

**IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH 'A', HYDERABAD**

**BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER
AND SHRI S. RIFAUR RAHMAN, ACCOUNTANT MEMBER**

ITA Nos. 1008 & 1009/Hyd/2018
Assessment Year: 2013-14 and 2014-15

Dy. Commissioner of Income-tax, Circle – 16 (2), Hyderabad.	vs. Ramoji Rao (HUF), Hyderabad. PAN – AADHR 6836E
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Assessee

Respondent

Revenue by: Shri M.H. Naik
Assessee by: Shri V. Raghavendra Rao

Date of hearing: 10/04/2019
Date of pronouncement: 10/05/2019

ORDER

PER S. RIFAUR RAHMAN, AM:

Both these appeals filed by the revenue are directed against the orders of CIT(A) – 4, Hyderabad, both dated, 19/02/2018 for AYs 2013-14 and 2014-15. As identical issues are involved in both these appeals, the same were clubbed and heard together and therefore a common order is passed for the sake of convenience.

2. On perusal of record, we find that there was a delay of 11 days in filing these appeals. To this effect, the assessee filed an affidavit, affirming therein, that due to mix up the appeal papers pertaining to these appeals with other records, could not trace the same immediately, due to which, the said delay occurred, which may kindly be condoned. As the assessee was prevented by sufficient reason in not filing these appeals within the stipulated time, we condone the said delay and admit the appeals for hearing and adjudication.

3. Brief facts of the case, as taken from AY 2013-14 are, the assessee, a HUF, filed its return of income for the AY 2013-14 on 30/11/2013 declaring total income of Rs. 3,47,41,356/- and the same was processed u/s 143(1) of the Income-tax Act, 1961 (in short 'the Act') Subsequently, the case was selected for scrutiny and accordingly, notices u/s 143(2) and 142(1) were issued, in response to which, the AR of the assessee filed the information as called for. The AO after verification of the information filed, completed the assessment u/s 143(3) of the Act by making the following disallowances:

1. Disallowance of expenditure u/s 14A of the Act
– Rs. 1,20,53,646/-
2. Disallowance of drawings and interest on drawings used for personal purposes - Rs. 45,41,244/-
3. Disallowance of expenditure debited in the HUF Unit of Ushakiron Properties - Rs. 75,92,998/-

4. When the assessee preferred an appeal against the order of CIT(A), the CIT(A) restricted the disallowance of expenditure u/s 14A. He deleted the disallowance of drawings and as regards the disallowance of expenditure debited in the HUF unit, he observed that the same was accepted by the assessee and did not contest the same before him.

5. Aggrieved by the order of CIT(A), the revenue is in appeal before us raising the following grounds of appeal:

- “1. The CIT(A) erred in restricting the disallowance u/s 14A from Rs. 1,20,53,646/- to Rs. 33,282/.*
- 2. The CIT(A) erred in deleting the disallowance of interest on drawings.*
- 3. Any other ground that may be urged at the time of hearing.”*

6. As regards ground No. 1 relating to disallowance u/s 14A, during the course of assessment proceedings, the Assessing Officer observed that the assessee HUF has borrowed funds from the public, through various deposit schemes on which the HUF is claiming interest expenditure. The Assessing Officer further observed that during the financial year 2012-13 relevant to assessment year 2013-14, HUF claimed interest on borrowed funds at Rs. 21,78,230/- in its profit and loss account and the funds borrowed were utilized by the HUF for investment in mutual funds share application money deposit, investment in intra units, investment in landed properties & residential buildings and for HUF drawings. The Assessing Officer further observed that the HUF is running on borrowed funds and has no capital of its own and the HUF is incurring losses year after year for the reason that the borrowed funds are invested in non-income yielding assets and interest has to be paid not only on these borrowed funds but also on fresh borrowings year after year. Thus, the Assessing Officer concluded that compounding interest has to be disallowed on the investments made in non-income yielding assets u/s 14A of the I.T. Act, 1961 to arrive at the correct income of the assessee. The Assessing Officer also observed that the assessee has made investment in intra units of HUF towards capital and grouped under investments in intra units out of borrowed funds and no income is generated out of above investment. The Assessing Officer further observed that the assessee has not only invested in share application money but also on lands, construction of residence for family occupation and personal withdrawals. Regarding the assessee's submission that part of the investments are from borrowed funds and the balance is met out of internal generation of other divisions of HUF units is not accepted by the Assessing Officer on the ground that each

division of HUF is not a separate legal entity and therefore, the HUF as a whole is running only on borrowed funds and returning huge losses. The Assessing Officer required the assessee to furnish the year-wise details of various investments made by the HUF as a whole, along with the profit available for the HUF to make such investment. The assessee was also required to furnish the cash flow statement of the HUF as a whole since the year in which the above investment were made in order to show the utilization of income/profit generated by the HUF for the purpose of making the above investments. But the reply submitted by the assessee was found to be incomplete by the Assessing Officer. Thus, the Assessing Officer worked out the disallowance u/ s 14A at Rs. 1,20,53,646/- and added the same to the income returned.

6.1 Before the CIT(A), the assessee submitted that a sum of Rs.1,20,53,646/- was disallowed notionally on an investment of share application money deposit of Rs.32,86,10,050/- and the notional interest was computed on compounding basis when the average borrowing rate works out to a mere 3.27% in respect of borrowed funds of Margadarsi Financiers. Thus, the notional interest of Rs. 1,20,53,646/- was disallowed against actual interest of Rs.33,282/- debited to profit and loss account of M/s. Margadarsi Financiers for the relevant year. The assessee further submitted that the amount invested in various group companies is in the form of 'share application money deposit' and not 'share capital' which earns dividend which do not form part of total income and the share application money deposits becomes share capital only after the allotment is made which until that point of time does not qualify as investment made to earn dividend income which does not form part of total income. In this regard the assessee relied on the decision of

Mumbai Tribunal in the case of Rainy Investments Pvt. Ltd. Vs. Asst. CIT (2013) 30 Taxmann.com 169 wherein it was categorically held that Section 14A is not applicable in respect of share application money. The assessee also submitted that the Assessing Officer failed to appreciate the fact that deposit liability remaining as at the end of the year is Rs.6.06 crores which the assessee strongly contends is represented by deposits held in Escrow Account with Union Bank of India amounting to Rs.6.65 crores (matured deposit) and Rs.0.99 crores in the form of Fixed Deposits both totalling to Rs. 7.64 crores and hence, the question of disallowance of notional interest on the above liability does not arise at all since the entire deposits borrowed are held in bank account and deposits with bank.

6.2 After considering the submissions of the assessee, the CIT(A) observed that on verification of the details and cash flow statement furnished by the assessee, it was found that the assessee has not utilized the borrowed funds for the purpose of investments which earn income which does not form part of total income and hence, the applicability of section 14A is not attracted in this case. Accordingly, he deleted the addition made by AO.

6.3 Further, CIT(A) observed that the assessee has claimed interest of Rs. 33,282/- in the profit and loss account. Since the assessee is having sufficient funds but still borrowed funds and the borrowed funds had been utilized for purposes other than business, the interest of Rs. 33,282/- is not allowed as expenditure and therefore, the interest amount was confirmed.

6.4 Before us, Id. DR submitted that CIT(A) has deleted the disallowance made by the AO with the observation that assessee has not utilized the borrowed funds for the purpose of investments, which does not form part of the total income, therefore, 14A disallowance is not attracted in this case. He relied on the order of AO and submitted that assessee has no exempt income, still AO can make 14A disallowance considering the fact that assessee has made huge investment in other companies. Therefore, he objected the conclusion reached by CIT(A).

6.5 On the other hand, Id. AR submitted a paper book and submitted that assessee has not invested during AY under consideration and all the investments were made in the earlier years and majority of the borrowed funds are from Margadarsi Financiers and there is no outflow of interest in all these companies. He brought to our notice the investment pattern of the assessee, as per which, only shares and application money invested in other companies. However, he brought to our notice, in fact the assessee is in receipt of dividend income from companies and he submitted that all the investments made in those companies are out of interest free funds. Further, he submitted that these investments were made in earlier AYs. Therefore, he submitted that provisions of section 14A will not be applicable to the assessee's case.

6.6 Considered the rival submissions and perused the material on record. We notice that assessee has claimed interest on borrowed funds and bank charges at Rs. 21,78,230/- in P&L A/c. Further, Assessing Officer noticed that assessee has loan funds to the extent of Rs. 6,06,84,830/- and investment of Rs. 46,63,21,591/-. Therefore, he invoked section 14A and disallowed interest expenditure to the extent

of Rs. 1,20,53,646/-, but, without following Rule 8D of IT Rules. He adopted other method to determine interest expenditure to the company. Even though assessee has claimed only interest expenditure to the extent of Rs. 10,69,752/-, at the same time, we notice that CIT(A) after considering assessee's submissions gave relief to the assessee with the observation that on verification of details and cash flow statement furnished before her, it was found that assessee has not utilized borrowed funds for the purpose of investment, which earn income, which does not form part of total income and she reached a conclusion that provisions of section 14A are not attracted in the case of assessee. In our considered view, AO as well as CIT(A) have not followed the provisions of section 14A as well rule 8D. As per the records, assessee has earned exempt income to the extent of Rs. 16,14,41,459/- and we notice that assessee has claimed actual interest expenditure in the P&L A/c. We direct the AO to calculate the expenditure which is relating to exempt income strictly following the rule 8D and disallow the expenditure claimed by the assessee as per rule 8D(1)(ii)&(iii) of the Act. AO has to take on record only the actual expenditure claimed by the assessee in the P&L A/c and apply the formula given in rule 8D and not to apply any presumptions as he cannot question the method applied by the assessee to run its affairs. Further, the AO is directed to take the investment, which has yielded the exempt income and not to consider any other investment, which is not yielded any income during the AY. We order accordingly and needless to say that proper opportunity of being heard to the assessee in the matter should be given. This ground is allowed for statistical purposes.

7. As regards ground No. 2 relating to disallowance of interest on drawings, on verification of details furnished by the assessee, the AO observed that the assessee-HUF has made withdrawals amounting to Rs.3,78,43,698/ - for its personal purposes. These drawings were made from the borrowed funds and the interest disallowable on this count comes to Rs.45,41,244/- (12% on Rs. 3,78,43, 698/-) and accordingly the same was disallowed.

7.1 Before the CIT(A), the assessee submitted that drawings were met out of profits of HUF and there is no interlacing of funds or nexus between borrowals made in Margadarsi Financiers and drawings from other units of HUF wherein no borrowed funds exist. The assessee further submitted that the drawings were incurred out of profits generated in the unit of HUF i.e. Ushodaya News Agencies where separate books of account are maintained and there is no interlacing of funds or nexus between Margadarsi Financiers and Ushodaya News Agencies and further, there are no borrowings in the unit from which drawings were made.

7.2 After considering the submissions of the assessee, the CIT(A) observed that since the interest amounting to Rs.33,282/- which was debited by the assessee to profit and loss account is not allowed as expenditure, the interest at the rate of 12% calculated by the Assessing Officer on drawings for personal purpose amounting to Rs 45,41,244/ - is deleted.

7.3 Considered the rival submissions and perused the material on record. We observe that Id. CIT(A) has considered only Rs. 33,282/- as the interest expenses but we notice from the financial records submitted before us, which shows that assessee has an interest expenditure of Rs. 10,69,752/- and

bank charges of Rs. 11,06,586/-. Similar issue came up for consideration before the coordinate benches of this Tribunal in assessee's own case for earlier years. In AY 2010-11, the coordinate bench in ITA No. 60/Hyd/2015 following its earlier order in AY 2006-07 in assessee's own case, remitted the issue back to the file of the AO with a direction to verify the claim of the assessee denovo after giving the assessee a fair opportunity to establish its claim that the withdrawals for the household expenses were made out of the profits generated and not out of the borrowed funds. Since the issue under consideration is similar to that of earlier years, following the same, we remit this issue to the AO to decide the same following the said directions. This ground is allowed for statistical purposes.

8. In the result, appeal of the revenue is treated as allowed for statistical purposes.

9. In AY 2014-15, the revenue has raised only one ground regarding restricting the disallowance u/s 14A from Rs. 79,63,952/- to Rs. 3,631/- by the CIT(A). Since this ground is similar to the ground No. 1 in AY 2013-14 9(supra), following the conclusions drawn therein, we remit this issue to the file of AO to decide the same as per the directions given in para 5.7(supra).

10. To sum up, both the appeals of the revenue are treated as allowed for statistical purposes.

Pronounced in the open court on 10th May, 2019.

Sd/-
(P. MADHAVI DEVI)
JUDICIAL MEMBER

Sd/-
(S. RIFAUR RAHMAN)
ACCOUNTANT MEMBER

Hyderabad, dated 10th May, 2019.

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Copy forwarded to:

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2. *Ramoji Rao – HUF, No.3, Chikoti Gardens, Begumpet, Hyderabad.*
3. *CIT(A) – 4, Hyderabad*
4. *Pr. CIT – 4, Hyderabad*
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