

IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 08TH DAY OF SEPTEMBER 2015

PRESENT

THE HON'BLE MR.JUSTICE VINEET SARAN

AND

THE HON'BLE MR.JUSTICE B MANOHAR

ITA Nos. 465 & 720-721 OF 2009 (IT)

BETWEEN :

M/S. EMBASSY DEVELOPMENT CORPORATION,
REP. BY ITS PARTNER SRI. NARPAT
SINGH CHORARIA,
1ST FLOOR, EMBASSY POINT,
150, INFANTRY ROAD,
BANGALORE – 560 001.

... APPELLANT

(BY SRI. A.SHANKAR & M.LAVA, ADVS.,)

AND:

THE ASSISTANT COMMISSIONER
OF INCOME-TAX,
CENTRAL CIRCLE-2(3),
C.R.BUILDING,
QUEENS ROAD,
BANGALORE – 560 001.

... RESPONDENT

(BY SRI. K.V.ARAVIND, ADV;
SRI. G.KAMALADHAR, ADV)

THESE INCOME TAX APPEALS ARE FILED UNDER SECTION 260-A OF I.T. ACT, 1961 ARISING OUT OF ORDER DATED 08-05-2009 PASSED IN ITA NO.738 TO 740/BNG/2008, FOR THE ASSESSMENT YEARS 2000-01 TO 2002-03, PRAYING THAT THIS HON'BLE COURT MAY BE PLEASED TO:

- (i) FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED THEREIN,
- (ii) ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE ITAT BANGALORE IN ITA NOS.738 TO 740/BNG/2008, DATED 08-05-2009 IN THE INTEREST OF JUSTICE AND EQUITY.

THESE APPEALS COMING ON FOR HEARING AND RESERVED FOR ORDERS ON **10/08/2015**, THIS DAY **B.MANOHAR J.**, PRONOUNCED THE FOLLOWING:

JUDGMENT

The assessee has preferred these appeals under Section 260-A of the Income Tax Act, 1961 (hereinafter referred to as '**the Act**' for short) being aggrieved by the common order dated 08-05-2009 made in ITA No.738-740/BNG/2008 passed by the Income Tax appellate tribunal, Bangalore Bench (hereinafter referred to as '**the Tribunal**' for short) confirming the order passed by

the Commissioner, Income Tax (Appeals)-V, Bangalore, (hereinafter referred to as '**the First Appellate Authority**' for short) as well as the assessment order passed by the assessing authority for the assessment years 2000-01 to 2002-03 disallowing the interest expenditure.

2. The assessee is a partnership firm which is in the business of real estate and construction of commercial and residential complexes. It has filed its return of income for the assessment years 2000-01 to 2002-03. The Assessing Officer processed the return under Section 143(1) of the Act. Subsequently, return of income was selected for scrutiny and notices under Section 143(2) and under Section 142(1) were also issued calling upon the assessee to furnish the necessary particulars. The authorized representative of the assessee appeared before the Assessing Officer and produced necessary documents contending that the

assessee availed a sum of Rs.2.50 crores from M/s. Karnataka State Industrial Investment and Development Corporation (hereinafter referred to as **“the KSIIDC”** for short) as medium term corporate loan on 23-07-1999 and 26-07-1999. Immediately thereafter, during the period from 23-07-1999 to 29-09-1999, an amount of Rs.248.10 lakhs was advanced to Dynasty Developers Private Limited, which is a sister concern of the assessee, carrying on construction of various commercial and residential projects. The authorized representative of the assessee contended that the borrowed amount advanced to its sister concern was in the nature of sale consideration that was being paid to the sister concern for the purpose of acquiring a portion of the property in the project proposed to be developed in the name and style **“Embassy Meadows”**. As per the agreement, the assessee was allotted a portion of the proposed building measuring 30000 sq.ft. along with 25 covered car park

units in the project of “Embassy Meadows” for the total sale value of Rs.3.25 crores. The whole amount was being paid for the purpose of acquisition of the said properties and sought for deduction of interest paid on the loan availed by the assessee for the assessment years 2000-01 to 2002-03. However, the Assessing Officer disallowed the assessee’s claim of interest paid, on the ground that though the assessee availed loan from KSIIDC, the same was diverted to its sister concern, the amount received was not utilized for the business of the assessee and no income has been accrued to the assessee. The sister concern of the assessee has also not utilized the said amount for the purpose of the project. Hence, the assessee is not entitled for deduction of interest. Further, the Assessing Officer also denied some of the other deductions under Section 43D towards the expenditure incurred for registration of documents, the expenditure claimed towards repairs under the head of house

property for the assessment years 2000-01 to 2002-03 and called upon the assessee to pay tax on the interest amount on Rs.30,49,721/- for the assessment year 2000-01, Rs.26,80,935/- for the assessment year 2001-02, Rs.30,28,155/- for the assessment year 2002-03. Being aggrieved by the same, the assessee preferred three appeals before the First Appellate Authority, challenging the three assessment orders on various grounds. The First Appellate Authority, after considering the matter in detail and taking into consideration the judgments of various High Courts, while partly allowing the appeals, denied the expenditure on interest for the three assessment years by its order dated 18-03-2008. The assessee being aggrieved by the order passed by the First Appellate Authority preferred three appeals before the Tribunal. The Tribunal after considering the matter in detail held that though the assessee availed loan for its business, the said amount was not utilized for its business

whereas the same was diverted to its sister concern, Dynasty Developers Private Limited Company (hereinafter referred to as **‘the DDPL’** for short). The veracity of exchange of letter between the assessee and its sister concern to treat the loan as an advance payment for the area to be purchased in the so called project “Embassy Meadows”, was not above board. The said DDPL has not yet started the Project. Hence, the assessee is not entitled for any deduction towards interest paid on the loan availed and dismissed the appeals. However, some relief was given insofar as other expenditure is concerned. The assessee being aggrieved by the order passed by the Tribunal, has preferred these appeals.

3. These appeals were admitted on 11-11-2009 to consider the following substantial questions of law:

- (i) *Whether the Tribunal was justified in law in disallowing interest on borrowed loan on the facts and circumstances of the case?*

- (ii) *Whether the Tribunal failed in law to apply the ratio of the Apex Court in S.A.Builders Vs. CIT reported in 288 ITR 1(SC) in matter of commercial expediency of appellant on the facts and circumstances of the case?*
- (iii) *Whether the Tribunal was justified in law in holding that earning of income is precondition for allowing expenditure under Section 36(iii) of the Act.*
- (iv) *Whether the Tribunal was justified in law in not following the decision of Apex Court in CIT Vs Rajendra Prasad Moody reported in 115 ITR 519 and CIT Vs Indian Bank Limited reported in 56 ITR 77 on the facts and circumstances of the case?*

4. Sri.A.Shankar, learned counsel appearing for the assessee contended that the order passed by the Tribunal confirming the orders passed by the First Appellate Authority and Assessing Authority insofar as disallowing the expenditure with regard to interest for the assessment years referred to above is contrary to law. The assessee is in the real estate business and construction of commercial and residential complexes and advanced money to various properties through its

sister concerns for which one of the Partners of the assessee is also a Director. The assessee availed loan from the KSIIDC as medium term corporate loan. The said loan amount was invested in a sister concern under the name and style of Dynasty Developers Private Limited (DDPL). In consideration of the said amount being paid to the sister concern by the assessee, the assessee was allotted a portion of the property to be developed by the sister concern admeasuring 30000 sq. ft. and 25 covered car park area. The amount being advanced to its sister concern was in the nature of sale consideration that was being paid to the sister concern for the purpose of acquisition of a portion of the property in the proposed project of its sister concern in the name and style, "Embassy Meadows". The advance was not in the nature of assets. The loan amount was invested in its sister concern as a measure of commercial expediency. In those circumstances, the assessee is entitled for deduction of expenditure

incurred towards the interest under Section 36(1)(iii) of the Act. The order passed by the Tribunal is contrary to the law laid down by the Hon'ble Supreme Court in the case of **S.A.BUILDERS LTD. v/s COMMISSIONER OF INCOME-TAX (APPEALS) AND ANOTHER**, reported in **(2007)288 ITR 1(SC)**. The amounts paid to the DDPL are business advance and in turn the DDPL provisionally allotted an area to an extent of 30000 sq.ft. and 25 covered car parking area in the project of "Embassy Meadows" for a consideration of Rs.3.25 crores. In the above said judgment, the Hon'ble Supreme Court, while examining Section 36(1)(iii) and Section 37 of the Act, held that interest on money borrowed from the Bank and lent to the sister concern without charging interest for the purpose of its business is an allowable deduction under Section 36(1)(iii) of the Act. The finding recorded by the Tribunal, First Appellate Authority and Assessing Authority, is without any basis and contrary to law. Apart from that, the

profit earned out of the said amount has already been taxed for the assessment year 2003-04. Disallowing the interest portion amounts to double taxation and sought for setting aside the same. In support of his contention, he relied upon the following judgments:

- (1) (2007) 288 ITR 1 (SC)
(S.A.BUILDERS LTD. v/s COMMISSIONER OF INCOME-TAX (APPEALS) AND ANOTHER;
- (2) (1969) 74 ITR 723
(COMMISSIONER OF INCOME-TAX, BOMBAY CITY II v/s BOMBAY SAMACHAR LTD., BOMBAY);
- (3) (1979) 118 ITR 200
(MADHAV PRASAD JATIA v/s COMMISSIONER OF INCOME-TAX, U.P.);
- (4) (2008) 298 ITR 194 (SC)
(DEPUTY COMMISSIONER OF INCOME-TAX v/s CORE HEALTH CARE LTD.); and
- (5) (1965) 56 ITR 77 (SC)
(COMMISSIONER OF INCOME-TAX, MADRAS v/s INDIAN BANK LIMITED.)

5. On the other hand, Sri.K.V.Aravind, learned counsel appearing for the Revenue argued in support of the order passed by the Tribunal confirming the orders

passed by the First Appellate Authority and Assessing Authority. He contended that Section 36(1)(iii) deals with the capital borrowed for the purpose of business or profession and the amount of interest paid. On any amount of interest paid in respect of the capital borrowed for acquisition of an asset for extension of existing business or profession, the assessee is entitled for deduction of the expenditure incurred in the form of interest paid to the said amount. In the instant case, though the assessee availed loan from KSIIDC, the said amount has not been utilized by the assessee, however it was diverted to its sister concern, for which one of the partners of the assessee, is also one of the Directors. Huge amount has been advanced for the alleged purchase of the properties, for which the approval and building plan has not been obtained from the competent authorities. Further, no formal agreement was also entered into between the assessee and its sister concern. In fact, the "Embassy Meadows" property is

owned by another sister concern of the assessee. It is impossible to believe the assessee borrowing the money with interest at the rate of 18.5% p.a. to book a flat in a Project which is not yet approved. The balance sheet of DDPL clearly discloses that no work is in progress and no amount has been advanced to the supplier for implementation of the said project. Hence, the Tribunal, taking into consideration all these aspects of the matter, disallowed the deduction of interest. The judgments relied upon by the assessee are not applicable to the facts of the present case and sought for dismissal of the appeals.

6. Heard the learned counsel appearing for the parties and perused the orders passed by the Tribunal, First Appellate Authority and the Assessing Authority.

7. The records clearly disclose that the assessee-Firm is engaged in the business of real estate and construction of commercial and residential complexes.

During the assessment year 2000-01, the assessee borrowed a sum of Rs.2.50 crores from KSIIDC as medium term corporate loan for its business. However, the said amount was diverted to its sister concern i.e. M/s. DDPL for which, one of the Partners of the assessee-Firm is also one of the Directors. During the assessment year 2000-01, the assessee debited a sum of Rs.30,49,721/- as interest towards loan amount and claimed it as an expenditure while preparing the profit and loss account and filed the returns. The said returns were taken up for scrutiny and notice under Section 143(2) was issued for appearance before the Assessing Authority. Also notice under Section 142(1) was issued calling for necessary particulars. In pursuance of the same, an authorized representative of the assessee appeared and produced necessary documents. The Assessing Authority, after examining the matter, disallowed the expenditure towards interest and other expenditures on the ground that though the

assessee availed loan of Rs.2.50 crores, the said amount was not utilized for its business, whereas the same was diverted to its sister concern as a loan transaction. Though the authorized representative made a submission before the Assessing Authority that the loan availed by the assessee was diverted to the sister concern as interest free business advance, since the sister concern of the assessee provisionally allotted an area of 30000 sq.ft. along with 25 covered car parking area which was valued at Rs.3.50 crores, the assessee claimed deduction of interest on the loan availed. However, the Assessing Officer disallowed the said deduction on the ground that the assessee has not utilized the loan availed whereas it was diverted to its sister concern for which, one of the partners of the assessee is also one of the Directors. The records produced by the assessee clearly disclose that the DDPL has also not utilized said loan amount for the purpose of "Embassy Meadows" project. The balance sheet of

the DDPL as on 31-03-2000 clearly discloses that no work - in progress or no advance to the material suppliers had been made for the said project. Before conception of the said project, the question of provisionally allotting 30000 sq.ft. of built up area and 25 covered car parking area in the said project, is impossible to believe. As per the terms and conditions of availing loan from KSIIDC, the assessee has to repay the said corporate loan in five quarterly installments of Rs.50,00,000/- each with an initial moratorium of six months from the date of disbursement of the loan. As per the terms and conditions, the assessee has to repay the loan by June 2001. It is impossible to believe availing loan with interest at the rate of 18.5% p.a. to book a flat, in a project for which the plan has not yet been sanctioned by the competent authorities and construction has not yet been started. The authorities below, after taking into consideration all these aspects of the matter, clearly held that the transaction between

the assessee and its sister concern is purely a loan transaction. There is no agreement entered into between the parties. The intention behind the advance is only book interest expenditure in the assessee's case to reduce the taxable income. The finding recorded by the authorities below is purely a question of fact. The same was confirmed by the Tribunal. Except saying that the sister concern provisionally agreed to allot an extent of 30000 sq.ft. and 25 covered car park area in the project "Embassy Meadows", no concrete material has been produced before the authorities concerned. Initially, the assessee itself wanted to put up "Embassy Meadows", however, the responsibility of construction has been given to its sister concern DDPL. The land belongs to another sister concern. Even after three years, the Project has not yet been commenced. Whether Rs.65,00,000/- paid for the assessment year 2003-04 is with respect to the profit or the loan amount is not made known. In view of that, all the authorities

have concurrently held that the amount advanced is not a business expediency and it is only a loan transaction. Hence, the assessee is not entitled for any deduction towards the interest paid for availing the loan. We find no infirmity or irregularity in the said finding.

8. The principle of commercial expediency has to be applied on the basis of analysis of the facts of each case. The decision of the Hon'ble Supreme Court in **S.A.Builders** case can be applied, only if commercial expediency is established with facts. Unless interest free loan goes to business interest of the assessee, there cannot be any commercial expediency. For example, if the Company or a Firm supplying raw materials for construction of the building help the assessee to carry on the business more successfully, certainly commercial expediency can be canvassed. However, in the instant case, loan amount advanced to the assessee's sister concern has not been used for construction of the

“Embassy Meadows” building, but it was used for some other Project. No prudent businessman would invest in a project which has not yet been commenced. What the assessee would get from the investment he made is not clear, and no formal agreement has been entered into between the parties. The Tribunal, First Appellate Authority and the Assessing Authority have concurrently held that the assessee has failed to establish commercial expediency. The finding recorded by the authorities is purely a question of fact. The decision of the Hon'ble Supreme Court in **S.A.Builders** case could be applied only, if on facts, the assessee establishes commercial expediency in advancing interest free loan to its sister concern.

9. The judgments relied upon by the assessee is not applicable to the facts of the present case. The Hon'ble Supreme Court in a judgment reported in (2007) 288 ITR 1 (SC) (**supra**), has clearly held as under:

“We wish to make it clear that it is not our opinion that in every case interest on borrowed loan has to be allowed if the assessee advances it to a sister concern. It all depends on the facts and circumstances of the respective case. For instance, if the Directors of the sister concern utilize the amount advanced to it by the assessee for their personal benefit, obviously it cannot be said that such money was advanced as a measure of commercial expediency. However, money can be said to be advanced to a sister concern for commercial expediency in many other circumstances.”

In the instant case, though the borrowed money was advanced in favour of the sister concern of the assessee in the year 1999-2000, the sister concern has also not utilized the said amount for the said purpose. Even after three years, the said project has not been commenced, however the sister concern has diverted the said amount for some other project. Hence, the judgment relied upon by the assessee is not applicable to the present case. The Tribunal, after examining the contention taken by the assessee, confirmed the order

passed by the First Appellate Authority as well as the Assessing Authority. We find that there is no infirmity or irregularity in the finding of the Tribunal. The finding recorded by the authorities below is purely a question of fact and the same is not liable to be interfered with by this Court. Hence, the substantial questions of law framed in these appeals are answered against the assessee and in favour of the Revenue. Accordingly, the appeals are dismissed.

**Sd/-
JUDGE**

**Sd/-
JUDGE**

mpk/-*