

IN THE HIGH COURT OF KERALA AT ERNAKULAM

PRESENT:

THE HONOURABLE MR.JUSTICE ANTONY DOMINIC
&
THE HONOURABLE MR. JUSTICE DAMA SESHADRI NAIDU

MONDAY, THE 6TH DAY OF JUNE 2016/16TH JYAISHTA, 1938

ITA.No. 1341 of 2009

AGAINST THE ORDER IN ITA 677/2007 of I.T.A.TRIBUNAL,COCHIN BENCH DATED 29-05-2008

APPELLANT/APPELLANT:

THE COMMISSIONER OF INCOME TAX,
COCHIN.

BY ADVS.SRI.P.K.R.MENON, SR.COUNSEL, GOI (TAXES)
SRI.JOSE JOSEPH, SC, FOR INCOME TAX

RESPONDENT/RESPONDENT:

M/S. ALAPATT BROTHERS,
KOCHI-11.

THIS INCOME TAX APPEAL HAVING BEEN FINALLY HEARD ON 06-06-2016 ALONG
WITH ITA 1344/09, THE COURT ON THE SAME DAY DELIVERED THE FOLLOWING:

ITA.No. 1341 of 2009 (C)

APPENDIX

PETITIONER'S ANNEXURES:

ANNEXURE A: COPY OF ASSESSMENT ORDER DATED 26.12.2006 FOR THE ASSESSMENT YEAR 2004-05.

ANNEXURE B: COPY OF ORDER DATED 18.4.2007 OF THE COMMISSIONER OF INCOME TAX (APPEALS).

ANNEXURE C: CERTIFIED COPY OF THE ORDER DATED 29.5.2008 OF THE INCOME TAX APPELLATE TRIBUNAL, COCHIN BENCH IN ITA NO.677/COCH/2007.

// TRUE COPY //

P.A. TO JUDGE

ANTONY DOMINIC & DAMA SESHADRI NAIDU, JJ.

I.T.A.Nos.1341 & 1344 of 2009

Dated this the 6th day of June, 2016

JUDGMENT

Antony Dominic, J.

These appeals are filed by the Revenue challenging the orders passed by the Income Tax Appellate Tribunal, Cochin Bench in I.T.A.Nos.677 and 676 of 2007. Annexure A assessments orders in these appeals were passed by the Assessing Officer, under Section 143(3) whereby interest expenses relatable to interest free advances were disallowed in terms of the provisions contained in Section 36(1)(iii) of the Income Tax Act. In the appeals that were filed by the assessee before the Commissioner Income Tax (Appeals), Annexure B orders were passed, allowing the appeals. Revenue carried the matter in appeals before the Tribunal and by the impugned Annexure C orders, the Tribunal dismissed the appeals. It is in this context, these appeals are filed and the main question of law raised is whether the Tribunal was right in allowing the deduction under Section 36(1)(iii) of the Income Tax Act.

2. We heard the Senior Counsel for the Revenue and the learned counsel appearing for the assessee.

3. Learned counsel appearing for the assessee questioned the maintainability of these appeals placing reliance on Circular No.21/2015 dated 10.12.2015 issued by the CBDT. According to the learned counsel, since the tax effect in these cases is less than 20 lakhs, in view of the provisions contained in the Circular, these appeals are liable to be withdrawn by the Revenue. Though we find that such a Circular has been issued by the CBDT, in the context of a Circular 3/11 issued in 2011, the Supreme Court itself has clarified in the judgment in Commissioner of Income Tax Central III v. Surya Herbal Limited [(2011) 15 SCC 482] that the High Court shall not dismiss the appeals merely with reference to the Circular and particularly cases involving issues having cascading effect. We also find that referring to Circular No.3/11, which preceded Circular No.21/2015 (supra), the Karnataka High Court in the judgment in Commissioner of Income Tax and another v. Ranka and Ranka [2013]

352 ITR 121 (Karn) took the view that it is for the department to apply its mind in all pending appeals and point out to the court, which are those appeals which it intends to prosecute. Therefore, it is essentially for the department to take a decision on the appeals which they intend to withdraw or prosecute. Therefore, having given our anxious consideration to the contents of the Circular and the law governing the same, we are of the view that these appeals involving a substantial question of law deserve to be considered on merits. Therefore, we reject the preliminary objection raised by the counsel for the assessee.

4. Section 36(1) of the Income Tax Act provides that, in computing the income referred to in Section 28 the deductions provided for in the various clauses of the said Section shall be allowed. One of the matters dealt with in Clause (iii) is the amount of interest paid in respect of capital borrowed for the purposes of the business or profession. This Section came up for consideration before this court, various other courts and the Apex Court.

5. In the judgment in CIT v. V.L.Baby and Co. 254 ITR 248 (Ker), a Division Bench of this court considered this provision and held that in a case where interest free advance was given by the assessee and deduction is claimed, the question to be considered is what is the benefit that is derived by the assessee by giving such interest free advance. It was also held that so long as the assessee is not the beneficiary of the investments made by the partners, their relatives and the sister concerns from out of the interest free advances, the Assessing Officer is perfectly justified in disallowing interest in proportion to the advances made. Subsequently, the Honourable Supreme Court also had occasion to consider the provisions of Section 36(1)(iii) in the judgment in S.A.Builders Ltd. v. CIT (Appeals) [2007] 288 ITR 1 (SC). In that case, after a detailed examination of the provisions, the Supreme Court held that when a claim for deduction under Section 36(1)(iii) is made, the authorities should enquire as to whether the interest free loan was given as a measure of commercial expediency and on facts if it is so

found, deduction is liable to be allowed. The court also explained that the expression “commercial expediency” is an expression of wide import and includes such expenditure that a prudent businessman incurs for the purpose of business and that such expenditure may not have been incurred under any legal obligation.

6. Having thus understood the scope of Section 36(1)(iii), we shall now turn to the orders impugned before us. Annexure A is the Assessment Order. Reading of this order shows that in response to the notice that was issued, assessee had produced the books of accounts and claimed the benefit of deduction. Without advertng to the facts that were urged by the assessee or examining whether the assessee had derived any benefit from the advances made or whether such advances were made on commercial expediency, the claim was disallowed merely referring to some judgments including the judgment in CIT v. V.I.Baby and Co. [254 ITR 248 (Ker)] and CIT v. Abhishek Industries Ltd. [286 ITR 1]. Insofar as the order that was passed by the Commissioner of Income Tax (Appeals) is concerned,

in that order also, by merely making reference to the records produced by the assessee, the Commissioner has made certain factual assumptions without any basis and it is on such erroneous assumption that the Commissioner has set aside the order passed by the Assessing Officer. It is also seen from paragraphs 2 and 3 of the order that the Commissioner has faulted the Assessing Officer for having not understood the basic accountancy and facts of the case. Though the Commissioner has referred to the judgment in S.A.Builders Ltd. v. CIT (Appeals) [2007] 288 ITR 1 (SC), the question as to how the principles therein would apply to the facts of the case, has not been examined.

7. Similar assumptions have been made by the Tribunal in Annexure C orders. Reading of the order passed by the Tribunal would show that, it has held that its work is only to decide whether the borrowed capital is used for the purpose of business. Thereafter without any further discussion, it has concluded that the

funds advanced to the sister concerns were out of business expediency.

8. According to us, all the three orders are totally unsustainable for the reason that the test for extending the benefit of Section 36(1)(iii) laid down by this court and Apex Court were not applied to the facts of the cases. For that reason, we set aside the orders impugned and answering the questions of law in favour of the revenue, these appeals are disposed of remitting the matter to the Assessing Officer who shall reconsider the cases of the assessee, after issuing notice to the parties.

Appeals are disposed of accordingly.

Sd/-
ANTONY DOMINIC
JUDGE

Sd/-
DAMA SESHADRI NAIDU
JUDGE

jes