

**IN THE INCOME TAX APPELLATE TRIBUNAL
RAJKOT BENCH, RAJKOT
(Conducted through E-Court at Ahmedabad)**

**BEFORE SMT. ANNAPURNA GUPTA, ACCOUNTANT MEMBER &
SHRI SIDDHARTHA NAUTIYAL, JUDICIAL MEMBER**

I.T.A. No.179/Rjt/2022
(Assessment Year: 2016-17)

Kishorkumar Bhalara, Prop. M/s. J. K. Industries, 11, Atika Industrial Area, Rubber Mill, Dhebar Road, Rajkot-360002	Vs.	The Principal Commissioner of Income Tax, Rajkot-1
[PAN No.ACGPP8481Q]		
(Appellant)	..	(Respondent)

Appellant by :	Shri D. M. Rindani, A.R.
Respondent by:	Shri Shramdeep Sinha, CIT DR

Date of Hearing	12.02.2024
Date of Pronouncement	23.02.2024

ORDER

PER SIDDHARTHA NAUTIYAL, JM:

This appeal has been filed by the assessee against the order passed by the Ld. Principal Commissioner of Income Tax, (in short “Ld. PCIT”), Rajkot-1 in DIN & Order No. ITBA/REV/F/REV5/2020-21/1032073082(1) vide order dated 31.03.2021 passed for Assessment Year 2016-17.

2. The assessee has taken the following grounds of appeals:-

“1. The learned Principal Commissioner of Income-tax - Rajkot - 1, Rajkot erred in holding that the assessment order dated 05-12 2018 passed u/s 143(3) of the Act was erroneous and prejudicial to the interest of revenue and thus erred in assuming jurisdiction u/s 263 of the Act, in the light of show cause notice and the order passed u/s 263 of the Act and hence the impugned order is bad in law.

2. The learned Principal Commissioner of Income-tax, Rajkot -1, Rajkot erred in setting aside the assessment order framed u/s 143(3)of the Act by holding that assessment order is passed by the assessing officer without making any inquires or

verification in respect of allowability of interest expenses as a deduction u/s 57 of the Act.

3. The learned Principal Commissioner of Income-tax, Rajkot -1, Rajkot erred in holding that no deduction u/s 57(ii) is allowable to the assessee and that no question was raised by the A.O. as regard nexus of interest expenses with interest income earned by the Appellant.

4. The learned Principal Commissioner of Income-tax, Rajkot -1, Rajkot failed to appreciate that the impugned issue was duly examined by the assessing officer by way of specific inquiries/notices and replies thereto, while finalizing assessment proceedings u/s 143(3) of the Act.

5. The appellant craves leave to add, amend, alter and withdraw any ground of appeal anytime up to the hearing of this appeal.”

3. The brief facts of the case are that the assessee filed return of income for A.Y. 2016-17 on 02.08.2016 declaring income of Rs. 9,50,750/-. The case of the assessee was selected for complete scrutiny and assessment was finalized under Section 143(3) of the Act accepting the returned income of Rs. 9,50,750/-.

4. Subsequently, the PCIT initiated 263 proceedings on the ground that on verification of profit and loss account, it is noticed that interest of Rs. 10,34,960/- has been paid by the assessee on loan taken from Central Bank of India, and the amount of loan was invested in M/s. J. K. Industries of which the assessee is a proprietor and the assessee utilized the loan to earn profit in the proprietary concern and not for earning interest income. Therefore, the same is required to be disallowed under Section 57 of the Act. Further, the PCIT observed that assessee has paid interest of Rs. 11,40,985/- on Bank loan from ICICI Bank and the amount of loan was utilized for purchase of property and not for earning interest income and therefore, the same is also required to be disallowed under Section 57 of the Act. The PCIT was of the view that the Assessing Officer has passed

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assessment order without proper verification and interest expenses amounting to Rs. 21,75,945/- claimed as deduction under Section 57 of the Act, were required to be disallowed.

5. During the course of 263 proceedings, the assessee submitted that as regards interest expenditure of Rs. 10,34,960/- the interest is accrued and paid on the cash credit from the Central Bank of India in the name of J. K. Industries and the amount has been utilized for giving loans and advances to other parties for earning interest income. Therefore, the assessee submitted that the interpretation that the amount has been invested in M/s. J. K. Industries which is the proprietary concern of the assessee, is incorrect. The assessee submitted that since the interest is expended wholly and exclusively for earning interest income from loans and advances interest deduction has been rightly claimed by the assessee under Section 57 of the Act and has been rightly allowed by the Ld. AO in the assessment made under Section 143(3) of the Act. As regards interest expenditure of Rs. 11,40,985/-, the assessee submitted before the Ld. PCIT that the assessee had taken total mortgaged loan of Rs. 2,74,00,000/- from ICICI Bank, out of which a sum of Rs. 1,50,00,000/- (i.e. approximately 55%) has been invested in “Ameo Reality Investment” as long-term investment and the balance amount of Rs. 1,24,00,000/- (i.e. approximately 45%) has been utilized for lending to other parties to earn interest income. Therefore, out of the total interest paid on the total mortgaged loan of Rs. 25,35,523/-, the assessee as claimed only a sum of Rs. 11,40,985/- (i.e. approximately 45%) under Section 57 of the Act, since the same was expended wholly and exclusively for earning interest income and the balance interest amount (i.e.

approximately 55%) has not been claimed by the assessee at all under Section 57 of the Act. The assessee submitted before PCIT that the mortgaged loan from ICICI Bank has been utilized for lending and earning interest income and the assessee has claimed only that portion of interest relatable to earning interest income under Section 57 of the Act and the balance amount has not been claimed by way of deduction under Section 57 of the Act. Accordingly, it was submitted that the assessment order is not erroneous and prejudicial to the interest of the Revenue.

6. However, Ld. PCIT rejected the arguments of the Ld. Counsel for the assessee and held that the assessment order is erroneous and prejudicial to the interest of the Revenue with the following observations:-

“8.1 Having considered the assessee's, submissions, and facts of the case in light of the provisions of section 57(iii) and the interpretation of the same by some of the highest judicial authorities, it is concluded that no deduction under section 57(iii) is allowable to the assessee. It is true that no question has been raised by the A.O. as regards the nexus of the interest expenses with the interest income earned by the appellant. But a mere perusal of the provisions of that section reveals that fulfilment of this condition, in itself, is not sufficient to make an expense deductible under section 57(iii).

8.2 The basic and foremost condition for allowability of deduction under section 57(iii) is that the said expense should be laid out or expended wholly and exclusively for the purpose of making or earning income against which it is claimed as deduction. In the present case, the borrowed funds have been given to other parties, prima facie appearing to be the family members. No purpose of giving the loans to other parties has been specified by the assessee during the assessment proceedings or during the present proceedings. But, on an appreciation of the fact that most the parties appears to be family members or related parties, it can be fairly concluded that the provision of funds was made by him so as to allow them to conduct their respective business activities. This would mean that the interest expenses, in question incurred by the "appellant were not expended wholly and exclusively for the purpose of making or earning interest income.

9. Further, as in the case of *Commissioner of Income Tax vs Smt.Swapna Roy (supra)*, in the appellant's case, too, the condition precedent to avail the benefit of s. 57(iii) of the Act viz. the investment must be proper and justified is not satisfied. In

paragraph no. 68 of its order, after referring to and relying upon the judgment of the apex court in the case of CIT vs Rajendra Prasad Moody (supra), Hon'ble Allahabad High Court has concluded that "proper investment means correct investment with intention to earn profit. .

10. As regards interest expenses of Rs. 11,40,985/-, it is submitted by the assessee that total mortgage loan of Rs. 2,74,00,000/- from ICICI Bank, out of which Rs.1,50,00,000/- (i.e. 55% approx.) have been invested in 'Amee Reality Investment' as Long term investment and the balance of Rs. 1,24,00,000/- (approx. 45% approx.) have been utilized for lending to other parties to earn interest. Therefore out of the total interest accrued and paid on the total mortgage loan was Rs. 25,35,523/-, the assessee has claimed only Rs.11,40,985/- (i.e. 45% approx.) under sec. 57 of the Act as the same was expended wholly and exclusively for earning interest income and balance interest have not been claimed at all.

11. The appellant's argument that he has claimed deduction on a proportionate-basis and not in full, does not help his cause. This is so because such an argument does not have any bearing in the context of deducibility under the provisions of section 57(iii). If the intention to earn income is missing in any such expenditure, no deduction under section 57(iii) can be allowed even if it is not claimed in full. It will be prudent to note that the mortgage loan of Rs. 2,74,00,000/- from ICICI Bank, out of which Rs.1,50,00,000/- (i.e. 55% approx..) have been invested in Amee Reality Investment as long term investment and hence the assessee has not been able to establish the purpose of acquiring the loan whether for long term investment or for the purpose of lending funds to other parties. Hence, it can be easily observed that the claim of interest of Rs.11,40,985/- that was in relation to the loan from ICICI Bank cannot be allowed as deduction under section 57(iii) because its intent, purpose and use was not to earn interest-income. However, there is nothing on record that can substantiate his contention that these loans were taken by the assessee for the purpose of lending funds to other parties.

12. The assessee placed reliance on the various judgments, is not supported by the facts of his case. In none of the judgments the ratio supports the argument that if the appellant has incurred any expense that has not been made for the purpose of making or earning of income, the same should be allowed as deduction under the provisions of section 57.

13. It would be pertinent to mention here that the appellant had incurred interest expenses not with the purpose of earning or making income and the loans given by him to other parties were also not given for the purpose that can be held to be wholly and exclusively for the purpose of earning interest income. The provisions of section 57(iii), in such circumstances, would not come into play and the deduction of Rs. 29,32,275/-, claimed by the assessee under that section, is therefore not allowable.

14. The above discussion makes it clear that the assessment order is passed without making inquiries or verification which should have been made. Resultantly, the order passed by the Assessing Officer is left erroneous in so far as it is prejudicial to the interests of the revenue. Thus, the order deserves to be revised as

per the provisions of section 263 of the Income-tax Act, 1961. There are various judicial decisions in support of such proposition which are as under:

- (i) *Rampyari Devi Sarogi Vs. CIT 67 ITR 84 (SC)*
- (ii) *Malabar Industrial Co. Ltd. Vs. CIT 243 ITR 83 (SC)*
- (iii) *Swarup Vegetable Products Industries Ltd. Vs. CIT 187 ITR 412 (ALL)*
- (iv) *Gee Vee Enterprises Vs. Addl.CIT & Ors 99 ITR 375 (Del.)*
- (v) *Rajalakshmi Mills Ltd. Vs. ITO 121 ITD 343, 313 ITR(AT) 182*
- (vi) *SRM Systems & Software Pvt. Ltd. Vs. ACIT 2010-TIOL-646-HC-MAD-IT (ITAT, SB-Chennai)*
- (vii) *Shakti Credits Ltd Vs. CIT 2015 Tax Pub (DT) 3058 (Luck. 'A' Trib)*
- (viii) *Shoreline Hotel Pvt. Ltd. Vs. CIT 2015 Tax Pub (DT) 2982 (Mum. 'E' Trib.)*
- (ix) *Kapil Ratan Associates Vs CIT 2015 Tax Pub (DT) 2931(Mum.'A' Trib) 69 SOT 188 (Mum.)*
- (x) *Swadeshi Vilas Private Ltd Vs. ACIT ITA No.599/Hyd/2013 dt: 25-09-2013*

15. *The above discussion makes it clear that the assessment order is passed without making inquiries or verification which should have been made. Resultantly, the order passed by the Assessing Officer is left erroneous in so far as it is prejudicial to the interests of the revenue. Thus, the order deserves to be revised as per the provisions of section 263 of the Income-tax Act, 1961.*

16. *As per the Explanation 2, the order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interest of the revenue if the order is passed without making inquiries or verification which should have been made by the AO and/or the order is passed allowing any relief without inquiring into the claim. In the present case, the Assessing Officer had accepted the version of the assessee regarding the claim of deduction u/s. 57 of the IT Act i.e. interest expenses of Rs. 10,34,9607- and 11,40,9857-without conducting any inquiry. The AO was required to disallow interest expenses to the tune of Rs. 21,75,945/- claimed as deduction u/s. 57 of the IT Act.*

17. *Thus, in the interest of justice and since the twin conditions namely, (i) the order of the Assessing Officer sought to be revised is erroneous: and (ii) it is prejudicial to the interests of the revenue are satisfied, **the impugned assessment order is set aside for fresh assessment only to the extent of the issues discussed supra.***

18. *Keeping in view these facts, I am of the considered view that this is a fit case for invoking section 263 of I. T. Act as the twin conditions namely, (i) the order of the Assessing Officer sought to be revised is erroneous: and (ii) it is prejudicial to the interests of the revenue are satisfied. Accordingly the impugned assessment order is set aside for fresh assessment only to the extent of the issue discussed supra. The AO is directed to examine the issue regarding interest expenses claimed u/s.57 of the Act and frame the assessment only after conducting proper inquiry on this issue.*

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19. *In view of the above facts, I consider that the assessment order passed by the AO u/s. 143(3) on 05.12.2018 as erroneous in so far as it is prejudicial to the interests of revenue and therefore, by virtue of section 263 of the I. T. Act 1961, the impugned assessment order is set aside for fresh assessment only to the extent of the issues discussed supra after allowing adequate opportunity of being heard to the assessee. The AO shall verify the issues as discussed above and pass a reasoned order accordingly.”*

7. The assessee is in appeal before us against the aforesaid order passed by Ld. PCIT.

8. Before us, the Counsel for the assessee submitted that the assessment proceedings were selected for limited scrutiny with the specific purpose of enquiry into claim of interest expenses under Section 57 of the Act. The Counsel for the assessee also drew our attention to notice dated 20.08.2018 issued by the Assessing Officer in which a specific enquiry regarding deduction claimed on account of interest expenses was raised by the Assessing Officer. Thereafter, the Counsel for the assessee drew our attention to reply dated 15.09.2018 submitted before the Assessing Officer in reply to the aforesaid query. Further, the Counsel for the assessee also drew our attention to submission dated 23.11.2018 submitted before the Assessing Officer regarding the allowability of claim of deduction under Section 57 of the Act. It was further submitted before us that specific submission was made with respect to interest expenditure amounting to Rs. 10,34,960/- and Rs. 11,40,985/- vide reply dated February 19, 2021 submitted before the Ld. PCIT. However, the submissions made by the assessee with respect to claim of deduction of the aforesaid amount have not been controverted by the Ld. PCIT while passing order under Section 263 of the Act. It was submitted before us that Ld. PCIT while holding that the assessment order is erroneous and prejudicial to the interest of the Revenue

has not controverted the submissions made by the assessee justifying the deductibility of interest paid and claim under Section 57 of the Act. Accordingly, it was submitted that firstly, the Assessing Officer during the course of assessment proceedings had made due enquiries on allowability of claim of deduction under Section 57 of the Act with respect to interest expenses incurred by the assessee and secondly, it was submitted that the Ld. PCIT has not controverted the factual submissions made by the assessee during the course of 263 proceedings giving the basis of claim of deduction of interest expenses under Section 57 of the Act. The Counsel for the assessee submitted that Ld. PCIT has not given any specific finding to controvert the submissions made by the assessee during the course of 263 proceedings and has simply proceeded to hold that the assessment order is erroneous and prejudicial to the interest of the Revenue without controverting the submissions made by the assessee before him.

9. In response, Ld. D.R. placed reliance on the observations made by Ld. PCIT in the 263 order.

10. We have heard the rival contentions and perused the material on record.

11. On going through the contents of the 263 order and the assessment records, we observe that firstly there was no evidence lack of enquiry on part of the Assessing Officer on the aspect of allowability of claim of deduction under Section 57 of the Act. We observe that the case of the assessee was opened under limited scrutiny to examine whether the deduction against interest income from other sources has been correctly

shown in the return of income and also to examine whether deduction claimed on account of interest expenses is deductible. The assessee had also filed replies to the query raised by the Assessing Officer during the course of assessment proceedings. Even before Ld. PCIT, the assessee had filed written submissions giving the basis for claim of deduction of interest expenses under Section 57 of the Act by stating that the aforesaid interest income had been incurred exclusively for the purpose of earning interest income and accordingly the order passed by the Assessing Officer was not erroneous and prejudicial to the interest of the Revenue. The assessee had filed detailed written submission before Ld. PCIT explaining that the notice issued under Section 263 of the Act was on an incorrect understanding / appreciation of the facts of the assessee's case and the assessee had submitted that the interest expenditure had been incurred wholly for the purpose of earning interest income. Further, the assessee had also submitted that only that part of interest expenditure had been claimed by way of deduction under Section 57 of the Act, which had been incurred for earning interest income and the proportionate part of the interest expenditure which was not utilized for earning interest income had not been claimed by the assessee as deduction under Section 57 of the Act. However, the PCIT did not give any specific finding to controvert the written submissions filed by the assessee during the course of 263 proceedings and proceeded to hold that the assessment order passed by the Assessing Officer is erroneous and prejudicial to the interest of the Revenue. Accordingly, looking into the facts of the instant case we are of the considered view that Ld. PCIT has erred in facts and law in holding that the assessment order passed by the Assessing Officer in the instant case is erroneous and prejudicial to the

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interest of the Revenue. Accordingly, we hereby direct that the order passed under Section 263 of the Act is liable to be set-aside.

12. In the result, the appeal of the assessee is allowed.

This Order pronounced in Open Court on	23/02/2024
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Sd/-
(ANNAPURNA GUPTA)
ACCOUNTANT MEMBER
Ahmedabad; Dated 23/02/2024

TANMAY, Sr. PS

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आदेश की प्रतिलिपि अग्रहित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. संबंधित आयकर आयुक्त / Concerned CIT
4. आयकर आयुक्त(अपील) / The CIT(A)-
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, राजकोट / DR, ITAT, Rajkot
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार Dy./Asstt.Registrar)
आयकर अपीलीय अधिकरण, राजकोट / ITAT, Rajkot