IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 8TH DAY OF JANUARY 2020

PRESENT

THE HON'BLE MR. JUSTICE ALOK ARADHE

AND

THE HON'BLE MR. JUSTICE RAVI V. HOSMANI

I.T.A. NO.85 OF 2010

BETWEEN:

M/S. YENEPOYA RESINS & CHEMICALS
ASHOKNAGAR, MANGALORE-575006
REP. BY ITS PARTNER
SRI. ABDULLA KUNHI
AGED ABOUT 63 YEARS
S/O SRI. Y. MOIDEEN KUNHI.

... APPELLANT

(By Smt. JINITA CHATTERJEE, ADV., FOR
Sri. S. PARTHASARATHI, ADV.,)

AND:

THE DEPUTY COMMISSIONER OF INCOME-TAX
INVESTIGATION CIRCLE
C.R. BUILDING, N.G. ROAD
ATTAVR, MANGALORE-575001.

... RESPONDENT

(By Sri. K.V. ARAVIND, ADV.)

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THIS I.T.A. IS FILED UNDER SECTION 260-A OF I.T. ACT, 1961 ARISING OUT OF ORDER DATED 9-10-2009 PASSED IN ITA No.447/BNG/2009, FOR THE ASSESSMENT YEAR 1997-98 PRAYING TO FORMULATE THE SUBSTANTIAL

QUESTIONS OF LAW STATED THEREIN. ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE ITAT BANGALORE IN ITA No.447/BNG/2009, DATED 9-10-2009, IN THE INTEREST OF JUSTICE AND EQUITY & ETC.

THIS I.T.A. COMING ON FOR HEARING, THIS DAY, **ALOK ARADHE J.,** DELIVERED THE FOLLOWING:

JUDGMENT

Smt.Jinita Chatterjee, learned counsel for the appellant.

Mr.K.V.Aravind, learned counsel for the respondent.

2. This appeal has been preferred by the assessee under Section 260-A of the Income Tax Act, 1961 (hereinafter referred to as 'the Act', for short) which was admitted by a Bench of this Court by an order dated 20.04.2010 on the following substantial questions of law:

> *a) Whether in law, the Tribunal is justified in ignoring the fact that the expenditure on borrowals was a business expenditure in as much as the same had been incurred during*

the course and for the purpose of business of the Appellant?

b) Whether in law, the Tribunal is justified in rejecting the claim under Section 36(1)(iii) of the Appellant towards the payment of interest on borrowing when the genuineness of such borrowings and the utilization of such amounts in the business is not disputed?

c) Whether in law, the Tribunal is justified in confirming the orders of the lower authorities holding that the Appellant had restored to an artificial arrangement to reduce its profit and in turn also make its sister concern eligible for more deduction under Section 80 HHC of the Act on mere surmise and conjectures?

d) Whether in law, the Tribunal is justified in rejecting the claim of the Appellant made towards the payment of interest on borrowings and discounting on LCs when the Appellant had fulfilled all the conditions laid down under the provisions of Section 36(1)(iii) Section 37 of the Act to claim the same as its business expenditure?

3. Facts giving rise to the filing of the appeal briefly stated are that the appellant is a registered firm engaged in the business of manufacture of resins and chemicals with the help of credit purchases bearing interest and largely selling its finished products to its sister concern namely M/s. Canara Wood and Plywood Pvt. Ltd., Mangalore for the assessment year 1997-98, the appellant filed the return of income on 25.09.1997 declaring an income of ₹4,47,710/-. The Assessing Authority, by an order dated 31.03.2000 made an order of assessment disallowing the interest expenditure claimed by the appellant on the ground that the appellant had deliberately adopted artificial and colourable device for reducing the income and tax thereon through arrangement of letter of credit discounting in respect of sale bills raised in the name of the sister concern M/s. Canara Wood and Plywood Pvt. Ltd. Being aggrieved, the appellant preferred an appeal

before the Commissioner of Income Tax (Appeals) which was dismissed by an order dated 30.03.2009. The Appellate Authority, *inter alia*, held that the letter of credit was obtained allowing the sister concern to enjoy higher income which was subjected to deduction under Section 80HHC of the Act. Being aggrieved, the petitioner preferred an appeal before the Income Tax Appellate Tribunal. The order passed by the Commissioner of Income Tax (Appeals) has been upheld by the Tribunal. In the aforesaid factual background, this appeal has been filed.

4. Learned counsel for the appellant, while inviting the attention of this Court to Section 36(1)(iii) of the Act, submitted that in order to attract the applicability of the aforesaid provision, three conditions are required to be satisfied namely that the money must have been borrowed by the assessee, it must have been borrowed for the purpose of business and the assessee must have

paid the interest on the aforesaid amount. It is further submitted that in case such conditions are complied with, the appellant is entitled to the benefit under Section 36(1)(iii) of the Act. It is further submitted that the Assessing Officer, the Appellate Authority as well as the Tribunal ought to have appreciated that the appellant had satisfied the aforesaid requirement and therefore, the appellant was entitled to the benefit contained in Section 36(1)(iii) of the Act. Learned counsel for the appellant further submitted that the appellant had obtained loan on account of business expediency and had paid interest on the amount of loan. However, the aforesaid aspect has not been appreciated. In support of the aforesaid submissions, reliance has been placed on the decisions in the case of ***'COMMISSIONER OF INCOME TAX Vs. BOMBAY SAMACHAR LTD.' (1969) 74 ITR 0723, 'S.A.BUILDERS LTD. Vs. COMMISSIONER OF INCOME TAX (APPEALS) & ANR.' (2007) 288 ITR***

0001, 'HOTEL ROOPA Vs. COMMISSIONER OF INCOME TAX' (2015) 231 TAXMAN 0425 (KARNATAKA), 'ASSISTANT COMMISSIONER OF INCOME TAX Vs. MICRO LABS LTD.' (2016) 380 ITR 0001 (SC) AND 'THE COMMISSIONER OF INCOME TAX Vs. M/s. SHRIRAM INVESTMENTS' IN TCA NO.166/2019 DATED 21.02.2019.

5. On the other hand, learned counsel for the revenue has taken us through the order of assessment, order passed by the Commissioner of Income Tax (Appeals) as well as the order passed by the Tribunal and has submitted that cogent reasons have been assigned by the Tribunal for disallowing the benefit to the appellant as claimed by it. It is also submitted that infact the substantial questions of law framed by this Court do not arise for consideration in this appeal.

6. We have considered the submissions made by the learned counsel for the parties and have perused the

record. From perusal of Section 36(1)(iii) of the Act, it is evident that 3 conditions have to be complied with namely, money must have been borrowed by the assessee, it must have been borrowed for the purpose of business and the assessee must have paid the interest on the aforesaid amount and claimed it as deduction. However, in the instant case, the Assessing Authority, by an order dated 31.03.2000 has held that the assessee mainly supplies its finished products to its sister concern namely M/s. Canara Wood and Plywood Pvt. Ltd. Mangalore, which is engaged in the manufacturing of plywood, boards, etc. and exports to foreign countries as well as enjoys the benefit of deduction under Section 80HHC of the Act. On perusal of the books of accounts, it has been held that against the supply of finished products, the assessee firm does not directly collect the sale proceeds from the sister concern. Instead of using the sale bill pertaining to sister concern, the assessee has availed of the letter of

credit discounting with the banks and has availed of the loan and has paid interest on the bank credit. The aforesaid borrowed loans are used to make payments towards interest bearing credit on the credit balance of the raw material suppliers etc. The Assessing Officer has, however, recorded that the assessee is made to bear the interest burden of sister concern namely M/s. Canara Wood and Plywood Pvt. Ltd. which is a private limited company enjoying the benefit of 80HHC of the Act and thus, the profit of the assessee is artificially reduced and inturn the income offered for taxation is decreased. It has further been held that this artificial arrangement has been made to reduce the interest burden on the sister concern. The Commissioner of Income Tax (Appeals) has upheld the aforesaid finding and has held that the assessee has tried to give the whole arrangement a colour of business expediency falling within the purpose and nexus to business. But on a close scrutiny, it is evident that it is nothing but

shouldering the interest burden on itself, thereby diverting the benefit in favour of the sister concern. It has further been held that where the borrowing is illusory or colourable, the interest paid on such borrowings is not allowable. Reference has been made to the decision of the Supreme Court in the case of '***MC DWELL & CO. LTD. VS. COMMERCIAL TAX OFFICER' (1985) 154 ITR 148***. The Tribunal, by the impugned order, in paragraph 6.2 has held that the assessee firm has supplied its finished products to its sister concern for which it has not insisted for the sale proceeds and has availed letter of credit against the bills and paid interest. This arrangement, by no stretch of imagination, can be considered as business prudence and expediency. It has further been held that no prudent businessman pays interest on the payment to his creditors and at the same time does not charge corresponding interest on the delayed payment from its debtor. It has further been held that the aforesaid arrangement has been made with

an object to circumvent the provisions of the Act to facilitate its sister concern to rest on the shoulders of the appellant. It has also been held that the appellant has deliberately created an artificial and colourable devise for reducing its income offered for taxation through an arrangement of letter of credit and thus, the deduction claimed by the assessee on account of interest paid to the bank and also to its creditors are not allowable.

7. The aforesaid findings of fact have been recorded by the Assessing Authority, the Commissioner of Income Tax (Appeals) as well as the Income Tax Appellate Tribunal. The Tribunal has assigned cogent reasons for not treating the borrowings as business expenditure incurred during the course of business which is evident from paragraph 6.2 of the order passed by the Tribunal. Therefore, the first substantial question of law does not arise for consideration in this appeal.

8. All the authorities have assigned cogent reasons which has been stated supra and have rejected the claim of the appellant filed under Section 36(1)(iii) of the Act. The second substantial question of law is based on incorrect factual finding inasmuch as the Assessing Authority, Appellate Authority as well as the Tribunal have doubted the genuineness of such a transaction and therefore, the substantial question of law as framed in the absence of any dispute with regard to genuineness of the transaction, whether the Tribunal was justified in rejecting the claim under Section 36(1)(iii) also does not arise for consideration. The Supreme Court in the case of ***SA BUILDERS LIMITED***, supra, has held that it is not in every case that interest on borrowed loan has to be allowed. If the assessee advances it to the sister concern, it all depends on the facts and circumstances of the respective case. Therefore, the question of genuineness of the transaction can be examined in the

fact situation of the case. The aforesaid question has been examined in detail by the authorities under the Act by assigning reasons.

9. It is once again reiterated that all the authorities under the Act have assigned valid and cogent reasons which is evident from perusal of the orders passed by them. Therefore, by no stretch of imagination, it can be held that the sister concern of the appellant is eligible for more deduction under Section 80HHC of the Act on mere surmise and conjectures. The finding that the sister concern is eligible for more deduction under Section 80HHC of the Act is based on mere surmise and conjectures also does not arise for consideration. Accordingly, the aforesaid question of law is answered against the assessee and in favour of the revenue.

10. In view of the preceding analysis, the fourth substantial question of law framed by this Court is also

answered against the assessee and in favour of the revenue.

11. In the result, we do not find any merit in this appeal. The same fails and is hereby dismissed.

Sd/-
JUDGE

Sd/-
JUDGE

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