IN THE HIGH COURT OF BOMBAY

Income Tax Appeal No. 1978 of 2011

THE COMMISSIONER OF INCOME TAX-10, MUMBAI

Vs

M/s MAHANAGAR GAS LTD

Mohit S Shah, CJ And M S Sanklecha, JJ

Dated : June 10, 2013

Appellant Rep. by : Mr. Suresh Kumar
Respondent Rep. by : Ms. Usha I. Dalal

JUDGEMENT

Per : M S Sanklecha, J :

This appeal by Revenue under Section 260A of the Income Tax Act, 1961 ("the Act") challenges the order dated 11 February 2011 passed by Income Tax Appellate Tribunal ("the Tribunal") for the assessment year 2004-05.

2) The Revenue seeks to raise the following questions of law for our consideration.

A) Whether on the facts and in the circumstances of the case and in law, the Tribunal was correct in confirming the order of CIT(A) in deleting the disallowance of Rs.76.76 lacs made by the Assessing Officer under Section 36(1)(iii) of the Income Tax Act?

B) Whether on the facts and in the circumstances of the case and in law, the Tribunal was correct in confirming the order of CIT(A) in deleting the disallowance of Rs.92,91,343/- made by the Assessing Officer on account of prior period expenses?

3) Regarding Question-A :-

(a) The Respondent-assessee filed its return of income for assessment year 2004-05 declaring a total income of Rs.100.76 crores. During the course of the assessment proceeding the Assessing Officer noted that the respondent had earned dividend income amount of Rs.63.73 lacs by way of dividend income from mutual funds. The dividend income earned from mutual fund was exempt from tax. However, the Assessing officer also noted that during the course of the year the Respondent-assessee had invested an amount of Rs.4147.44 lacs in mutual funds on which dividend was earned. The Assessing officer noticed that the Respondent-assessee had borrowed a sum of Rs.30 crores during the year and had paid total interest of Rs.613.26 lacs on the same. On the above basis the Assessing Officer concluded that the amount of Rs.4147 lacs was invested out of borrowed funds and disallowed expenditure on account of interest to the extent of Rs.77.76 lacs on the ground that the above interest was not attributable to business carried on by the Respondent-assessee. Thus, the Assessing Office disallowed the

expenditure of Rs.77.76 as interest under Section 36(1) (iii) of the said Act as not being for purposes of business.

(b) In appeal, the CIT (Appeals) found that the respondent assessee had invested its own funds for investment in mutual funds and not from the amount of loan of Rs.30 crores taken as External Commercial Borrowings (ECB). The loan of Rs.30 crores taken as ECB was utilized to repay a loan taken from Indian Oil Board of Rs.30 crores so as to take advantage of lesser rate of interest on ECB. The CIT (Appeals) also recorded a finding of fact that the investment in mutual funds was made directly from sales tax deferral amount available to Respondent-assessee. In view of the above, the CIT(Appeals) held that no amount of interest paid can be disallowed as no amount which was borrowed was invested in mutual funds.

(c) The Revenue carried the matter in appeal to the Tribunal. The Tribunal upheld that finding of fact arrived at by the CIT (Appeals) and held that no part of the borrowed funds of Rs.30 crores was utilized to make the investment in mutual funds. Further reliance was placed upon the decision of this Court in the matter of *CIT vs. Reliance Utility and Powers Limited reported in 313 ITR Page 340* wherein it has been held that where interest free funds were available with the assessee, the presumption has to be that investments have been made out of such interest free funds and not out of borrowed funds. In the above view, the appeal of the revenue was dismissed.

(d) The grievance of the Revenue before us is that the entire amount invested in mutual funds came out of a common fund maintained by the respondent assessee. Thus, the Respondent-assessee not having maintained separate account in respect of borrowed funds and own funds the disallowance of interest to the extent of Rs.76.76 lacs by the Assessing officer was justified. As against the above, the Counsel for the assessee submits that the issue is covered by the decision of the jurisdictional High Court in the matter of Reliance Utility and Power Limited (supra). Therefore, no substantial question of law arises for consideration by this Court.

(e) We find that both CIT (Appeals) and the Tribunal have arrived at a concurrent finding of fact that the investment in mutual funds was made by the Respondent-assessee out of its own funds and not out of interest bearing borrowed funds. Further, both the authorities have found that the entire borrowed funds of Rs.30 crores was utilized to repay the loan taken from Oil India Development Board of Rs.30 crores so as to take advantage of lesser rate of interest. Hence, there was no borrowed funds available with the Respondent-assessee to be invested in mutual funds. The aforesaid findings are findings of fact and the same is not shown to be perverse. Moreover, as held by this Court in the matter of Reliance Utility and Powers Limited (supra) when sufficient interest free funds were available with the assessee, the presumption has to be that investment was made out of such interest free funds. There is no requirement under the law that an assessee should have separate account in respect of non interest bearing funds from that of interest bearing funds to establish that the investments have been made out of its own funds i.e. non interest bearing funds.

In view of the above, we see no reason to entertain Question A as the same is based on finding of fact and on facts found is covered by the decision of this Court in the matter of Reliance Utility (supra) in favour of the Respondent assessee and against the Appellant-revenue.

4) Regarding Question B :

(a) In its return of income for assessment year 2004-05 while declaring total income of Rs.100.76 crores the Respondent-assessee claimed an expenditure of Rs.92.81 lacs as prior period expenses. The Assessing Officer disallowed the expenditure relating to prior period on the ground that as the respondent followed mercantile system of accounting expenditure relatable to an earlier year cannot be allowed as deduction in the assessment year under consideration. Thus an amount of Rs.92.81 lacs was added to the income of the Respondent-assessee.

b) In appeal, the CIT(A) held that the method of accounting consistently followed since many years by the respondent was that expenses were claimed as a liability as and when the bills were received even though the work was done in earlier year and not in the assessment year under consideration. The liability to make payment for work and services received in an earlier year was crystallized only in current assessment year when the bills were received by the respondent assesses from the person who did the work and/or rendered services. The CIT(A) also noted that the Assessing Officer had taxed income attributable to work rendered in the earlier years in the year under consideration depending upon the time when the amounts were crystallized. On the same principle, the expenses attributable to earlier years but crystallized in the year under consideration ought to be allowed. In view of the above, the CIT(Appeals) held that in view of the consistent practice followed by the Respondent-assessee and accepted by the Revenue the prior period expenses which were crystallized during the assessment year under consideration, on receipt of the bills are to be allowed as an expenditure.

(c) On further appeal by the revenue the Tribunal upheld the finding of fact arrived at by the CIT(Appeals) and held that prior period expenditure was claimed in respect of the bills received during the assessment year 2004-05, even though the work/services was received in an earlier year. This has been consistent practice followed by the respondent-assesses according to which the liability is to be accounted when the bills are received and the payments made in the subsequent year. Thus the appeal of the Respondent-assessee was allowed.

(d) The Revenue's grievance is that in mercantile system of accounting the respondent assessee has to account for the expenditure in the year in which the work/service was received by them and not when the bills were received by the respondent assesses.

(e) We find that the liability in respect of work/services rendered in earlier year was crystallized only on receipt of the bill in the current assessment year. Moreover, the method adopted by the respondent assesses has been accepted by the revenue for the earlier assessment year and also while accounting for the income earned in respect of the work done in earlier years. In the circumstances, the Revenue is required to adopt consistent approach and allow the expenditure which was crystallized during the assessment year under consideration as done in the earlier years. This finding of fact has not been shown to be perverse.

In view of the above we see no reason to entertain question B as the same does not raise any substantial question of law as it is essentially a finding of fact arrived at by two authorities concurrently.

5) Accordingly, the appeal is dismissed with no order as to costs.