

Court No. - 35

Case :- INCOME TAX APPEAL No. - 46 of 2016

Appellant :- M/S Venus Auto

Respondent :- C.I.T. -II, Agra

Counsel for Appellant :- Shambhu Chopra

Counsel for Respondent :- S.C., Krishna Agarawal

Hon'ble Bharati Sapru, J.

Hon'ble Saumitra Dayal Singh, J.

(Delivered by Hon'ble Saumitra Dayal Singh, J)

This income tax appeal, under Section 260 A of the Income Tax Act, 1961 (hereinafter referred to as the 'Act') has been filed by the assessee against the order of the Income Tax Appellate Tribunal, Agra Bench dated 06.11.2015, for A.Y. 2010-11.

The assessee is aggrieved by part of the Tribunal's order insofar whereby it has disallowed the claim of interest expenditure under section 36(1)(iii) of the Act and has, to that extent dismissed the appeal filed by the assessee.

The above appeal was admitted on the following two questions of law:-

- “1. *Whether on the facts and circumstances of the case was the learned ITAT legally justified in upholding the order of the CIT (Appeals) for directing the AO to recompute the disallowance of the interest when in fact the recomputed the ITAT has itself given a finding that the A.O. has not established the nexus between the interest bearing funds with interest free loans.*
2. *Whether on the facts and circumstances of the case was the learned ITAT legally correct and justified in upholding the CIT(A)'s order partly when, admittedly the lower authorities including the ITAT accepted that the assessee had interest free funds available with it of Rs. 39,45,705/- and loans of Rs. 4 lakhs to M/s Venus Satiata Vehicle Service Pvt. Ltd. were interest free made for business purposes.”*

The facts of the case briefly stated are that the assessee is engaged in trading in auto bikes. In the original assessment order for the assessment year 2010-11 dated 23.02.2013, the Assessing Officer disallowed, under section

36(1)(iii) of the Act, part expenditure claimed by the assessee, being interest paid on Rs. 58 lacs borrowed by it for business purpose. Thus, the Assessing Officer made an ad-hoc disallowance of Rs. 5,00,000/- under Section 36 (1) (iii) of the Act.

According to the Assessing Officer the assessee was not eligible to claim interest expenditure on the interest bearing loan of Rs. 58,00,000/- taken by it as the assessee had in its books recorded interest free loans given by it for non business purpose of value Rs. 92.75 lacs.

Further, in the course of the assessment proceedings the assessee had offered an explanation that the interest free loans had been given by it from interest free advances available with it and that it also had available Rs. 1.80 crores by way of partner's capital. However, the assessing officer rejected this explanation with the observation that the assessee had failed to substantiate it.

Upon appeal to the Commissioner, the assessee further clarified that out of Rs. 92.75 lacs standing in its books as interest free loans given by it, it had, in the previous year relevant to the assessment year 2010-11, given out only Rs. 75,000/- and that the balance of Rs. 92 lacs had been given out as interest free loans in earlier years prior to previous year relevant to A.Y. 2010-11. Also, the assessee further clarified that in the previous year relevant to the assessment year 2010-11 it had available with it Rs. 39,45,705/- by way of interest free advances from customers that were sufficient to give a loan of Rs. 75,000/- in that year.

It was thus explained that in the previous year relevant to the assessment year 2010-11 the only interest free loan given by it was of Rs.75,000/- from non interest bearing advances available with the assessee to the tune of Rs. 39,45,705/-. As such no part of the interest bearing borrowing was claimed to have been utilized by the assessee for giving non interest bearing loan.

The Commissioner of Income Tax (Appeals) however required the assessee to explain the purpose of making such loans. To that the assessee had explained that the loans had been given to the business concerns owing to commercial expediency and not to any individual for their personal use. In that

regard the assessee had given a written explanation which it would be profitable to extract here itself:-

“1.As submitted in written submission dated 29.10.2014, the grievance taken in ground no. 3 of the appeal is in respect of lump sum disallowance of Rs. 5 lac out of total interest paid. In this connection, it is respectfully submitted that interest free advance or the advance for share was given to the business concerns and not to any individual or the partner or to any relative. Since the advance is given by the assessee to a business concern, the commercial expediency is established.

2. Further, the judgment of Hon'ble Allahabad High Court passed in the case of CIT Vs. Sahu Enterprises (P) Ltd. [2013] 31 taxmann.com 270 (Allahabad) specifically deals with the situation when advance is given to relatives or the directors out of borrowed funds. Since, the appellant has not given advance to any relative or to its partner, the findings of judgment (supra) are not applicable. Findings in para 22 are relevant as the appellant has its own funds of Rs. 1.8 crore.

For immediate consideration, the following details may kindly be appreciated--

A.Y. 2009-10	Particulars	A.Y. 2010-11	Sch.	Particulars	A.Y. 2010-11	A.Y. 2009-10
13029838	Owned fund (Partner Capital)	15735250	Sch. 1	SNG Buildwell	2675000	2600000
1394374	Adv. From Customers (Intt. Free)	3945705	Sch. 6	Venus Auto Sales & Services	4750000	4750000
			Sch. 2	Venus Satiare Vehicles (Share App.)	400000	400000
				Venus Ventures	1450000	1450000
14424212	Total	19680955		Total	9275000	9200000

It is humbly submitted that proving commercial expediency is required only when borrowed funds are diverted as interest free advance but no such requirement, as expected to be proved when there are sufficient owned funds. From the tally given above, your honour will kindly appreciate that the interest free advance is much less than the owned funds of the appellant.....”

The CIT (Appeals) however, rejected the claim made by the assessee by relying on a Division Bench judgment of this Court in the case of **Commissioner of Income Tax-I, Lucknow Vs. Sahu Enterprises (P.) Ltd. (2013) 352 ITR 8**, wherein as the CIT (Appeals) has noted, it has been held

“The test to be applied in such cases is not the source of the funds but the purpose for which the loans were extended.”

Thus the CIT (Appeals) was of the view that it would be irrelevant for the purpose of claim made under Section 36 (1) (iii) of the Act to examine whether the assessee had his own funds available from which it had given interest free loans and that it would be relevant for the assessee to establish business purpose for making such a loan.

Further, the CIT (Appeals), in exercise of his powers to enhance the assessment, issued directions to the Assessing Officer to compute the interest by applying the product computation method taking the period during the year and consideration for which loan was given to the sister concern remained outstanding and the rate of interest on which interest was paid by the assessee (appellant) firm on the borrowed monies.

Upon further appeal, the Tribunal has by the impugned order, after making note of the submission of the assessee that it had given loan of only Rs. 75,000/- in the previous year relevant to the assessment year 2010-11 while it had available with it interest free advances from its customers of Rs. 39,45,705/- and partners capital of Rs. 1,57,35,250/-, directed the Assessing Officer to recompute the disallowance by giving benefit to the assessee of Rs. 39,45,705/-, being interest free advance available with it and of another Rs. 4 lacs advanced to one Venus Satiata Vehicle Service Pvt. Ltd. which advance has been believed to be made for business purposes.

However, the Tribunal rejected the claim of the assessee that it had also available to it by way of interest free funds in the shape of partners capital. This finding of the Tribunal has not been questioned by the assessee as such we are not examining its correctness in this appeal.

Also, it appears that the Tribunal has considered the figure of total loan (given by the assessee) standing in the books of assessee being Rs. 92,75,000/- for the purpose of considering expenditure claim made under Section 36 (1) (iii) of the Act for the assessment year 2010-11 while it was the case of the assessee that it had advanced only Rs. 75,000/- in the previous year relevant to

the assessment year 2010-11 and the balance of Rs. 92,00,000/- was the closing balance of the previous year relevant to the assessment year 2009-10. No finding has been recorded by the Tribunal on the total amount of interest free loan given by the assessee during the previous year relevant to A.Y. 2010-11.

We have heard Sri Shambhu Chopra, learned counsel for the appellant-assessee and Sri Krishna Agarwal, learned counsel for the respondent-department as also perused the record.

We find that there are two aspects in the matter. First, the quantum of interest free advance given by the assessee in the previous year relevant to the assessment year 2010-11 and the other being the amount of own funds or non interest bearing funds available with the assessee for the purpose of making the interest free advance in the previous year relevant to the assessment year 2010-11.

In the original assessment proceedings the Assessing Officer considered the entire amount of closing value of interest free loan found standing in the books of account of the assessee as on 31.03.2010, which totaled Rs. 92.75 lacs which the assessee probably did not bifurcate and it did not show to the Assessing Officer as to what part of that amount it had advanced in the previous year relevant to the assessment year 2010-11.

While before the CIT (Appeals) the assessee did give separately, full details of interest free loans given by it, during the previous year relevant to A.Y. 2009-10 as also 2010-11, the CIT (Appeals) after recording the submission of the assessee did not record any finding on the issue but disallowed the grounds of appeal raised before him in view of the Division Bench Judgment of this Court in **CIT Vs. Sahu Enterprises (P.) Ltd.** (supra).

In that case it was an admitted fact that in the relevant year the assessee did not have available with it own funds for the purpose of giving interest free loans and that interest free loans had been given by that assessee to its Directors and their family members for their personal use from out of its interest bearing borrowings. In such circumstances, this Court had concluded that the test of commercial expediency was not satisfied and therefore

disallowance of interest under Section 36 (1) (iii) of the Act was held justified. To that extent there is no doubt and we are in agreement with the same.

However in the end, this Court had also observed that the test commercial expediency would have to be applied irrespective of the source of the fund from which interest free advance had been made. While making the said observation, it appears that the earlier judgments of this Court in the cases of **CIT Vs. M/s Radico Khaitan 1982 UPTC 82**; **CIT, Agra Vs. Krishna Murari Lal Agarwal Surya Nagar Agra, ITA No. 333 of 2013 decided on 26.11.2013** and **CIT, Lucknow Vs. M/S Appolo Trade Links, Moradabad, ITA No. 28 of 1996 decided on 27.04.2005** had not been brought to its knowledge and were thus not considered.

In **CIT Vs. M/s Radico Khaitan 1982 UPTC 82**, in para 25, this court held as below:

“25. In view of the findings recorded by the Tribunal that the assessee Company has sufficient fund other than the borrowed money for giving the amount in question as loan to its sister concern, which finding has not been specifically challenged in the present appeal, we are of the considered opinion that the conditions of Section 36 (1)(iii) of the Act have been complied with and, therefore, the assessee Company was entitled to full allowance of the amount of interest paid by it on borrowed capital. Moreover, the Assessing Officer himself had not allowed the proportionate amount of interest on the aforesaid loan during the relevant assessment year when the said loan had been advanced by the assessee Company to its sister concern. The Tribunal has rightly deleted the disallowance of proportionate interest on this count.”

Then in **CIT, Agra Vs. Krishna Murari Lal Agarwal Surya Nagar Agra** (supra) the appeal had been heard on question no.5 which is quoted herein below:-

“5. *Whether the Hon'ble ITAT was legally correct in deleting the addition of Rs.1,34,794/- made by AO u/s 36 (1) (iii) of the Act ignoring the fact that the assessee was compelled to resort to borrowing on interest due to diversion of his own funds for purpose (s) other than his own business.*”

On that question the Court held as under:-

“10. *On question no.5 we find that the Tribunal recorded the findings that the assessee in his individual account was having*

sufficient capital of Rs.1,78,85,290/-. Even if he had given the amount as interest free loan of Rs.1,73,38,986/- to his family members, that by itself could not be put to doubt and on which the interest was disallowed under Section 36 (1) (iii) of the Act.

11. *The AO added Rs.1,78,85,290/- as interest on the ground that the amount was not advanced by way of any business expediency. The Tribunal, however, held that where the amount was not advanced from the business, but was the capital of the assessee, he could have advance to his family members.*

12. *The question no.5 is also concluded by findings of fact recorded by the Tribunal, which is the final court of fact and thus does not arise for consideration of the Court.”*

Also, in the case of **CIT Vs. M/S Appolo Trade Links, Moradabad** (supra) this Court had held as under:-

“This Court in the case of Commissioner of Income Tax, Bareilly and another Versus M/s Radico Khaitan Ltd., Rampur reported in 2005 UPTC, 82 had considered this aspect and has held that where the amount of any interest free loan is sufficiently covered with the non interest bearing fund available with the assessee, the question of disallowance of interest on borrowed fund does not arise. This view has been followed by this Court in Income Tax Reference No. 89 of 1996 Commissioner of Income Tax, Meerut Versus M/s Prem Heavy Engineering works (P) Ltd. Meerut.”

While we may have otherwise been detained on the issue of precedential value of the judgment in the case of Sahu Enterprise (P.) Ltd. (Supra), to the extent it holds “The test to be applied in such cases is not the source of the funds but the purpose for which the loans were extended.”, the issue now stands conclusively resolved by the Supreme Court in the case of **Hero Cycles Private Ltd. Vs. CIT Central Ludhiana 2015 (379) ITR 347** wherein one of the two issues (in that case) had arisen in respect of interest free advance of Rs. 34,00,000/- given by that assessee to its own directors, commensurate to which amount, interest expenditure on borrowed funds had been disallowed by its Assessing Officer.

In the above facts, the Supreme Court in para 16 of the judgment has held as under:-

“16. *Insofar as the loans to Directors are concerned, it could not be disputed by the Revenue that the assessee had a credit balance in the Bank account when the said advance*

of Rs. 34 lacs was given. Remarkably, as observed by the CIT (Appeal) in his order, the company had reserve/surplus to the tune of almost 15 crores and, therefore, the assessee company could in any case, utilise those funds for giving advance to its Directors.”

Thus it is clear that the judgment of the three earlier division bench in the cases of **CIT Vs. M/s Radico Khaitan 1982 UPTC 82; CIT, Agra Vs. Krishna Murari Lal Agarwal Surya Nagar Agra, and CIT, Lucknow Vs. M/S Appolo Trade Links, Moradabad** discussed above are good law and the later division bench decision in the case of **CIT Vs. Sahu Enterprises (P) Ltd.** in so far as it holds that the test of business expediency must be satisfied by the assessee irrespective of the source of funds (from which it may have made interest free loans) is not good law being inconsistent with the law laid down by the Supreme Court in the case of **Hero Cycles Private Ltd. Vs. CIT Central Ludhiana 2015 (379) ITR 347**, that besides the fact judgement in CIT Vs. Sahu Enterprises (P) Ltd (supra) was pronounced in ignorance of or without considering the earlier categorical and consistent view of this court expressed in three earlier division bench pronouncements.

Thus, on a principle of law it is no longer open to the revenue to disallow interest expenditure under section 36(1)(iii), if it is established as a fact that interest free loans were given by the assessee from its own funds or from funds which are not part of its interest bearing borrowings. To this extent the order of the CIT appeals is patently wrong.

Coming to the order of the Tribunal we find that the Tribunal has misdirected itself and also not decided the issue in light of the law expounded by the Supreme Court in **Hero Cycles Private Ltd. Vs. CIT Central Ludhiana 2015 (379) ITR 347**. In fact, the Tribunal has returned what we consider only half a finding necessary to decide the issue as it has directed the Assessing Officer to grant benefit of entire amount of Rs. 39,45,705/- that was available with the assessee by way of interest free advance from customers. The Tribunal has thus, by necessary implication, accepted the claim made by the assessee - that Rs. 39,45,705/- was available with the assessee by way of interest free advance in the relevant period.

However, the Tribunal has failed to record any finding on the second

part of the claim made by the assessee namely that in the previous year relevant to the assessment year 2010-11 the assessee had given, by way of interest free loan Rs. 75,000/- only. If that claim were to be found to be correct then in view of the finding of the Tribunal that the assessee had available interest free advance to the tune of Rs. 39,45,705/-, no disallowance would be warranted under section 36(1)(iii) of the Act.

Thus, it appears that the Tribunal has misdirected itself and has recorded incomplete finding inasmuch as the Tribunal has failed to record any finding as to the amount of interest free loan given by the assessee in the previous year relevant to A.Y. 2010-11.

In this context it has also been contended by Shri Krishna Agarwal that even if the assessee is found to have granted interest free loans of Rs. 92 lacs in earlier years - all prior to previous year relevant to A.Y. 2010-11, the department could still disallow interest expenditure A.Y. 2010-11 for reason of the assessee not having sufficient interest free advances available with it in previous year relevant to A.Y. 2010-11 to cover the entire amount of interest free loans standing in its books at Rs 92,75,000/-.

This submission cannot be accepted. First, there is no statutory intention either express or implied available to advance or infer such intendment. Second, it would, if accepted, run contrary to the concept of each assessment year being an independent unit as the assessing authority would then be looking at facts occurring in two or more previous years relevant to two or more different assessment years to allow or disallow interest expenditure incurred in each year. Three, different conclusions as to allowability of interest expenditure on same interest free loan may then be recorded in different assessment years, depending on the quantum of interest free advance available in each year. Four, from a businessman's stand point it would introduce impracticality in his business and other dealings, for if in a year, upon surplus amount being available and in absence of any business need existing at that point of time, he may give an interest free loan to his family members. Later, in a subsequent year he may feel the need for fresh business funds which he may borrow against payment of interest. It cannot then be said that such a businessman may

either first recall the interest free loan advanced by him in the earlier year and only thereafter proceed to borrow funds or else face disallowance of interest expenditure on borrowed funds under section 36(1)(iii) of the Act.

Such a rule, if accepted, would actually be a prescription against giving of any interest free sum to any one for any non-business purpose and may in fact curb the human nature to help another person in need of money by giving interest free loan on a return-when-able basis. There is neither any legal or other basis for such a rule or principle which we observe would be unreasonable and impractical and wholly undesirable to accept.

Each assessment year being a separate unit, the disallowance of interest expenditure in such circumstances cannot be based on the closing balance of interest free loan in a given year. Rather, the Assessing Officer may examine the amount of interest free loan given in the previous year relevant to the assessment year in question and only if the Assessing Officer is satisfied that the assessee had not available to it, sufficient own funds to give such a loan in that year he may invoke section 36(1)(iii) of the Act and disallow such interest expenditure as may be warranted and not otherwise.

An assessee who had available to him sufficient own funds or interest free funds in any previous year and had given the interest free loans in that previous year itself would only be burdened to establish only that much i.e. he advanced the said loan/s from such interest free advances or surplus funds, and no more. Once this is established no disallowance under section 36(1)(iii) of the Act would be warranted against interest paid on business borrowings for reason of having given interest free loans.

Thus, while the Tribunal has found Rs. 39,45,705/- were available by way of interest free advance with the assessee and that disallowance under Section 36(1)(iii) of the Act, commensurate to such deposit was not warranted, yet there is a total lack of any finding as to the amount of interest free loan given by the assessee in the previous year relevant to the assessment year 2010-11, both by the Tribunal and also by the CIT (Appeals).

We are therefore of the view that the questions of law raised in the memo of appeal deserve to be answered partially in favour of the assessee to

the extent that in view of the finding recorded by the Tribunal as to availability of Rs. 39,45,705/- by way of interest free advance, the Tribunal was further required to record a finding as to the amount interest free loan given by the assessee in the previous year relevant to the assessment year 2010-11.

If such a finding of the Tribunal were to the effect that the amount interest free loan given by the assessee in the previous year relevant to the assessment year 2010-11 was not more than the aforesaid amount of Rs. 39,45,705/- then, in view of the law laid down by the Supreme Court in the **Hero Cycles Private Ltd. Vs. CIT Central Ludhiana 2015 (379) ITR 347** the assessee would not be liable to suffer any disallowance of the interest expenditure under Section 36(1)(iii) of the Act.

In view of the above the questions of law raised by the assessee in the memo of the appeal are answered partially in favour of the assessee, as indicated above. Consequentially, the matter is further remitted to the Tribunal, only to record a specific finding as to the amount of interest free loan given by the assessee in the previous year relevant to A.Y. 2010-11 and to pass consequential orders in accordance with what has been observed above.

The Tribunal may complete the exercise in remand within a period of six months from the date of production of certified copy of this order which may be produced before the Tribunal by the assessee within a period of two weeks from today.

The appeal stands partly allowed. No order as to costs.

Order Date:10.03.2017

Lbm/-