

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "D", MUMBAI**

**BEFORE SHRI SAKTIJIT DEY(JUDICIAL MEMBER) AND
SHRI N.K. PRADHAN (ACCOUNTANT MEMBER)**

**ITA No. 6856 /MUM/2013
Assessment Year: 2003-04**

**ITA No. 6857 /MUM/2013
Assessment Year: 2004-05**

M/s Danmet Chemicals P. Ltd.
9, Bussa Ind Estate, Century Bazar
Lane, Prabhadevi
Mumbai – 400025

Vs.

ITO 6(2)(2)
R.No. 562, Aayakar Bhavan
Mumbai

PAN No. AAACD1891K

(Appellant)

(Respondent)

Appellant by : Shri. Sanjay R. Parikh
Respondent By : Smt. Amrita Singh

Date of Hearing : 11/08/2016

Date of pronouncement : 26/08/2016

ORDER

PER N.K. PRADHAN, A.M

The appeals have been filed by the assessee. Both the appeals are taken together for a decision as they address a common issue. The relevant assessment years are 2003-04 & 2004-05. The appeals are directed against the order of the learned CIT(A) – 12 Mumbai, and arise out of the assessment completed by the Assessing Office (AO) u/s 143(3) read with section 147 of the Income Tax Act 1961 (hereinafter 'the Act').

2. The only ground of appeal raised by the appellant is that the learned CIT(A) erred in holding that the investment in shares of Bharat Bijlee Ltd. was not for the purpose of business, while confirming the disallowance of interest of Rs. 8,79,999/- for assessment year 2003-04 and Rs. 8,54,836/- for assessment year 2004-05 u/s 40A(2)(b) of the Act.

3. The AO during the course of assessment proceedings found that the assessee company had raised a loan of Rs. 55,00,000/- from its Directors / Shareholders and had utilized the said amount to purchase the shares Bharat Bijlee Ltd wherein the same Directors had substantial interest . He disallowed interest expenditure of Rs. 8,79,999/- in assessment year 2003-04 and Rs. 8,54,836/- in assessment year 2004-05 u/s 40A(2)(b) of the Act.

4. The learned CIT(A) came to a finding that the assessee had borrowed funds from the banks on security of stocks and debtors @ 13.5%. It had borrowed Rs. 55,00,000/- from its Directors and paid interest thereon@ 16%. The borrowings made from the Directors were utilized for making investment in shares of Bharat Bijlee Ltd. wherein the assessee's Directors had substantial interest. He held the interest expenditure is not allowable u/s 36(1)(iii). He also held that the disallowance made by the AO of the said interest expenditure u/s 40A(2)(b) is justifiable.

5. The learned counsel of the assessee relied on the judgment of the Hon'ble Supreme Court in the case of **S.A. Builders vs. CIT [2007] 288 ITR 1 (SC)**. He also referred to the 'Articles of Agreement' between the assessee and Bharat Bijlee Ltd. Specific reference was made by him to clause (c) of

the above agreement. He also referred to the 'Memorandum of Loan Sanction' from the United Western Bank Ltd., Satara wherein the rate of interest has been fixed at 13.5%. He referred to para 17 of his submission dated 02/09/2013 before the learned CIT(A) wherein he had submitted that the Directors/Shareholders are all assessed to tax and are paying tax at the maximum marginal rate of tax @ 30% plus surcharge. He had filed copies of computation of their income before the learned CIT(A). Reliance was also placed by him on the decision in the case of **Bharti Airtel Ltd. vs. ACIT [2010] 48 DTR (Mum)(Trib) 416** wherein the assessee was paying interest @ 14% to bank and @ 7 to 18% to its sister concern. The AO has disallowed interest paid over 12%. The Tribunal held *inter alia* that in absence of any material to show that the payment of interest made by the assessee is in excess of fair market value, 18% rate of interest was reasonable.

The learned counsel also relied on the judgment of the Hon'ble Bombay High Court in case of **CIT vs. Indo Saudi Services (Travel) P. Ltd. (2009) 310 ITR 306 (Bom)** wherein it has been held that under Board Circular No. 6-P dated July 1968, no disallowance was to be made under section 40A(2) in respect of payment made to the relatives and sister concern where there was no attempt to evade tax.

6. The learned DR strongly supported the order passed by the learned CIT(A).

7. We have carefully considered the matter and also perused the materials on record placed before us. In **S.A. Builders**(*supra*) , their Lordships observed the following:

" that once it is established that there was nexus between the expenditure and the purpose of the business (which need not necessarily be the business of the assessee itself), the Revenue cannot justifiably claim to put itself in the armchair of the businessman or in the position of the board of directors and assume the role to decide how much is reasonable expenditure having regard to the circumstances of the case. No businessman can be compelled to maximize his profit. The IT authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. The authorities must not look at the matter from their own viewpoint but that of a prudent businessman"

In the instant appeal, the assessee is in the business of manufacturing and trading in electrical and industrial chemicals. We find that as per clause (c) of the 'Articles of Agreement', the assessee shall manufacture and sell to Bharat Bijlee Ltd. electrical/electronic and industrial products for distribution in India. One has to see the transfer of the borrowed funds to a sister concern from the point of view of commercial expediency. We find that the case of the assessee with regard to section 36(1)(iii) is squarely covered by the decision in the above case.

7.1 Also the case of the assessee with regard to Section 40A (2) is covered by the judgement of the Hon'ble Bombay High Court in the case of **Indo Saudi Services (Travel) P. Ltd.** (*supra*) as the Directors / Shareholders are all

assessed to tax and have paid tax at the maximum marginal rate @ 30% plus surcharge.

7.2 Now we shall consider the finding of the learned CIT(A) for A.Y. 2004-05 that interest of Rs. 8,54,836/- was otherwise disallowable u/s 14A. We have gone through the assessment for the above year and find that the AO has not mentioned anything about disallowance of interest under section 14A. Before applying the provisions of sec.14A of the Act, the AO has to record a satisfaction that having regard to the accounts of the assessee, the claim is not correct. Though the aforesaid conditions enshrined in sec. 14A(2) was brought into the statute by Finance Act, 2006 w.e.f. 1st April 2007, however, it has been held in judicial precedents, such condition will apply even in respect of earlier assessment years. Thus, recording of satisfaction by the AO is a mandatory requirement. This is absent in present case. Therefore the issue of disallowance u/s 14A in A.Y. 2004-05 does not arise.

7.3 In view of the above factual matrix and legal position, the disallowances of Rs. 8,79,999/- for A.Y. 2003-04 and Rs. 8,54,836/- for A.Y. 2004-05, made by the AO and upheld by the learned CIT(A) are deleted.

8. In the result, the appeals filed by the assessee are allowed.

Order pronounced in the open court 26/08/2016

Sd/-
(SAKTIJIT DEY)
JUDICIAL MEMBER

Sd/-
(N.K. PRADHAN)
ACCOUNTANT MEMBER

Mumbai; Dated: 26/08/2016

AG(On Tour)

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.

//True Copy//

BY ORDER,

(Dy./Asstt. Registrar)
ITAT, Mumbai