IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "B", PUNE – VIRTUAL COURT

BEFORE SHRI R.S. SYAL, VICE PRESIDENT AND
SHRI PARTHA SARATHI CHAUDHURY, JUDICIAL MEMBER

ITA No. 2405/PUN/2017
निर्धारण वर्ष / Assessment Year : 2011-12

Devi Construction Company, 1161/10, Devi Niwas, Shivaji Nagar, Pune – 411 005 PAN : AAAFD8922A	Vs.	DCIT, Circle-2, Pune
Appellant		Respondent

Assessee by	Shri Kishor Phadke
Revenue by	Shri Mahadevan A.M. Krishnan & Shri Deepak Garg
Date of hearing	06-08-2020
Date of pronouncement	07-08-2020

आदेश / ORDER

PER R.S.SYAL, VP :

This appeal by the assessee emanates from the order dated 25.07.2017 passed by the CIT (A)-2, Pune, in relation to the assessment year 2011-12.

2. The first issue, on merits, in this case is against the confirmation of addition of Rs.27,16,280/- towards Hawala purchases made by the assessee from M/s. Parshwa Trading Company.

3. Facts anent to this issue are that the Assessing Officer (AO) obtained some information from the Sales Tax Department indicating that the assessee was one of the beneficiaries of transactions shown by some Hawala operators. The assessee had recorded purchases amounting to Rs.27,16,280/- from M/s Parshwa Trading Company, which was one of such Hawala operators. On this basis, a notice u/s.148 was issued. During the course of assessment proceedings u/s 147, the AO confronted the assessee with the details obtained *qua* the hawala transactions indicating bogus purchases of Rs.27,16,280/-. The assessee tried to explain the genuineness of the transactions but without success for the reasons indicated in the assessment order. This led to disallowance of Rs.27,16,280/-. The ld. CIT(A) affirmed the assessment order on this point.

4. We have heard the rival submissions and gone through the relevant material on record. The ld. AR did not seriously press the ground of genuineness of purchases, but insisted that even if the purchases were from hawala operators, still only the excess gross profit element ought to have been added instead of full amount of purchase. It is seen that the issue of bogus purchases came up for

consideration before the Hon'ble Bombay High Court in *Pr.CIT Vs. Mohommad Haji Adam & Co.* Vide its judgment dated 11-02-2019 in ITA No.1004 of 2016 and others, the Hon'ble jurisdictional High Court has held that no *ad hoc* addition for bogus purchases can be made. It laid down that the addition should be made to the extent of difference between the gross profit rate on genuine purchases and gross profit rate on hawala purchases. Such case specific details were not readily available either with the ld. AR or the ld. DR for facilitating the calculation of gross profit rate of genuine and hawala purchases. Under these circumstances, we set-aside the impugned order and remit the matter to the file of the AO for applying the *ratio* laid down by the Hon'ble jurisdictional High Court in the above noted case and recompute the amount of additions, if any, after allowing a reasonable opportunity of hearing to the assessee. Similar view has been taken by the Pune Benches of the Tribunal vide its order dated 26.09.2019 in a bunch of appeals led by Dinesh Rathi Vs. DCIT in ITA No.975/PUN/2017.

5. Ground No.4 is against the sustenance of disallowance at Rs.97,008/- out of the addition made by the AO on account of Vehicle and Telephone expenses.

6. The facts apropos this issue are that during the course of proceedings u/s 147 of the Income-tax Act, 1961 (hereinafter also called `the Act'), the AO observed that the assessee had claimed Telephone and Vehicle expenses at Rs.6,44,245/-, The assessee could not prove that such expenses were incurred wholly and exclusively for the purpose of business. Considering the fact that some personal use was involved, the AO made disallowance at 20% of expenses under both the heads, which amount came at Rs.1,94,016/-. The ld. CIT(A) reduced the rate of disallowance from 20% to 10%, thereby bringing down the amount of addition to Rs.97,008/-. The assessee is aggrieved by the confirmation of addition to this extent.

7. We have heard the rival submissions and gone through the relevant material on record. The ld. AR took a preliminary objection assailing the making of such addition in proceedings u/s.147 of the Act. It was contended that no fresh material *qua* the above addition came to the notice of the AO in the proceedings u/s

147 and hence he could not have made this addition on the basis of roving enquiries in the reassessment proceedings. He harped on the words `which comes to his notice subsequently' as employed in section 147 for bolstering his submission. This was countered by the ld. DR.

8. Relevant part of section 147 of the Act provides that : `If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153, assess or reassess such income *and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently* in the course of the proceedings under this section …'. This provision primarily refers to two components of income. The first component deals with the triggering of the jurisdiction of the AO and forms the basis for initiation of assessment or reassessment u/s 147, being the outcome of the AO having reason to believe about a specific income chargeable to tax escaping assessment. The second component, starts with the words `and also' *any other income* chargeable to tax which has escaped assessment and which comes to the notice of the AO subsequently

in the course of the proceedings under this section. This latter component is naturally *de hors* the subject matter of initiation of reassessment. An income is said to come to the notice of the AO when he finds for the first time during the course of proceedings u/s 147 that such income escaped earlier assessment. Whereas the first component must necessarily satisfy the relevant jurisdictional conditions of formation of valid reasons to believe by the AO, there is no such requirement for the second component to pass such tests. Once an assessment is validly reopened, the AO is free to assess income of the second component which comes to his notice in the course of the proceedings u/s 147.

9. Viewed in the light of the above discussion, it is seen that re-assessment in this case was initiated on the ground of bogus purchases and the addition on that score has been sustained hereinabove with a direction to the AO for recomputing the same in accordance with the law laid down by the Hon'ble Bombay High Court in *Pr.CIT Vs. Mohommad Haji Adam & Co. (supra).* Once the re-assessment proceedings are held to be validly initiated, we fail to find any eclipse on the powers of the AO in making addition towards any other income that escaped earlier assessment

and came to his notice in the course of the assessment proceedings u/s 147.

10. The ld. AR harped on the expression *"comes to his notice subsequently"* to bolster his submission that disallowance of expenses cannot be considered as income escaping assessment in the original round and coming to the notice of the AO subsequently. In our opinion, the expression `coming to the notice of the AO' does not mean that the AO, on finding some fresh escaped income during the course of reassessment proceedings, should quietly make the addition without confronting it to the assessee. The correct sequence of events for taxing the income of the nature of the second component is that when some *ex facie* income chargeable to tax, which earlier escaped assessment, comes to the notice of the AO during the course of proceedings u/s 147, he should confront the assessee with his point of view and seek comments before making the addition, if warranted, after making further enquiry. There is a palpable difference in two situations, viz., one, where some *ex facie* escaped income comes to the notice of the AO and he makes enquiry before making the addition and two, where enquiry is made before some *ex facie* escaped income

comes to the notice of the AO. To put the second situation simply, the enquiry itself results in digging out the escaped income coming to the notice of the AO in the proceedings u/s 147. What is prohibited u/s 147 is the second situation, namely, the enquiry preceding the escaped income coming to the notice of the AO and not *vice-versa*.

11. Adverting to the facts of the instant case, we find that the assessee claimed Vehicle and Telephone expenses in entirety without offering any *suo motu* disallowance on account of personal use by the partners, more so, when the vehicles and telephone were also admittedly used for non-business purpose as the assessee had not maintained any log books etc. to show their exclusive user for business purpose. Non-offering of such disallowance on account of personal use came to the notice of the AO during the course of proceedings u/s 147 of the Act. Once the position was such, we find no hesitation in holding that the test of such escaped income `coming to the notice of the AO' during the course of proceedings u/s 147, got fully satisfied inasmuch as the disallowance of the instant expenses duly answered the description of "any other income chargeable to tax which has escaped assessment and which

comes to his notice subsequently, in the course of proceedings in this section". *Ex consequenti,* the submission of the ld. AR in this regard is jettisoned.

12. Coming to the merits of the addition, it is seen that the assessee could not adduce proper evidence in support of Vehicle and Telephone expenses having been incurred wholly and exclusively for the purpose of business inasmuch as no log books for vehicle etc., were produced despite the AO's specific requisition. Considering the totality of the facts and circumstances prevailing in the instant case, we are satisfied that sustenance of disallowance at 10% of the expenses is reasonable and does not require any interference.

13. The next issue raised in this appeal is against the sustenance of disallowance of Rs.1,97,430/- made by the AO on account of Membership and Subscription fees.

14. Succinctly, the facts of this issue are that the assessee debited Rs.1,97,430/- towards Membership fees and Subscription expenses. On being called upon to furnish the details of such expenses, the assessee submitted that these expenses pertained to membership fees paid to clubs where partners were members.

Since such expenses, in the opinion of the AO, were incurred for the personal enjoyment by the partners, he disallowed the entire amount. During the first appellate proceedings, the assessee submitted that a sum of Rs.1,37,875/- was towards subscription fees paid to Times Business Solutions Ltd. towards Internet services of magicbricks.com, which was for business purpose. Not convinced, the ld. CIT(A) echoed the assessment order on this point.

15. Having heard both the sides and gone through the relevant material on record, it is seen that the assessee is engaged in the real estate sector. In such circumstances, subscription to magicbricks.com is obviously for the advancement of the business purpose. A sum of Rs.1,37,875/- included by the assessee in the overall expenditure of Rs.1,97,430/- under the head Subscription fees is held as deductible. As regards the remaining amount, the assessee could not substantiate the claim of such expenditure passing the test of commercial expediency and having been incurred wholly and exclusively for the purpose of business. The finding of the ld. CIT(A) is ergo affirmed *pro tanto* and the disallowance is sustained at Rs.59,555/-.

16. The only other issue on merits which is involved in this appeal is against the confirmation of addition of Rs.31,54,535/- made by the AO u/s. 36(1)(iii) of the Act.

17. Briefly stated, the facts of this ground are that the AO noticed that out of total investments of Rs.41 crore recorded in the books of assessee, investments to the extent of Rs.6.74 crore were in Plots/lands. As the assessee had incurred huge interest expenditure, the AO did not allow interest u/s.36(1)(iii) to the extent of Rs.31,54,535/- in relation to six investments made by the assessee, which have been tabulated at page 18 of the assessment order. The contention of the assessee that it was having enough own funds to invest in these properties and hence no disallowance was called for, did not find favour with the AO. He found that the assessee had taken interest bearing loan of Rs.10.83 crore and had also paid interest on capital contribution of partners. As the assessee claimed deduction for interest paid to partners at Rs.1.04 crore and to others at Rs.83.92 lakh, the AO held that interest relatable to Investments of Rs.6.74 crore was not deductible, which amount was computed at Rs.31,54,535/-. The ld. CIT(A) countenanced the assessment order on this count.

18. We have heard the rival submissions and gone through the relevant material on record. Section 36(1)(iii) provides for deduction of : `the amount of the interest paid in respect of capital borrowed for the purposes of business or profession'. It is thus overt that so long as the `business purpose' test is satisfied, there can be no disallowance of interest. `Business purpose' does not encompass only the revenue field, but also covers the capital sphere. If a loan is taken and some capital asset, say machinery, is purchased, interest on such a loan is also deductible in the same way as a loan is taken for satisfying working capital requirements. It is for the *raison d'etre* that as such loan for purchasing capital asset satisfies the requirement of business purpose.

19. The assessee under consideration is engaged in real estate sector. Thus, any investment made by it for purchase of land or building, whether as stock in trade or as a capital asset for its business purpose, falls within the realm of `business purpose'. Interest paid on the capital borrowed for such investment, satisfies the test of section 36(1)(iii) as it involves payment of interest; such interest being in respect of capital borrowed; and such capital having being used for the purpose of business.

20. Reverting to the factual scenario, we find from the table given on page 18 of the assessment order that there is reference to six types of investments made by the assessee, which have resulted in not allowing interest u/s.36(1)(iii) of the Act. There is no discussion about the purpose for which these properties were acquired. On a pointed query about the purpose of such investments, the ld. AR stated some of these properties were purchased for use in the business, while others were meant for let out, income from which is chargeable to tax under the head "Income from house property". Due to paucity of details, he was unable to classify as to which of these six properties were meant for earning `Business income' or "Income from house property". In view of the foregoing discussion, there can be no doubt that the provisions of section 36(1)(iii) will apply to allow interest in respect of the Investments made by the assessee for earning `Business income'. We, therefore, set-aside the impugned order on this score and direct the AO to verify the six investments, one by one, for ascertaining which of these were made for earning "Business income". There can be no question of disallowance of interest in respect of such Investments.

21. However, any interest relatable to investments meant for earning income under the head `Income from house property' cannot be allowed as deduction under the head `Profits and gains from business or profession' as the `business purpose' is wanting. The ld. AR strenuously argued that the assessee's capital was much more than the amount of investments and hence no disallowance was called for. He relied on the judgment of Hon'ble Bombay High court in *CIT Vs. Reliance Utilities and Power Ltd. (2009) 313 ITR 340 (Bom.)* for contending that if interest free funds available with the assessee are sufficient to meet its investment and at the same time, a loan is raised, it can be safely presumed that the investments were from interest free funds.

22. There is no quarrel on the proposition advanced by the ld. AR as the same is duly supported by the judgment of Hon'ble jurisdictional High Court. The moot question which is required to be answered here is as to whether any interest bearing funds were available with the assessee which could be construed to have been utilised for making such investments for non-business purpose. The ld. AR accentuated on the capital contribution by the partners for fortifying his point of view of the availability of interest free

funds. *Au contraire,* the AO has categorically noted that the assessee paid interest of Rs.1.04 crore on partners' capital balances. Once interest gets paid on capital of partners, such capital ceases to be interest free fund. The ld. AR pitched another facet of the contention that interest to partners on capital claimed u/s.40(b) is not the same as interest defined u/s.2(28A) and hence, interest to partners should not be considered for the purpose. This contention is again untenable. The logic behind *Reliance Utilities (supra)* is the presumption of utilization of interest free funds for making investments for non-business purpose. For application of this proposition, it is *sine qua non* that there should be some interest free funds available with the assessee, whether in the shape of capital or borrowings, which can then be presumed to have been utilized firstly towards Investments. If, on the other hand, there are no interest free funds, the presumption fails. Once the assessee paid interest on capital to partners, the capital no more remained interest free fund, notwithstanding the definition of interest u/s 2(28A) read in juxtaposition to section 40(b) of the Act. It is further noted that section 36(1)(iii) talks of allowing deduction towards interest on *capital borrowed*. The term `capital' here also refers to the amount borrowed and not the capital in strict sense as contributed by partners. Capital can never be borrowed as it is always contributed in contrast to a loan which is borrowed and not contributed.

23. In view of the above discussion, it becomes explicitly clear that the assessee did not have any interest free funds available at its disposal which could have been used for making investments for non-business purpose. To that extent, the disallowance of interest pertaining to the Investments made in relation to properties meant for non-business purpose, is rightly called for.

24. No argument was advanced in support of ground no.2 challenging the initiation of re-assessment proceedings except the part concerning with the disallowance of certain expenses, which aspect has been dealt with and rejected in an earlier para. This ground, therefore, fails.

25. In the result, the appeal is partly allowed.

Order pronounced in the Open Court on 07th August, 2020.

Sd/-	Sd/-
(PARTHA SARATHI CHAUDHURY)	**(R.S.SYAL)**
JUDICIAL MEMBER	**VICE PRESIDENT**

पुणे Pune; दिनांक Dated : 07th August, 2020
सतीश

<u>आदेश की प्रतिलिपि अग्रेषित/Copy of the Order is forwarded to</u>:

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. The CIT(A)-2, Pune
4. The Pr. CIT-1, Pune
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे "**बी**" / DR 'B', ITAT, Pune
6. गार्ड फाईल / Guard file

आदेशानुसार/ BY ORDER,

// True Copy //

Senior Private Secretary
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune

		Date	
1.	Draft dictated on	06-08-2020	Sr.PS
2.	Draft placed before author	06-08-2020	Sr.PS
3.	Draft proposed & placed before the second member		JM
4.	Draft discussed/approved by Second Member.		JM
5.	Approved Draft comes to the Sr.PS/PS		Sr.PS
6.	Kept for pronouncement on		Sr.PS
7.	Date of uploading order		Sr.PS
8.	File sent to the Bench Clerk		Sr.PS
9.	Date on which file goes to the Head Clerk		
10.	Date on which file goes to the A.R.		
11.	Date of dispatch of Order.		

*