

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

1. ITA-64-2012

Mascot Footcare, Faridabad

....Appellant

VS.

Commissioner of Income Tax (Appeals), Faridabad

...Respondent

2. ITA-192-2012

Mascot Footcare, Faridabad

....Appellant

VS.

Commissioner of Income Tax (Appeals), Faridabad

...Respondent

Date of decision:- 12.05.2023

**CORAM: HON'BLE MS. JUSTICE RITU BAHRI
HON'BLE MRS. JUSTICE MANISHA BATRA**

Present: Mr. Pankaj Jain, Sr. Advocate with
Mr. Shakti Singh, Advocate
for the appellant (s).

Ms. Pridhi Jaswinder Sandhu, Standing counsel
for the respondent-department.

Ritu Bahri, J.

1. This judgment shall dispose of the above mentioned two appeals together, as common questions of law and facts are involved therein. However, for facility of reference, the facts are being taken from ITA-192-2012.

2. The appellant-M/s Mascot Footcare has filed the above mentioned two appeals under Section 260-A of the Income Tax Act, 1961

(for short 'Act 1961') challenging order dated 27.05.2011 and order dated 20.04.2012 in M.A No.292/Del/2011 arising out of ITA No. 998/DEL/2011 dated 27.05.2011, whereby the appeal filed by the revenue-department was partly allowed.

3. Brief facts of the case are that the assessee-company filed return of income declaring income of Rs.81,63,354/- on 07.06.2007, which was processed under section 143(1) of the Act on 28.03.2008. The assessee firm is engaged in the business of manufacturing of Hawai Chappals. During the course of assessment proceedings, the Assessing Officer observed that the assessee had invested a sum of Rs.3,66,684,014/- over the years in the shares of Lakhani India Ltd. from which the dividend income was not taxable and the interest pertaining to the investments in the share capital was not allowable expenditure in view of the provisions of section 14A of the Act 1961. Similarly, the Assessing Officer disallowed interest of Rs. 3,25,674/- u/s 36(1)(iii) of the Act pertaining to the debit balances in the capital accounts of two partners namely Suman Lakhani and Kamlesh Lakhani aggregating to Rs.21,41,072/-as on 31.03.2006 relying upon the decision of a Coordinate Bench of this Court in the case of ***CIT Vs. Abhishek Industries Ltd. (2006) 286 ITR 1 (P&H)***. The Assessing Officer had observed that the withdrawals by the partners were out of the sale proceeds received by the assessee concern and not out of the borrowings of the assessee concern. A perusal of the bank account showed that the payments by the assessee concern to the partners were out of the CC account where the balance was in debit on the date when the payments were made to the partners. Thus, the assessee concern was making payments by utilizing the overdraft facility on which the interest had been paid. Further

the interest pertaining to withdrawals made by the partners having debit balance was not allowable as per the provisions of Section 36 (1) (iii) of the Act 1961, as the personal withdrawals by partners of an amount more than the capital amount could not be taken as business purpose or for the purpose of commercial expediency. Reference was made to judgment of Hon'ble Supreme Court in a case of ***S.A Builders Pvt. Ltd v. Commissioner of Income Tax (Appeals) Chd and another, 2007 (1) SCC 781***, wherein it has been held that the personal purpose cannot be considered for commercial expediency. Reference had further been made to ***Abhishek Industries case (supra)*** wherein it was observed as under:-

“We do not subscribe to the observation in the judgments to the effect that if the amount is advanced from a mixed account or share capital or sale proceeds or profits, etc., the same would not be termed as diversion of borrowed capital or that the Revenue had not been able to establish nexus of the funds advanced to the sister concerns with the borrowed funds. Once it is borne out from the record that the assessee had borrowed certain funds on which liability to pay tax is being incurred and on the other hand, certain amounts had been advanced to sister concerns or others without carrying any interest and without any business purpose, the interest to the extent the advance had been made without carrying any interest is to be disallowed under section 36(1) (iii) of the Act. Such borrowings to that extent cannot possibly be held for the purpose of business but for supplementing the cash diverted without deriving any benefit out of it. Accordingly, the assessee will not be entitled to claim deduction of the interest on

the borrowings to the extent those are diverted to sister concerns or other persons without interest."

4. The Assessing Officer further observed that the partner had not withdrawn his own funds but the business funds which bear interest cost. Prevailing bank rate of interest at the relevant time was 12% per annum. The total interest pertaining to the funds advanced to the partners (Smt. Suman Lakhani & Smt. Kamlesh Lakhani) on account of their debit balance with the firm came to Rs.3,25,674/- (92306+ 233368), interest of Rs. 3,25,674/ pertaining to the debit balances of the partners was disallowed as per the provisions of sec. 36 (1) (iii) of the I.T. Act.

5. Aggrieved by the order of the AO, the appellant filed appeal before the CIT (A), Faridabad and the same was allowed, vide order dated 29.11.2010 (Annexure A-7). Against the order of CIT (A), the revenue-department filed the appeal before the Tribunal on the following grounds:-

(i) On the facts and in the circumstances of the case, the Ld. CIT(A) has erred on facts and in law in deleting the addition of Rs.18,00,001/- made by the Assessing Officer on account of interest on investment in the shares of Lakhani India Limited under Section 14A of the Income Tax Act, 1961 particularly when the investment in shares which yield dividend income are not forming part of the total income by virtue of section 10(34) of the Income Tax Act, 1961 and hence, since dividend does not form the part of total income and when the financial burden incurred by the assessee for acquiring shares should have been proportionately disallowed by invoking section 14 of the Income Tax Act, 1961."

(ii) On the facts and in the circumstances of the case, the Ld CIT(A) has erred on facts and in law in deleting the addition of Rs.3,25,674/- made by the Assessing Officer on account of interest on debit balance of partners u/s 36(1)(ii) of the Income

Tax Act, 1961 disregarding the fact that the partners had not withdrawn their own funds but the business funds which bear interest cost and in contradiction with the judgment of the Hon'ble Punjab & Haryana High Court in the case of CIT Vs. Abhishek Industries Ltd. (2006) 286 ITR 1 (P&H)"

(iii) That the appellant craves for the permission to add, delete or amend the grounds of appeal before or at the time of hearing of appeal."

6. The appeal of the revenue was partly allowed and with respect to ground No. 1, the Tribunal set aside the orders of authorities below to work out the disallowance on reasonable basis. It has been observed that it is the disallowance u/s 14A wherein expenditure incurred in relation to the income not includible in the total was required to be disallowed. In the case of **Godrej & Boyce vs. DCIT 328 ITR 81 (Bom)**, Bombay High Court has held that section 14A supersedes the principle of law that in the case of a composite business expenditure incurred towards tax free income could not be disallowed and incorporates an implicit theory of apportionment of expenditure between taxable and non-taxable income and once a proximate cause for disallowance is established regarding the relationship of the expenditure with income, which does not form part of the total income, disallowance u/s 14A has to be effected. With respect to ground No. 2, the Tribunal found no fault in the order of the CIT (A) and dismissed this ground. The ground No. 3 was found to be general in nature.

7. The assessee then filed MA and the same was also dismissed on 20.04.2012. Hence the present appeals.

8. **Bombay High Court in Godrej and Boyce case (supra)** examined the provisions of Rule 8 (d) read with Section 14A(2) of the Act

and held that Rule 8(d) is not retrospective and applies from AY 2008-09.

For earlier years, disallowance has to be worked out on 'reasonable basis' under Section 14 (A) (1).

9. In the present case, the assessment year is 2006-07 and hence disallowance has to be worked out on reasonable basis under Section 14 A . The method prescribed for the purpose of section 14A of the Act is contained in Rule 8D of the Income Tax Rules, 1962 ("the Rules"). Rule 8D had been inserted vide Notification 45 of 2008 and has been held to be prospective in nature i.e. applicable from AY 2008-09. [See *CIT vs. Essar Teleholdings Ltd. (2018) 401 ITR 445 (SC)*; *Maxopp Investment Ltd. vs. CIT (2018) 402 ITR 640 (SC)*.] The Rule 8D has been amended vide Notification No. 43 dated 2nd June 2016. The sub- rule (2) of the amended Rule 8D, as it stands on date and which is effective from AY 2017-18, provides that the disallowance u/s Section 14A is to be computed as an aggregate of the following:

- 1.Expenditure directly incurred for earning exempt income (e.g. demat charges, bank charges, interest cost etc.)
- 2.1% of the annual average of the monthly averages of the opening and closing balances of the value of investments, income from which does not or shall not form part of the total income.

10. The constitutional validity of provisions of section 14A(2) and (3) read with Rule 8D has been upheld in *Godrej and Boyce Mfg Co. Ltd's case (supra)*. However, Rule 8D shall not be applicable for assessment year prior to AY 2008-09; and the AO had to enforce the provisions of section 14A(1) by determining expenditure by adopting a reasonable basis or method consistent with all relevant facts and circumstances. Thus, the Tribunal, vide impugned order had rightly partly allowed the appeal of the assessee by giving direction to work out the disallowance on reasonable basis.

11. Accordingly, the order of the Tribunal dated 27.05.2011 and order dated 20.04.2012 passed in M.A No.292/Del/2011 arising out of ITA No. 998/DEL/2011 dated 27.05.2011 do not require any intereference by this Court. No substantial question of law arises for consideration by this Court.
12. The appeals stand dismissed.

(RITU BAHRI)
JUDGE

12.05.2023
G Arora

(MANISHA BATRA)
JUDGE

Whether speaking/reasoned

Whether reportable

: Yes/No

: Yes/No