

IN THE INCOME TAX APPELLATE TRIBUNAL
COCHIN BENCH, COCHIN
BEFORE SHRI GEORGE GEORGE K., JUDICIAL MEMBER

I.T.A. No.575/Coch/2019
Assessment Year : 2008-09

Mavoor Trade Links, Y.M.C.A. Road, Calicut-673 001. [PAN: AADFM 7732N]	Vs.	The Assistant Commissioner of Income-tax, Circle-1(1), Kozhikode.
(Assessee-Appellant)		(Revenue-Respondent)

Assessee by	Shri R.V. Viswanathan, CA
Revenue by	Shri Mritunjaya Sharma, Sr. DR

Date of hearing	28/01/2020
Date of pronouncement	03/02/2020

ORDER

Per GEORGE GEORGE K.,JUDICIAL MEMBER:

This appeal at the instance of the assessee is directed against the order of the CIT(A), Kozhikode dated 10.07.2019. The relevant assessment year is 2008-09.

2. The solitary issue that is raised is whether the CIT(A) is justified in upholding the addition of Rs. 12 lakhs made by the Assessing Officer on account of disallowance of interest expenses, for the reason that the interest bearing funds were diverted for purchase of a land.

3. Briefly stated, the facts of the case are that the assessee is a firm. For the assessment year 2008-09, the return of income was filed on 14.11.2008 declaring an income of Rs.3,45,850/-. The scrutiny assessment u/s. 143(3) of the I.T. Act was completed vide order dated 10/12/2010. One of the additions made in the scrutiny assessment was with regard to proportionate disallowance of interest expenses claimed by the assessee. The Assessing Officer noticed that the assessee had purchased land for a sum of Rs. 1 crore out of the OD account of the assessee. The Assessing Officer issued a show cause notice to the assessee proposing to disallow proportionate interest on the amount of Rs.1 crore used for the purchase of land. The assessee filed its objections vide letter dated 03/12/2010 wherein it was stated that the amounts were advanced for purchase of land which is intended to be assessee's asset. It was submitted that purchase of a property in the firm's name, utilizing the firm's funds cannot be considered as diversion of funds. It was further submitted that the profit that is to be earned on investment of the property is going to be the firm's income on which the assessee is going to be liable for income tax. However, the Assessing Officer rejected the contentions of the assessee and held that the advance given for acquiring the land from the enhanced CC limit is nothing but diversion of funds and the same cannot be treated as wholly and exclusively for the purpose of business. It was concluded by the Assessing Officer that the proportionate

interest expenditure for Rs. one crore which is utilized for purchase of land is to be disallowed and added back to the total income.

4. Aggrieved by the order of the Assessing Officer, the assessee raised this issue before the first appellate authority. Before the CIT(A), it was contended that the advance given for the purchase of the property has been registered in the name of the firm subsequently. It was submitted that being the assessee firm's asset, the same will be utilised for its business and the interest expenses incurred cannot be disallowed. The CIT(A) however rejected the contentions raised by the assessee. The CIT(A) noted that the asset has not been registered till date in the name of the firm. It was held by the CIT(A) that the contention of the assessee that the land is the business asset and would be used for the purpose of business is only an afterthought to avoid tax. The relevant finding of the CIT(A) reads as follows:

"7.2 I have considered the submissions of the Appellant. The Appellant has not been able to prove with any evidence that the advance given for the asset or property purchase is for the purpose of running or augmenting the business of the firm. There is a direct nexus between the loan and the purchase of an asset which is not a business asset till today. After expiry of 10 years, the asset has not put to use but is standing as a dead investment in the name of the firm. Hon'ble Punjab & Haryana High Court in 286 ITR 1 came to a finding that any fund which was advanced without carrying any interest and without any business purpose the interest to the extent the advance had been made without carrying any interest is to be disallowed u/s.36(1)(iii). Such borrowings to the extent cannot be possibly to be held for the purpose of business but for supplementing the cash diverted without deriving any benefit out of it. As

stated, the Appellant did not derive any benefit out of an advance of Rs.1 crore even after a lapse of 10 years and any plea taken by the Appellant that it is business asset and shall be used for purchase of business asset appears to be only an afterthought to avoid tax. Therefore, in the circumstances, I uphold the addition made by the Assessing Officer for Rs.12,00,000/- and the ground is dismissed."

5. Aggrieved by the order of the CIT(A), the assessee has filed this appeal before the Tribunal, raising the following grounds:

1. The Learned CIT(Appeals) erred in upholding the addition of Rs.12,00,000/- made by the AO. The addition was made on the ground that the sum of Rs.1 crore invested in land (by availing of a limit from the bank) is not for business purpose.

2. The sum of Rs.1 crore availed from bank was utilized by the Appellant for investing in a land which is now an asset of the firm. The income to be derived from the said asset is going to be declared as the firm's income and as such, the amount invested cannot be considered as diversion of funds for non business purposes.

3. The intention of the partners of the Appellant firm is to earn income by exploiting the land. The funds have not been totally taken out from the firm's business, but have been used to invest in a land, which is now the firm's property.

4. As and when the investment yields income, such income will be the firm's income and therefore, the funds cannot be considered as having been diverted.

5. The case law cited in para 7.2 of the order of the CIT(Appeals) .. High Court of Punjab and Haryana Commissioner of Income-tax-I, Ludhiana vs. Abhishek Industries Ltd. Reported in 286 ITR 1 .. cannot be directly applied to the Appellant's case for the following reasons:

i) This case has been overruled in 2008 168 Taxman 43 (SC).

ii) The case relates to a situation where funds were diverted without charging interest) to a sister concern, which is not the case here.

6. A reference to section 36(1)(iii) is necessary to understand the wide scope of allowability of interest on funds borrowed for purpose of business.

7. There is the expression “for the purpose of business” in section 36(1)(iii) and also in section 37(1). A similar expression with different wording also occurs in section 57(iii) which reads as “for the purpose of making or earning income”. The expression occurring in section 36(1)(iii) is wider in scope than the expression occurring in section 57(iii). This phrase, as held by many legal pronouncements, is the most important yardstick for the allowability of deduction under section 36(1)(iii) of Income Tax Act, 1961.

8. The Hon’ble Supreme Court in the case of S.A. Builders Ltd. Vs. CIT(A), Chandigarh reported in 288 ITR 1 has used the phrase “commercial expediency”. By using this phrase, the Hon’ble Supreme Court has given a new dimension and clarified the concept of “for purpose of business” further. In the said judgment, the Hon’ble Supreme Court has defined commercial expediency as “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”.

9. The High Court of Delhi, in the case of Punjab Stainless Steel Inds. vs. CIT 324 ITR 396, has further elaborated “commercial expediency” would include such purpose as is expected by the ass to advance its business interest and may include measures taken for preservation, protection or advancement of its business interests, which has to be distinguished from the personal interest of its directors or partners, as the case may be”.

10. In view of the above, it cannot be said that the investment in land from out of borrowed funds is for non business purposes or that the funds have been diverted from the business. Such a view is too narrow and does not consider the intention of the partners with regard to future expansion. For, the land could be exploited for business of the firm.

For these and other grounds that may be urged at the time of hearing of the appeal, it is prayed that the disallowance of Rs.12,00,000/- may be deleted.

6. The Ld. AR has produced the documents to prove that the property purchased was now the asset of the assessee firm. The Ld. AR has filed a brief written submission which reads as follows:

"The phrase "for the purpose of business" occurring in Section 36(1)(iii) is the most important yardstick for determining allowability of deduction under Section 36(1)(iii) of Income Tax Act, 1961. A similar expression with different wording also occurs in Section 57(iii) which reads as "for the purpose of making or earning income". The expression occurring in Section 36(1)(iii) is wider in scope than the expression occurring in Section 57(iii).

2) The Hon'ble Supreme Court in the case of S. A. Builders Ltd. Vs. CIT(A), Chandigarh reported in 288 ITR 1 has given a new dimension to expression "commercial expediency" and clarified the concept of "for purpose of business". In the said judgment, the Hon'ble Supreme Court has defined commercial expediency as 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".

3) The High Court of Delhi, in the case of Punjab Stainless Steel Inds. Vs. CIT 324 ITR 396, has further elaborated "commercial expediency would include such purpose as is expected by the assessee to advance its business interest and may include measures taken for preservation, protection or advancement of its business interests, which has to be distinguished from the personal interest of its directors or partners, as the case may be".

4) In view of the above, it cannot be said that the investment in land from out of borrowed funds is for non-business purposes or that the

funds have been diverted from the business. Such a view is too narrow and does not consider the intention of the partners with regard to future expansion. The land could be exploited for business of the firm. (The firm is a operating fuel sales outlets with a turnover that is nearing Rs.100 crores and an expansion by opening a new outlet is on the cards. The new land could well serve this purpose.

5) It is prayed that the disallowance of Rs.12,00,000 may be deleted.

6.1 The Ld. DR on the other hand submitted that by virtue of amendment by Finance Act, 2003 with effect from 01/04/2004, proviso to section 36(1)(iii) of the I.T. was introduced, whereby the interest on borrowed funds till the asset was to be used cannot be allowed as deduction. In support of his contention, the Ld. DR relied on the order of the Chennai Bench of the Tribunal in the case of M/s. Narasu's Spinning Mills vs. ACIT in ITA No.957/Mds/2015 dated 09/12/2015.

6.2 In a rejoinder, the Ld. AR has filed written submissions which read as follows:

1) Proviso to Section 36(1) (iii) was inserted by Finance Act, 2003 w.e.f. 01.04.2004 relating to A.Y. 2004-05 and subsequent years. This was inserted to disallow interest on moneys borrowed for acquiring a capital asset till the date on which the asset was put to use even if it is for extension of existing business.

2) The Appellant has not done any extension or expansion of business, but merely purchased an asset, namely, land. The already available overdraft limit was enhanced and utilized to buy this land. Though the sum of Rs. 1 crore was appearing as advance for property in the balance sheet as at 31st March 2008 the same was capitalized as a fixed asset during 2017-18

assessment after getting the purchase of the property registered vide documents dated 10-06-2016.

3) It is incorrect to equate the purchase of this land with a case where a new unit is set up as part of a business expansion. The land has been purchased by the Appellant in the ordinary course of business. This purchase cannot be considered as "diversion" of funds for non-business purposes. Merriam Webster Dictionary defines "Diversion" as "the act or instance of straying from an activity or course or use". The act of purchasing land cannot by any means be considered as a "diversion" of funds.

4) In this scenario, it is unjust to disallow the proportionate interest paid to bank on the ground that funds have been diverted from the business. Funds have not been diverted but retained in the business. The act of investing in land ought to be treated as an activity in the ordinary course of business of the Appellant.

5) The learned First Appellate Authority has remarked in para 7.2 on page 6 of his order - "... any plea taken by the Appellant that it is a business and shall be used for purchase of business asset appears to be only an afterthought to avoid tax". This interpretation is quite strange as no businessman would put away interest bearing funds simply to claim the benefit of interest write off.

6) That interest on borrowings used for capital expenditure relating to a totally new business apart from existing business is to be capitalized as pre-commencement expenditure was held in the case of CIT vs. Vadilal Dairy International Ltd. 328 ITR 544 (Guj.)

7) In Core Health Care Ltd. vs. DCIT (SC) 298 ITR 194 the Hon'ble Supreme Court has clearly remarked "The provisions under Section 36(1) (iii) make no distinction between money borrowed to acquire a capital asset and a revenue asset.

8) Therefore, it is incorrect to stipulate that the interest paid has to be capitalized. The interest paid, if capitalized will not enable the benefit of write off as expenditure in any way as no depreciation can be claimed, the asset being land.

9) When the Appellant commences operations on the land, the interest capitalized would merely be in the balance sheet as an addition to the value of the land.

10) The Honourable Supreme Court of India has held in Vardhaman Polytex v. Commissioner of Income-tax(Appeals) Nos.6438 and 443 of 2012) that Interest in respect of borrowings for acquisition of capital assets not put to use in the concerned financial year can be permitted as allowable deduction under section 36(i) (iii) of the Income tax Act 1961.

11) Considering the above, it is prayed that the disallowance of Rs.12,00,000 may be deleted.

7. I have heard the rival submissions and perused the material on record. As rightly pointed out by the Ld. DR, amendment to Finance Act, 2003 w.e.f. 01/04/2004 has inserted proviso to section 36(1)(iii) of the I.T. Act which clearly states that interest on borrowed funds in respect of capital borrowed for acquisition of an asset shall not be allowed as deduction till the date on which the said asset was put to use for the purpose of business. In the instant case, amounts borrowed have been diverted for purchase of an asset which belongs to the assessee's firm. Admittedly, the said asset was not put to use even as on date of hearing of this appeal. Therefore, going by the proviso to section 36(1)(iii) of the I.T. Act, interest expenses on capital borrowed for purchase of asset cannot be allowed as deduction. In other words, interest expenditure has to be necessarily capitalised. The judicial pronouncements relied on by the Ld. AR relates to the case laws prior to the introduction of proviso to section 36(1)(iii) of the I.T. Act. Admittedly, the proviso to section 36(1)(iii) of the Act is

applicable during the relevant assessment year, namely 2008-09 and since the asset (land) has not been put to use by the assessee, the interest expenditure for acquiring the same cannot be allowed as a deduction. It is ordered accordingly.

8. In the result, the appeal of the assessee is dismissed.

Pronounced in the open court on 03-02-2020.

sd/-
(GEORGE GEORGE K.)
JUDICIAL MEMBER

Place: Kochi

Dated: 3rd February, 2020

GJ

Copy to:

1. Mavoor Trade Links, Y.M.C.A. Road, Calicut-673 001.
2. The Assistant Commissioner of Income-tax, Circle-1(1), Kozhikode.
3. The Commissioner of Income-tax(Appeals), Kozhikode.
4. The Commissioner of Income-tax, Kozhikode.
5. D.R., I.T.A.T., Cochin Bench, Cochin.
6. Guard File.

By Order

(ASSISTANT REGISTRAR)
I.T.A.T., Cochin