

IN THE INCOME TAX APPELLATE TRIBUNAL
COCHIN BENCH, COCHIN
BEFORE S/SHRI CHANDRA POOJARI, AM & GEORGE GEORGE K., JM

ITA No. 457/Coch/2018
Assessment Year: 2005-06

Mangalam Publications (India) Private Limited, S.H. Mount P.O., Kottayam. [PAN: AACCM 2086K]	Vs.	The Asst. Commissioner of Income-tax, Circle-1, Kottayam.
(Assessee -Appellant)		(Revenue-Respondent)

Assessee by	Shri P.M. Veeramani, CA
Revenue by	Shri Mritunjaya Sharma, Sr. DR

Date of hearing	05/03/2020
Date of pronouncement	09/03/2020

ORDER

Per CHANDRA POOJARI, AM:

This appeal of the assessee is directed against the order of the CIT(A), Kottayam dated 16/07/2018.and pertain to the assessment year 2005-06 .

2. The assessee has raised the following grounds of appeal:

1. The order of the Commissioner of Income tax (Appeals) is against facts and law.
2. The Commissioner of Income Tax (Appeals) erred confirming the disallowance u/s 36(1)(iii) of a sum of Rs.8,35,805 rejecting the appellant's arguments that the advances were made out of own funds and the same was out of commercial expediency
3. The Commissioner of Income tax (Appeals) erred in his conclusion that the advances to sister concern were out of borrowed funds since the appellant had

not furnished detailed cash flow statement. The Commissioner of Income Tax (Appeals) failed to note that the appellant had a cash profit of Rs.1,00,36,565 during the year and the advance to sister concerns was only Rs.46, 42,633 and thus the availability of own funds was established. The Commissioner of Income Tax (Appeals) failed to follow the decision of the various courts that existence of own funds can be established by comparison of financial statements and not necessarily the cash flow statement.

4. Commissioner of Income tax (Appeals) erred in his conclusion that there was no commercial expediency for the appellant based on the decision of ITAT Chandigarh bench in the case of C.R.Auluck & Sons Private Ltd, which was rendered following the decision of Punjab and Haryana High Court in the case of CIT vs Abhishek Industries Ltd (286 ITR1) which was subsequently reversed by Supreme Court.

3. The facts of the case are that the Assessing Officer disallowed the interest expenses incurred on advancement of loans to the sister concerns on account of commercial expediency. The Assessing Officer observed that the language of section 36(1)(iii) of the I.T. Act is clear and ambiguous. The amount of interest paid in respect of capital borrowed for the purposes of business or profession shall be allowed as deduction. According to the Assessing Officer the interpretation of the phrase "for the purpose of business" cannot be stretched beyond a point where it invalidates the section itself . In the present case, assessee has allowed its assets to be mortgaged for facilitation borrowing by the sister concerns. Assessee claimed that the banks may initiate recovery proceedings against it in the event of non payment of bank liability by sister concerns. The Assessing Officer observed that commercial expediency is not something which arose in the normal course of business. According to the Assessing Officer the assessee and the sister concerns are in totally different streams of business. This expediency, if at all a commercial expediency, cannot be considered as a genuine one.

4. On appeal, the CIT(A) observed that though the assessee made the argument that advancement of loans by the assessee to its sister concerns was for the purpose of saving the sister concerns from being declared as NPA by the Bank or to save the properties mortgaged by the assessee to the bank as a guarantee, the assessee has not produced any evidence to show that advancement of loans to the sister concerns had impact on the assessee's income. Therefore, it was observed by the CIT(A) that the loans advanced by the assessee have no element of commercial expediency. Accordingly, he confirmed the action of the Assessing Officer in disallowing the interest expenses incurred on advancement of loans to the sister concerns.

4. Against this, the assessee is in appeal before us. The Ld. AR relied on the judgment of the Supreme Court in the case of S.A. Builders vs. CIT (288 ITR 1) and submitted that money has been advanced to the sister concerns on account of commercial expediency and it is to be allowed. Further, the Ld. AR relied on the judgment of the Supreme Court in the case of Munjal Sales Corporation vs. CIT (298 ITR 298) wherein it was held as follows:

“Under the Income-tax Act, 1961, after amendment of the Act by the Finance Act, 1992 in order that interest paid on borrowings can be allowed as a deduction in computing the business profits, every assessee, including a firm, has to establish, in the first instance, that it was allowable under section 36(1)(iii); and in the case of a firm, further that the amount does not exceed the limit fixed by section 40(b)(iv).

Held, however, on the facts, in this case, that since the assessee had borrowed the moneys from its partners as early as 1991, and the Appellate Tribunal had held that the loans were given by the partners for business purposes and the interest did not exceed 18 percent per annum simple interest, the assessee-firm

was entitled to deduction of interest on the borrowings for the assessment years 1993-94 to 1997-98."

4.1 The Ld. AR also relied on the following decisions:

- i) ITA Nos. 618 & 619/Coch/2006 and 681/Coch/2005 dated 15/04/2008 in assessee's own case .
- ii) CIT vs. Harrisons Malayalam Ltd. (414 ITR 344)(Ker)
- iii) CIT (Large Taxpayer Unit) vs. Reliance Industries Ltd. (410 ITR 466)(SC)
- iv) Hero Cycles P. Ltd. vs. CIT (379 ITR 347) (SC).

5. On the other hand, the Ld. DR submitted that the assessee has not explained any commercial expediency to advance loans to the sister concerns. The Ld. DR submitted that even if the issue is remitted to the file of the Assessing Officer for fresh consideration, it is not known for what purpose the funds were transferred to the sister concerns. Since the assessee has not explained the purpose for which the funds were transferred to the sister concerns, it cannot be said that money has been advanced on account of commercial expediency. Hence, the interest paid on borrowed funds relates to the funds transferred to the sister concerns and has to be disallowed. The Ld. DR relied on the following case laws:

- 1) CIT vs. C.R. Auluck and Sons (P) Ltd. vs. CIT (360 ITR 193) (P&H)
- 2) Poabs Rock Products (P) Ltd. vs. DCIT (137 ITD 296) (Cochin Trib.)
- 3) CIT vs. Accelerated Freeze Drying Co. Ltd. (324 ITR 316)) (Kerala)

6. We have heard the rival submissions and perused the record. In the present case, the assessee had advanced funds to the sister concerns to the tune of Rs.1,25,22,538/-. At the same time, the assessee incurred bank interest charges at Rs.71,54,557/-. The Assessing Officer computed the proportionate interest on the

amount advance to the sister concerns at Rs.11,48,683/- and disallowed the same. Though the issue was decided by the Tribunal in favour of the assessee on earlier occasion, the issue travelled to the High Court and the High Court remitted the issue back to the file of the Assessing Officer in ITA No. 1554/2009 dated with the following observation:

"2. Even though the Tribunal has followed the decision of the Supreme Court in S.A. BUILDERS LTD. V. COMMISSIONER OF INCOME-TAX, APPEALS & ANOTHER (2007) 288 ITR 1) we notice that the Tribunal has just accepted arguments without referring to the facts. In the first place, the assumption of the Tribunal is that the advances were made out of own funds because assessee had a huge profit. However, we notice that the interest-free advances made every year is Rs. 2 crores when the assessee had substantial borrowings. The argument of the assessee is logically unacceptable because if assessee had huge profits and own funds, we do not know why the assessee should depend on borrowed funds. In any case if at a given point of time assessee has own funds and they have advanced it as interest-free loans to sister concerns for meeting their business needs in which assessee also has an interest, then such advances should not lead to disallowance of st paid on subsequent borrowings. In other words, unless the assessee establishes with cash flow statements about availability of its own funds at the time of making the interest-free advances, the finding of the Tribunal cannot stand. Besides this, going by the decision of the Supreme Court, unless the assessee establishes the benefit it derives from each sister concern to which loans were advanced and the financial plight of such business concerns deserving interest-free advances, we do not know how the test of business expediency is satisfied. The Tribunal has just accepted the argument of the assessee that the sister concerns were in financial difficulties and the cheques issued by them could be honoured only with the interest-free advances made by the assessee. We have to necessarily accept the argument of the Standing Counsel that the Tribunal has decided the case without verifying facts available on record and by assuming arguments as true facts. The settled law is that interest on borrowed funds can be allowed under section 36(1) (iii) of the Income-tax Act only if it is for business purposes. Admittedly the funds borrowed were not used directly for the business of the assessee and the only question is whether interest-free advances made to sister concerns is also a business purpose. The Supreme Court has held that if loan is justified by applying the principle of commercial expediency, then claim can be allowed. We are of the view that it is for the assessee to establish the interest it has in the sister concern, the business carried on by it, the financial position of the sister concern and the interest derived by the assessee to prove commercial expediency for justifying interest-free advances made from out of borrowed funds. We notice that the decision of the Supreme

Court relied on by the Tribunal also was not available when the assessment was made. We, therefore, allow the appeals vacating the orders of the Tribunal and by remanding the cases to the Assessing Officer for the assessee to produce cash flow statements showing availability of own funds for advances made to sister concerns, constitution, assessee's interest, etc., in the sister concerns and the documents showing nature of assessee's business interest and financial position of such business concerns at the time of making the advances for the officer to consider eligibility for deduction of interest on borrowed capital. In order to avoid further contest, we direct the Assessing Officer to examine the details furnished by the assessee, issue a written pre- assessment notice containing proposals for disallowance of interest, if any, and the reasons thereof so that the assessee gets an opportunity to file written objection and that the assessment completed after giving sufficient opportunity to the assessee."

6.1 In the course of passing consequential order by the lower authorities, the assessee has not led any evidence to show the commercial expediency to advance funds to the sister concerns. In addition to this, the assessee failed to file the cash flow statement to show that own funds were advanced to the sister concerns. Hence, the issue was decided against the assessee by the lower authorities. Though the assessee made an oral plea that the money had been advanced to the sister concerns on account of commercial expediency, the assessee failed to place any evidence to suggest whether funds advanced by the assessee to the sister concerns was in the nature of interest free own funds or the funds were advanced on account of commercial expediency. The interest paid by the assessee on such account cannot be allowed. The only plea of the assessee is that the assessee had mortgaged its property to avail bank loans for the sister concerns and if the sister concerns failed in their business, it will effect the profitability of the assessee. However, the assessee has not produced an iota of evidence to prove that it has mortgaged its property, and on its classification of funds as NPA, it would affect the

assessee's profitability. Being so, we are not in a position to uphold the argument of the Ld. AR on this issue. Further, the judgment of the Supreme Court relied on by the Ld. AR in the case of Munjal Sales Corporation vs. CIT (supra) cannot be applied to the facts of the assessee's case. In that case, the issue was with regard to allowability of interest u/s. 36(1)(iii) subject to provisions of section 40(b)(iv) of the I.T. Act. Hence, this ground of appeal of the assessee is rejected.

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

Order pronounced in the open court on 9th March, 2020.

sd/-
(GEORGE GEORGE K.)
JUDICIAL MEMBER

sd/-
(CHANDRA POOJARI)
ACCOUNTANT MEMBER

Place: Kochi

Dated: 9th March, 2020

GJ

Copy to:

1. Mangalam Publications (India) Private Limited, S.H. Mount P.O., Kottayam.
2. The Assistant Commissioner of Income-tax, Circle-1, Kottayam.
3. The Commissioner of Income-tax(Appeals), Kottayam.
4. The Pr. Commissioner of Income-tax, Kottayam.
5. D.R., I.T.A.T., Cochin Bench, Cochin.
6. Guard File.

By Order

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

