

**IN THE HIGH COURT OF JUDICATURE FOR RAJASTHAN
BENCH AT JAIPUR**

JUDGMENT

DB Income Tax Appeal No.147/2004
The Commissioner of Income Tax, Alwar
Vs
M/s. Vijay Solvex Limited

Judgment reserved on 2nd December, 2014
Judgment pronounced on 10th December, 2014

PRESENT

HON'BLE THE ACTING CHIEF JUSTICE MR. SUNIL AMBWANI
HON'BLE MR. JUSTICE J.K. RANKA

Mrs. Parinitoo Jain, counsel for appellant
Mr. Sanjay Jhanwar, counsel for respondent

Reportable

BY THE COURT (Per Hon'ble Ranka, J.):

1. This Income Tax Appeal by the appellant-revenue u/s 260A of the Income Tax Act (for short, "IT Act") is directed against the order dt.12/01/2004, passed by the Income Tax Appellate Tribunal, Jaipur Bench, Jaipur (for short, "ITAT") in ITA No.1296/JP/96 by which the ITAT has partly allowed the appeal filed by the respondent-assessee. It relates to assessment year 1992-93.

2. The appeal was admitted on the following substantial question of law:-

“.Whether under the facts and circumstances of the case and in law the findings of the Tribunal are perverse on account of deletion of addition of Rs.5,80,215/- confirmed by the CIT(A) towards

disallowance of interest as interest free advances were given to its sister concerns ?”

3. The brief facts, which can be noticed on perusal of the order impugned and the orders of the lower authorities are that the respondent-assessee is a limited company and had furnished Return declaring income of Rs.1,22,05,430/-. During the course of the assessment proceedings, the Assessing Officer (for short, “AO”) noticed that the respondent-assessee had claimed a total amount of Rs.18,69,880/- out of which an amount of Rs.13,99,733/- had been charged to revenue as interest and the remaining balance amount of Rs.3,52,962/-, Rs.70,097/- and Rs.47,088/- represent Bank charges, commission, insurance premium and commitment charges. On further scrutiny, the AO noticed that the assessee paid interest to RIICO, RFC, Bank of Baroda and other debtors from whom the assessee had raised loans. It was also noticed that the assessee had received interest from some of the debtors and after analyzing the material on record, the AO was of the view that on the one hand, the assessee is making payment of interest to RIICO, RFC Banks and debtors but on the other hand, had advanced money to other sister concerns, on which no interest was charged and after calculating the interest on the debtors as well as creditors, came to the conclusion that out of the total claim of interest of Rs.11,67,756/-, which has been claimed to have been paid to RIICO, RFC and Bank and

interest bearing loans have been diverted to non-business purposes accordingly disallowed an amount of Rs.5,80,215/-.

4. The disallowance was challenged in appeal by the respondent-assessee before the Commissioner of Income Tax (Appeals) [for short, "CIT(A)"] who also agreed with the findings of the AO and approved the disallowance made by the AO.

5. On a further appeal before the ITAT, the ITAT, after analyzing the evidence on record, particularly, in view of the fact that the assessee was having its own sufficient funds and was maintaining a composite account and the revenue was unable to prove the nexus between the borrowed funds and the advances given, came to the conclusion that the disallowance is not proper and deleted the notional/hypothetical interest disallowed by the AO.

6. Learned counsel for the appellant-revenue contended that the AO so also the CIT(A), after detailed analysis of the material on record, had correctly come to the conclusion that the assessee had diverted money to sister concerns from whom either interest was not charged or if charged, was at lower rate of interest and on the one hand, the assessee paid huge amount of interest to RIICO, RFC and Bank but on the other hand, did not receive amount from the sister concerns and contended that the disallowance by the AO was just and

proper and the ITAT, in view of this fact that the interest was not charged from the sister concerns, was not justified in holding that the assessee had sufficient funds at its disposal and by this diversion of interest free loans, in-fact, has borne the burden of interest more which is not proper and accordingly contended that the finding of the ITAT is unjustified and deserves to be reversed.

7. Learned counsel for the respondent-assessee, on the contrary, contended that it is an admitted fact that the assessee had its own funds and when the assessee had its own funds, at least to the extent of the amount available at its disposal, the assessee was certainly capable of doing whatever it liked. In support of his submission, counsel for the respondent-assessee relied upon judgments in the case of CIT Vs. Navyug Oil & Dal Mills: (2001) 251 ITR 535 (Raj.); CIT Vs. Banswara Fabrics Ltd.: (2004) 267 ITR 398 (Raj.); CIT Vs. Prem Heavy Engineering Works (P) Ltd.: (2006) 150 Taxman 90 (All); CIT Vs. Indo Kopp Ltd.: (2008) 167 Taxman 172 (Del); Elmer Havell Electrics & ors Vs. CIT: (2005) 277 ITR 549 (Del); CIT Vs. Tin Box Co.: (2003) 260 ITR 637 (Del) and Munjal Sales Corporation Vs. CIT: (2008) 298 ITR 298 (SC) and while relying upon the aforesaid judgments, contended that the Hon'ble Apex Court and this Court as well as other High Courts, in such facts and circumstances, have come to the conclusion that once the assessee has its own capital, to

that extent it is for the assessee to manage its own affairs. He further contended that the AO has not been able to prove the nexus in between the amount borrowed and diverted towards non-business/ interest bearing funds.

8. After hearing counsel for the parties and going through the material on record, we notice that it is an admitted fact that the assessee had its own capital balance to the tune of Rs.80 lacs in addition to reserve and surplus of Rs.446.80 lacs and to this extent the said funds were available with the assessee for advancing or acting in accordance with the business expediency. It is also a fact that the amount, on which the interest has been paid by the assessee, is even otherwise lower than what was available with the assessee in the shape of its own capital balance and reserve & surplus, referred to herein above.

9. It may be that the assessee on account of business expediency advanced money to sister concerns or other concerns at a lower rate of interest or did not charge interest that by itself does not prove that the assessee diverted interest bearing loans to the said firms. An assessee is required to run business looking to the commercial expediency and several other factors.

10. Apex Court, in the case of S.A. Builders Ltd. Vs. CIT;

(2007) 288 ITR 1 (SC), after considering what is commercial/business expediency, has observed as under:-

“The expression “commercial expediency” is an expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. The expenditure may not have been incurred under any legal obligation, but yet it is allowable as a business expenditure if it was incurred on grounds of commercial expediency.”

10.1 The Hon'ble Apex Court further observed in the above judgment as under:-

“To consider whether one should allow deduction under Section 36(1)(iii) of interest paid by the assessee on amounts borrowed by it for advancing to a sister concern, the authorities and the courts should examine the purpose for which the assessee advanced the money and what the sister concern did with the money. That the borrowed amount is not utilized by the assessee in its own business but had been advanced as interest free loan to its sister concern is not relevant. What is relevant is whether the amount was advanced as a measure of commercial expediency and not from the point of view whether the amount was advanced for earning profits.

Once it is established that there was nexus between the expenditure and purpose of the

business (which need not necessarily be the business of the assessee itself) the Revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the board of directors and assume the role to decide how much is reasonable expenditure having regard to the circumstances of the case. No businessman can be compelled to maximize his profits.”

11. The Hon'ble Apex Court, in the case of Munjal Sales Corporation (supra) observed as under:-

“As stated above, for the assessment year 1992-93 and the assessment year 1993-94, the Tribunal held that the loans given to the sister concerns were out of the firm's funds and that they were advanced for business purposes. Once it is found that the loans granted in August/September, 1991 continued up to the assessment year 1997-98 and that the said loans were advanced for business purposes and that interest paid thereon did not exceed 18/12 per cent per annum, the assessee was entitled to deductions under Section 36(1)(iii) read with section 40(b)(iv) of the 1961 Act.

One aspect needs to be mentioned during the assessment year 1995-96, apart from the loan given in August/September, 1991, the assessee advanced interest-free loan to its sister concern amounting to Rs.5 Lacs.

According to the Tribunal, there was nothing on record to show that the loans were given to the sister concern by the assessee-firm out of its own funds and, therefore, it was not entitled to claim deduction under Section 36(1)(iii). This finding is erroneous. The opening balance as on April 1, 1994, was Rs.1.91 crores whereas the loan given to the sister concern was a small amount of Rs. 5 Lakhs. In our view, the profits earned by the assessee during the relevant year were sufficient to cover the impugned loan of Rs.5 Lakhs.”

12. Allahabad High Court in the case of **CIT vs. Radico Khaitan Ltd.** (2005) 274 ITR 354 has held that the assessee Company had sufficient fund other than the borrowed money for giving the amount in question as loan to its sister concern, which finding had not been specifically challenged in the present appeal. The conditions of Section 36(1)(iii) of the Act had been complied with and, therefore, the assessee company was entitled to full allowance of the amount of interest paid by it on borrowed capital.

13. Delhi High Court, in the case of **CIT vs. Dalmia Cement (Pvt.) Ltd.** (2002) 254 ITR 377 has held that once it is established that there was nexus between the expenditure and the purpose of the business, Revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the board of directors and assume the role to decide

how much is reasonable expenditure having regard to the circumstances of the case.

14. The Calcutta High Court in the case of **CIT vs. Britannia Industries Ltd. (2006) 280 ITR 525** held as under:-

“From the above discussion, we find in relation to each assessment years involved in this appeal that the recipient of interest-free loan was not a firm of relatives; the advance was made for the purpose of business within meaning of section 36(1)(iii); that there was regular course of business between the assessee and the firm; and that the advances were made to MCAP in the regular course of business; such advances were made in the course of business for commercial expedience and for the purpose of business; the findings arrived at by the learned Tribunal were not perverse; the entire expenditure was made from the mixed account; therefore, there would be a presumption that the amount was made out of the own fund of the assessee and not from the borrowed capital; that there were sufficient funds and that the advance were made from the mixed account. Therefore, the Commissioner (Appeals) and the learned Tribunal both were right in presuming that the advance was made out from the assessee's own fund eligible for the benefit of section 36(1)(iii).”

15. The Allahabad High Court in the case of **CIT vs. Motor Sales Ltd. (2008) 304 ITR 123 (Allahabad)** has held that it was finding of fact as found in the case that respondent-assessee had capital/reserve/surplus of Rs.6.10 Crores on

which no interest was being paid and therefore interest free advances made by it are covered and ultimately held that there is no question of any disallowance of notional interest on loan taken by it. It was further held that the Tribunal had also recorded a finding that the assessee had not diverted any borrowed fund on which interest was paid for non-commercial purposes and therefore, there is no question of disallowance of interest out of the interest paid by the assessee.

16. In view of the authoritative pronouncement of the Apex Court and other judgments referred supra, in our view, the assessee admittedly had its own funds, as referred to earlier, and admittedly such funds/reserves being substantially higher than, even otherwise, the advances to the debtors, no notional interest or hypothetical interest could have been disallowed on such facts. The revenue has failed to prove nexus. In our view, the ITAT has correctly appreciated the facts and law.

17. In view of our observations herein above, the ITAT was correct in deleting the notional interest, disallowed by the AO at Rs.5,80,215/- and accordingly the appeal is decided against the revenue and in favour of the assessee. No costs.

[J.K. RANKA],J.

[SUNIL AMBWANI], ACTING C.J.

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All corrections made in the judgment/order have been incorporated in the judgment/order being e-mailed.

Raghu, Sr. PA.

