

**IN THE HIGH COURT OF PUNJAB AND HARYANA
AT CHANDIGARH.**

ITA No. 332 of 2005
Date of Decision : 16.07.2018

R.K. Saboo & Sons HUF

Appellant

Versus

The Commissioner of Income Tax, Chandigarh

Respondent

**CORAM : HON'BLE MR. JUSTICE AJAY KUMAR MITTAL
HON'BLE MR. JUSTICE AVNEESH JHINGAN**

Present : Mrs. Radhika Suri, Senior Advocate with
Mr. M.S. Kanda, Advocate
for the appellant.

Mrs. Urvashi Dhugga, Sr. Standing Counsel
for the respondent.

AVNEESH JHINGAN, J.

The assessee has filed the present appeal under Section 260A of the Income Tax Act, 1961 (for short 'the Act') against the order dated 26.05.2005 of Income Tax Appellate Tribunal, Chandigarh (for short 'Tribunal'). The assessment year involved is 1997-98.

2. According to the appellant-assessee, the following substantial questions of law arise for consideration :-

i). Whether in facts and circumstances of the case, the Tribunal was right in law in disallowing deduction of Rs. 3,21,877/- which was interest paid on fund borrowed for investments in shares for the purpose of earning income in the form of dividend.

ii). Whether the decision of the Tribunal is contrary to the ratio of the Supreme Court in CIT vs. Rajender Parshad Modi 115 ITR Page 519.

iii). Whether in facts and circumstances of the case, the Tribunal was right in holding that the beneficial owner of shares is not entitled to deduction u/s 57(iii) of the Income Tax Act.

iv). Whether the order of the Tribunal is perverse as conclusions drawn by it are contrary to the material on record namely agreements dated 22nd January, 1996 and 8th October, 1996.

v). Whether in facts and circumstances of the case, the Tribunal, could adjudicate on a matter not pleaded before it?

3. Appeal was admitted for considering question Nos. (i), (ii) and (iii).

4. The assessee-HUF filed a return declaring income of ₹ 5,61,781/- for the assessment year 1997-98. The case was selected for scrutiny and a notice was issued. The Assessing Officer, vide order dated 19.11.1999, amongst other things, made an addition of ₹ 3,21,877/- by disallowing deduction of interest claimed under Section 57 (iii) of the Act.

5. Aggrieved of the assessment order, an appeal was filed. The Commissioner of Income Tax (Appeals), Chandigarh [CIT(A)], vide order dated 26.11.2001, allowed the appeal.

6. The revenue filed an appeal before the Tribunal. The Tribunal, vide order dated 26.05.2005, set aside the order of C.I.T.(A) deleting the addition of ₹ 3,21,877/- and upheld the addition made by the Assessing Officer.

7. Aggrieved of the order, the present appeal has been filed by the assessee.

8. As per the agreement entered by the assessee with four persons, the assessee borrowed funds to invest in shares of M/s Kamla Dials and Devices Limited at Parwanoo. Rate of interest of loan was 28% per annum.

The lenders were to buy shares of M/s Kamla Dials and Devices Limited in

their own name and to retain the same for a period of one year and one day. Thereafter, the appellant was to pay money and shares were to be transferred to the assessee. During the relevant assessment year, the lenders had purchased shares in his name. It was claimed that the assessee was the beneficial owner of these shares. The assessee claimed deduction of interest paid to the lenders under Section 57(iii) of the Act.

9. Though three substantial questions of law have been framed. The issue involved would be whether in the facts and circumstances of the case, the assessee was entitled to deduction under Section 57 (iii) of the Act?

10. The challenge in the appeal to the disallowance of deduction by relying upon the decision of the Supreme Court in the case of C.I.T. Vs. Rajendra Prasad Moody (1978) 115 ITR 519 is not well founded.

11. It would be appropriate to quote clauses 9 and 10 of the agreement :-

9. With the mutual agreement of both the parties, the lenders may purchase upto 50% of the shares allotted to him at the total cost of acquisition of these shares, and in this case, the Borrower shall not repay the proportionate amount of principal and interest due on such number of shares as are opted to be purchased by the lenders.

10. In case the Borrower fails to repay the principal or interest due on the amount of loans under this Agreement, granted from time to time, after the period of this Agreement i.e. 1 year and 1 day, the lenders shall have after giving a notice in writing of at least one month, an option to either enforce the specific performance of the Agreement OR sell the shares through the Stock Exchange where the shares are listed, or in the open market, or through public auction and recover the balance amount due from the Borrower.

12. From plain reading of the Clause 9 of the agreement it is evident that the appellant was not bound to purchase all the shares from the

lenders. By mutual agreement, lenders could purchase upto 50% of the shares allotted. The deduction was rightly disallowed, as it was only after end of the year, it would emerge as to how many shares were actually transferred to the appellant.

13. According to Clause 10, in case the borrowers failed to repay the amount of loan, lenders had option to enforce specific performance or to sell the shares through Stock Exchange, in open market or auction and thereafter recover the balance amount. As per this clause also, the appellant was to become owner of the shares at the end of one year and one day of the allotment of the shares if the shares were transferred to the appellant.

14. The Tribunal, considering the facts and circumstances of the case, decided the issue against the assessee. The operational part of the order is quoted below:-

13. After hearing both the parties, we are of the considered view that the disallowance made by the AO is justified and the CIT (A) is wrong in deleting the disallowance. In this case, it is not disputed that the company, namely, M/s Kamla Dials & Devices had decided to float the right share in the market at a premium of Rs. 18/- per share. The respondent has entered into an agreement with four different parties. As per the agreement, the investors were required to subscribe to equity shares against the renounced forms to be arranged by the respondent. The application money was to be paid by the lenders @ Rs.14 per share. As per the agreement, the lenders was entitled to retain the shares in their name for a period of one year and one day from the date of allotment and the borrower was required to transfer the shares to the respondent or his nominee. The borrower later on was also required to pay for the call money allotted to the lenders. On the basis of this arrangement, the assessee claimed interest @ 28% as deduction which was denied by the AO and allowed by the CIT(A). In our considered view, the deduction of the Hon'ble Supreme Court in the case of Rajendra Prasad Moody (supra), is inapplicable to the facts of this case insofar as the assessee was to acquire the shares after the expiry of one year and one day. Since no shares were held in the name of the respondent nor was any investment made in the name of the respondent in the year under appeal, the respondent was not entitled to deduction u/s 57 of the Income Tax Act, 1961. Section 57(iii)

provides for deduction of any expenditure laid out or expended wholly and exclusively for the purposes of making or earning of income. In the year under appeal, admittedly, assessee could not have received any income as shares were neither held in his name nor was there any possibility of transfer of such shares in the name of the assessee during the year under appeal. The shares were allotted in the name of the lenders and dividend, if any, declared would be in the name of the lenders and not in the name of the assessee. Since no investment was made for earning of the dividend income in the year under appeal, the decision of Supreme Court in the case of Rajendra Prasad Moody (supra), as already pointed out, is inapplicable. The said decision applies in such cases where the investment is made by the assessee for the purposes of earning dividend income. Though receipt of dividend is not a condition precedent for allowance of deduction, yet the intention of the assessee to earn income is necessary for the purposes of allowance of deduction. In this case, the assessee never intended to earn any dividend income in the year under appeal, and therefore, the interest claimed by the assessee as deduction has wrongly been allowed by the CIT(A), the addition of Rs. 3,21,877/- is accordingly restored.

15. In the facts and circumstances of the present case, the pre-requisite of Section 57(iii) of the Act that expenditure was made for the purpose of making or earning income is not satisfied. The Supreme Court in **Rajendra Prasad Moody's** case (supra) held that there is no requirement under Section 57(iii) and deduction would be allowed only if any income is actually made or earned. There is no quarrel with the said proposition. Undisputedly, during the relevant year, the appellant was not the owner of the shares. The shares were purchased in the name of lenders who kept the shares for the entire year. Accordingly, the argument that the appellant was the beneficial owner of the shares and the lenders had kept the shares only for the purpose of security deserves rejection. Thus, in the absence of the appellant-assessee being the owner of the shares during the year under consideration, no benefit can be derived from the aforesaid pronouncement.

16. There is no reason to interfere with the findings recorded by the

Tribunal.

17. The substantial question of law as claimed is answered accordingly.

18. The appeal is dismissed.

[AJAY KUMAR MITTAL]
JUDGE

[AVNEESH JHINGAN]
JUDGE

16.07.2018
pankaj baweja

<i>Whether speaking/reasoned ?</i>	Yes / No
<i>Whether reportable ?</i>	Yes / No