* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ ITA 894/2011

CIT ..... Appellant
Through Ms. Rashmi Chopra, Sr. Standing Counsel.

versus

SWETA ESTATES PVT LTD ..... Respondent
Through Mr. Rajat Navet, Advocate.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R.V.EASWAR

O R D E R

% 14.05.2012

Having heard learned counsel for the parties in this appeal, which pertains to the assessment year 2005-06, we frame the following substantial question of law:-

> "Whether the Income Tax Appellate Tribunal was right in dismissing the appeal of the Revenue and was correct in holding that the Assessing Officer had rightly disallowed the interest of Rs.63,08,097/- and Rs.2,23,787/- paid to bank on account of interest free loan of Rs.28,00,000,00/- granted to sister companies?"

2. Before examining the aforesaid issue, we record that the Revenue has raised another issue/aspect, which relates to failure of the assessee to deduct tax at source on payment of US $ 86250

(Rs.75,90,001/-) on two occasions to M/s. HOK International (Beijing) Limited for the architectural work undertaken by them.

3. The tribunal has referred to the Article 14 of the Double Taxation Avoidance Agreement between India and China, which reads:-

> "ARTICLE 14 - Independent Personal Services
> "1. Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that Contracting State except in one of the following circumstances, when such income may also be taxed in the other Contracting State :
> (a) if he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State;
> (b) if his stay in the other Contracting State is for a period or periods exceeding in the aggregate 183 days in the taxable year concerned, in that case, only so much of the income as is derived from his activities performed in that other Contracting State may be taxed in that other
> Contracting State."

4. The finding recorded by the tribunal is that the payments in question were for architectural work and covered by the term "professional services". The tribunal has also recorded a finding that the recipient i.e. M/s. HOK International (Beijing) Limited did not have a permanent establishment or a fixed base in India. It is not the

case of the Revenue that clauses (a) or (b) to Article 14 are attracted and satisfied.

5. In view of the said factual findings, which are not under challenge, we do not think that any substantial question of law arises on the said aspect. Article 14 of the Double Taxation Avoidance Agreement between India and China is squarely applicable. The situs or the place of residence of the recipient who renders and performs professional services determines the place/country where the said income is taxable. In the present case, M/s. HOK International (Beijing) Limited was a China based company and had rendered "professional services" from there. No amount therefore will be taxable in India. The assessee was not liable to deduct tax at source on the said services and the tribunal has rightly held that Section 40(a)(ia) is not attracted.

6. The tribunal while examining the question of law mentioned above has reproduced the findings recorded by the Assessing Officer in paragraph 2 of the order and then quoted the findings recorded by the CIT (Appeals), who had deleted the said addition. For the sake of completeness, we are reproducing the findings recorded by the Assessing Officer and the CIT (Appeals):-

Finding of the Assessing Officer

"2. During the period under consideration the assessee has given Rs.28,37,55,528/- as interest free loans to sister concerns, the assessee was asked vide order sheet dated 10/12/2007 and 14/12/2007 to show cause why interest paid to bank amounting Rs.63,08,097/- and Rs.2,23,787/- to sister concerns be not disallowed. The assessee replied vide its letter dated 14.12.2007 submitted that "the sister concerns has financed the assessee company's project by interest free funds of over Rs. 18 Crore during the previous year as also during this assessment year".

This plea of the assessee is not in accordance with the audited accounts of the assessee filed with the return of income for A.Year 2005-2006, as per which liabilities are reflected as "Advances received against booking of flats/space Rs.42,57,12,100/- (Previous yearRs.15,44,64,357/-)". Therefore, the consideration of receiving funds from sister concerns as well as from other miscellaneous customers is purely against booking of flats/space, and is not an exgratia interest free loan from sister concerns. This is further corroborated by the assessee's reply dated 22.06.2007, wherein the details of amounts received on "Booking of flats as on 31.3.2005" covers all the payments received from sister concerns as well. Even in tax audit report they are not reflected as loans received. Thus as the business consideration for receiving the amount from sister concerns is towards booking of flats and not to finance the company's project with interest free loans.

The plea of the assessee is not acceptable. Therefore, income attributable on interest free loans to the extent of interest paid is treated as income of the assessee, which comes to Rs.65,31,884/- (63,08,097/- + 2,23,787)."

Finding of the CIT (Appeals)

> "4.6. I have perused the details along with the submission made by the assessee. I have also considered the Remand Report of the AO. I find that the notional income assessed by Assessing Officer as income does not have any corroboration with the interest bearing funds. Moreover, the assessee has noninterest bearing funds available with it which has not been denied by the Assessing Officer to cover the interest free loans given to the sister concern. I do not find any justification in making the said addition unless some nexus is established on account of diversion of funds to the sister concern from interest bearing funds. There cannot be any notional addition. Hence, this ground of appeal of the assessee succeeds and the addition of Rs.65,31,884/- is deleted."

7. After reproducing the aforesaid findings, the tribunal has dealt with the issue in paragraph 11, which again for the sake of completeness is reproduce below:-

> "11. After hearing both the sides, we find that the revenue has failed to establish the corroboration that the advances were made from the interest bearing funds. The assessee was having sufficient non-interest bearing funds to cover up the interest free loans to the sister concerns. In view of this matter, we uphold the order of CIT (A) on this issue and dismiss this ground of revenue's appeal."

8. A reading of the aforesaid paragraph exposits that there is hardly any discussion on the issue in question. It is only recorded that the assessee had sufficient non-interest bearing funds to cover the interest

free loans to the sister companies. It is not disputed that the assessee was a construction company and was in the process of constructing flats at Gurgaon. The assessee had received booking advances from the customers. As per the assessment order, an amount of Rs.42,57,12,100/- had been received as advances from public and group sister companies. This includes Rs.18.11 crores received as advance payment from group companies. The Assessing Officer after examining the factual matrix came to the conclusion that the assessee had advanced interest free loan of Rs.28,00,000,00/- to some of the group companies. The said group companies had not paid advance deposit for booking of flats. At the same time, the assessee had borrowed money from the banks and had paid interest of Rs.63,08,097/- and Rs.2,23,787/- (total Rs.65,31,884/-) to the banks.

9. The advances were paid by the customers including group companies, who had booked flats. The contention raised by the learned counsel for the Revenue is that these advances cannot be treated as interest free loans given by third parties or group companies to the respondent-assessee. It is further submitted that out of Rs.42.57 crores, an amount of Rs.21.70 crores was deposited/paid by public for booking of flats. The entire amount was to be spent on construction of

building/flats. Rs. 18.11 crores, it is urged, cannot be treated as non-interest bearing loan as it was a booking amount for purchase of flats.

10. These aspects and facts have not been examined and considered by the tribunal. We may now notice the legal position explained by the Supreme Court in ***S.A. Builders Ltd. Vs. Commissioner of Income-Tax (Appeals) and Another*** *[2007] 288 ITR 1 (SC)*. In the said case, it has been held as under:-

> "**25.** In our opinion, the High Court as well as the Tribunal and other Income Tax Authorities should have approached the question of allowability of interest on the borrowed funds from the above angle. In other words, the High Court and other authorities should have enquired as to whether the interest-free loan was given to the sister company (which is a subsidiary of the assessee) as a measure of commercial expediency, and if it was, it should have been allowed."
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> 26. 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."
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> "**31.** The High Court and the other authorities should have examined the purpose for which the assessee advanced the money to its sister concern, and what the sister concern did with this money, in order to decide whether it was for commercial expediency, but that has not been done."

> "**32.** It is true that the borrowed amount in question was not utilised by the assessee in its own business, but had been advanced as interest-free loan to its sister concern. However, in our opinion, that fact is not really relevant. What is relevant is whether the assessee advanced such amount to its sister concern as a measure of commercial expediency."
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> "**36.** 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 utilise 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 (which need not be enumerated here). However, it is obvious that a holding company has a deep interest in its subsidiary, and hence if the holding company advances borrowed money to a subsidiary and the same is used by the subsidiary for some business purposes, the assessee would, in our opinion, ordinarily be entitled to deduction of interest on its borrowed loans."

11. In view of the aforesaid position, noticing the arguments, which were advanced by the Revenue and the reasons given by the tribunal, we deem it appropriate to remit the matter to the tribunal for deeper scrutiny and examination. The tribunal will re-examine the issue and record factual finding and apply the legal ratio explained in ***S.A.***

Builders Ltd. *(supra)*. Accordingly, we answer the aforesaid question of law in favour of the Revenue with an order of remit. The tribunal will examine the merits without being influenced by the observations made above. The appeal is accordingly disposed of. No costs.

SANJIV KHANNA, J.

R.V.EASWAR, J.

MAY 14, 2012
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