trading shares is required to be made under section 14A of the Act. But in view of the judgment of Hon'ble High Court of Karnataka in case of CCI vs. JCIT (supra), which is directly on the issue, disallowance of interest in relation to dividend received from trading shares can not be made. The Id. AR has also argued that investment in shares was the business of the assessee and, therefore, no disallowance should be made under section 14A. We, however, note that the assessee had been making only long term strategic investment in group companies the income from which either in the form of long term capital gain or in the form of dividend is exempt from tax. Therefore, the expenditure incurred in relation to such investment is required to be disallowed under section 14A of the Act. However, interest relating to the borrowings used in the purchase of trading shares from which dividend had been received is required to be excluded from such disallowance. We, therefore, restore the issue of computation of disallowance of interest to the file of AO for making fresh computation after

necessary examination in the light of observations made above and after allowing opportunity of hearing to the assessee.

5. The third dispute which is relevant in all the appeals, is regarding disallowance of interest under section 36(1)(iii) of the Act. The Assessing Officer, during the course of assessment proceedings, noted that the assessee had made huge borrowings on which substantial interest running into crores had been paid in all the years under consideration. The own funds of the assessee had been completely eroded and became negative due to loss. The assessee had advanced the borrowed funds for allotment of shares of group companies which has been pending for an unreasonably long time. The assessee had also advanced Rs.25 crores to Panther Invest-trade Ltd. for acquisition of equity shares of companies in Information Communication and Technologies through the said company. The shares were neither delivered nor the money was refunded and the matter was pending in Court. The Assessing Officer, therefore, asked the assessee to explain, as to why the interest on borrowings to that extent should not be disallowed as not incurred for the purpose of business. The assessee submitted that the assessee was in the business of trading, investment in equities capital of companies in different sectors. It was part of the business activities of the assessee. The assessee advanced money as a part of financial participation which was the business of the assessee company. It was accordingly requested that no disallowance of interest should be made. The Assessing Officer, however, did not accept the contentions raised by the assessee. It was observed by him that the assessee had advanced the borrowed funds as share application money for purchase of shares of associated concerns for the purpose of having controlling interest over those concerns. These were long term strategic investments which was not the business of the assessee. The Assessing Officer, therefore, disallowed interest in relation to such loans and advances. He computed interest @ 15%. The AO did not accept the argument that in some of the years, the assessee had interest free funds in the form of share application money received. The disallowance made by the Assessing Officer for three years under reference, were as under:

<i>A.Y.</i>	<i>Interest on share application</i>	<i>Interest on advance to Panther Invest Trade Ltd.</i>	<i>Interest in relation to advance to Asian Broadcast P. Ltd.</i>
<i>2001-02</i>	<i>1,55,04,851</i>	<i>73,97,267</i>	<i>3,114</i>
<i>2002-03</i>	<i>2,61,89,488</i>	<i>3,75,00,000</i>	<i>5,521</i>
<i>2003-04</i>	<i>3,39,83,145</i>	<i>3,75,00,000</i>	<i>5,521</i>

5.1 In assessment year 2003-04, the total disallowance of interest came to Rs.7,14,88,666. The Assessing Officer, however, noted that the total claim of interest was Rs.10,15,12,308, against which a sum of Rs.3,83,21,891, had been attributed towards the speculation business. He, therefore, restricted the disallowance of interest under section 36(1)(iii) to Rs.6,31,90,417 [Rs.10,15,12,308 (-) Rs.3,83,21,891].

5.2 In appeal, the learned CIT(A) confirmed the disallowance of interest under section 36(1)(iii) for assessment years 2001—02 and 2002—03. In assessment year 2003—04, the successor CIT(A) also agreed with the Assessing Officer that advancement of interest free funds for share application in the group concerns and payment of Rs.25.00 crores to Panther Invest-trade Ltd., etc. were not for the purpose of business of the assessee. However, he noted that during this assessment year (assessment year 2003-04), the assessee had substantial interest free funds amounting to Rs.169.09 crores., which constituted 83.47% of the total funds and interest bearing funds constituted only Rs.33.49 crores i.e., 16.53% of total funds. The CIT(A) observed that neither the Assessing Officer had given direct nexus between interest bearing funds and payments for share application money, interest free advance and loans nor the assessee had been able to establish that interest free funds had been used to finance the above investments / loans. Since both the funds were mixed up, CIT(A) took the view that disallowance of interest has to be worked out on proportionate basis after taking into account the total interest free funds and interest bearing funds and investments made. The assessee had filed computation of disallowance of interest at Rs.75,76,314. The CIT(A), however, observed that the same could not be accepted and required fresh examination. It was

noted by him that loss this year had gone up from Rs.65.06 crores in assessment year 2002—03 to Rs.87.44 crores in assessment year 2003—04, whereas the assessee's own funds had gone down to Rs.115.15 crores in assessment year 2003—04 compared to Rs.117.53 crores for assessment year 2002—03. Further, this year investments had also gone up to Rs.19.23 crores against Rs.11.57 crores in the preceding year while the assessee's own funds had gone down. CIT(A) also observed that while computing disallowable interest on proportionate basis under section 36(1)(iii), the disallowance of interest already made towards trading transactions amounting to Rs.3,83,21,891/- and allocation of interest towards the dividend income will be excluded and only from balance amount disallowance under section 36(1)(iii) will be made. This was because of the fact that the dividend income in assessment year 2003—04 was taxable. The CIT(A) directed the Assessing Officer to compute disallowance accordingly. Aggrieved by the decision of the learned CIT(A), the assessee is in appeal before the Tribunal in all the years, whereas the Department has disputed the decision of the learned CIT(A) in assessment year 2003-04 to compute disallowance of interest under section 36(1)(iii) on proportionate basis ignoring the factual the position that the assessee was having a debit balance of Rs.36.17 crores in the Profit & Loss account.

5.3 We have heard both the parties in the matter. The Id. DR strongly supported the order of AO and argued that CIT(A) was not justified in ignoring the negative balance in the P&L Account. It was also submitted that there was no business purpose served in giving the interest free advances. The Id. AR on the other hand submitted that the advances were given for the purpose of business and were also justified on commercial expediency. He placed reliance on the following judgments in support of the case.

- i) 288 ITR 01(SC) in the case of S.A. Builders vs. CIT
- ii) 298 ITR 194 (SC) in case of DCIT Vs. Core Health Care Ltd.
- iii) 4 CTR 226(Bom.) in case of CIT vs. Phil Corporation Ltd.

5.4 We have perused the records and considered the rival contentions carefully. The dispute is regarding disallowance of interest under section 36(1)(iii) of the Act. Under the provisions of said section, interest on capital borrowed for the purpose of business is required to be allowed as deduction and, therefore, in case, any borrowed capital had been raised not for the purpose of business, the corresponding interest is to be disallowed. The assessee had made huge borrowings on which substantial interest running into crores had been paid. The assessee had however advanced substantial funds towards application money for purchase of shares of group companies which had been pending for a long time and no interest was paid to the assessee. It had also advanced a sum of Rs.25.00 crores to Panther Invest - trade Ltd. for acquisition of shares of certain companies but, neither the shares were purchased, nor money was refunded and matter was pending in dispute. The AO has computed the interest in relation to the above advance @ of 15% and disallowed the same in all the years. He has also disallowed interest in relation to interest free advances given to Asian Satellite Broadcast P. Ltd. The details of these disallowances are given in para-5 of this order earlier. CIT(A) has confirmed the disallowance in assessment years 2001-02 and 2002-03 but in 2003-04, CIT(A), noted that the assessee had own interest free funds amounting to Rs.169.09 crores. It has also been noted by him that both interest free funds and interest bearing funds are mixed up. He had therefore directed the AO to compute disallowance of interest on proportionate basis after taking into account the interest bearing funds and interest free advances made. He has also held that since in assessment year 2003-04 the dividend income was taxable, the investment made in shares have to be excluded from disallowance and also the disallowance of interest already made in relation to trading transactions. The assessee has appealed against the order of CIT(A) confirming the disallowance in assessment year 2001-02 & 2002-03 whereas the department has challenged the order of CIT(A) giving relief in assessment year 2003-04.

5.5 We have carefully considered the various aspects of the matter. The Id. AR for the assessee has argued that trading and investment in shares was

business of the assessee and therefore, the borrowed funds used for making advances for acquisition of shares have to be considered as used for the purpose of business and no disallowance should be made. We are unable to accept the contentions raised. The assessee had advanced money for purchase of shares of the group companies for the purpose of acquiring controlling interest and for the acquisition of other companies for the group. The acquisition of controlling interest in companies was not the business of the assessee as the assessee had not acquired controlling interest in any company with a view to managing the same. The assessee is an investment arm of the Zee group who has the management control over the companies. Advancing money interest free is also not the business of the assessee. Therefore, acquiring shares in the group companies for maintaining the controlling interest does not promote the business of the assessee and is only helpful to the group for having the management control over the companies. The Id. AR has relied on the judgment of the Hon'ble Supreme Court in the case of S.A. Builders (288 ITR 01) to argue that advances had been made on commercial expediency and therefore interest on borrowings should be allowed. It has not been shown to us as to how business of those companies promotes the business interests of the assessee so that interest free advances to them could be justified on commercial expediency. Reliance has also been placed on the judgment of the Hon'ble Supreme Court in the case of Core Health Care Ltd. (298 ITR 194) (supra), in which it has been held that once the capital has been borrowed for the purpose of business, interest has to be allowed irrespective of the fact whether the borrowed fund has been used for acquisition of capital assets or for revenue assets. The said judgment is not applicable as advancing interest free fund to the group companies is not the business of the assessee. The judgment of the Hon'ble High Court of Bombay in the case of CIT vs. Phil corporation Ltd. (4 CTR 226) (supra), is also not applicable as in that case there was no dispute that the amount had been paid to the sister concern as an integral part of business, which is not so in the present case.

5.6 Therefore, the interest expenses incurred by the assessee towards such interest free advances made for share application in group companies

or for acquisition of other companies from the group has to be considered for disallowance. However, in case there are some interest free funds available, the benefit has to be given to the assessee to that extent. On careful perusal of the records, we note that the share capital of the assessee was only Rs.1.04 crores in 2001-02. There was negative balance of Rs.21.64 crores in P&L Account which was shown on the asset side of the balance sheet and, therefore, own funds of the assessee were negative to the tune of about Rs.20.00 crores in assessment year 2001-02. The assessee had no reserve and surplus nor any other interest free fund in assessment year 2001-02. Therefore, disallowance of interest computed by AO in assessment year 2001-02 in relation to interest free advances utilized for making application for shares of group companies and advances given to Panther Invest-trade as well as to Asian Satellite Broadcast P. Ltd. is upheld. The position in assessment years 2002-03 and 2003-04 is, however, different. The assessee in these years had also received interest free share application money and total capital including share capital and share application money was Rs.117.50 crores for assessment year 2002-03 and Rs.115.15 crores in 2003-04. The interest free funds available at the time of making advances for purchases of shares are required to be taken into account while computing attribution of interest towards interest free advances. This aspect has been considered by CIT(A) only in assessment year 2003-04 but not considered in assessment year 2002-03. Both, the borrowed funds and own funds are admittedly mixed up and, therefore, in such cases, disallowance of interest has to be made on proportionate basis. While computing disallowance, the disallowance of interest already made towards the borrowings used for trading of shares is required to be excluded and similarly the investment made in shares in respect of which disallowance of interest has been made in assessment year 2002-03 under section 14A is also required to be excluded. In assessment year 2003-04, the dividend income was taxable and, therefore, no disallowance of interest could be made in relation to investment in shares in that year. There is one more factor which needs to be considered and which has been omitted to be considered by CIT(A) in assessment year 2003-04, which is regarding the negative balance in the P&L Account and on this aspect a ground has also been raised by the

department in assessment year 2003-04. These negative balances which were Rs.26.82 crores in assessment year 2002-03 and Rs.36.17 crores in assessment year 2003-04 will neutralize the own funds of the assessee to that extent and, therefore, own funds are required to be reduced to that extent while computing the interest proportionate to the interest free advances. We therefore, set aside the orders of CIT(A) for assessment years 2002-03 and 2003-04 on this issue which is restored to the file of AO for passing fresh orders after necessary examination in the light of observations made above and after allowing opportunity of hearing to the assessee.

6. In the result, all the appeals are partly allowed for statistical purposes.

Order pronounced in the open court on 20.7.2012.

Sd/-
(D. MANMOHAN)
VICE PRESIDENT

Sd/-
(RAJENDRA SINGH)
ACCOUNTANT MEMBER

Mumbai, Dated: 20.7.2012.
Jv.

Copy to: The Appellant
The Respondent
The CIT, Concerned, Mumbai
The CIT(A) Concerned, Mumbai
The DR " " Bench

True Copy

By Order

Dy/Asstt. Registrar, ITAT, Mumbai.