IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

ITA No.224 of 2013 (O&M)
RESERVED on: 15.07.2015
DATE OF DECISION: 24.07.2015

Bright Enterprises Pvt. Ltd. …..Appellant

versus

Commissioner of Income Tax, Jalandhar (Punjab)
.....Respondent

CORAM:- HON'BLE MR.JUSTICE S.J. VAZIFDAR, ACTING CHIEF JUSTICE
HON'BLE MR. JUSTICE G.S. SANDHAWALIA

Present: Mr. Pankaj Jain, Senior Advocate with
Mr. Divya Suri and Mr. Sachin Bhardwaj,
Advocates for the appellant

Mr. Rajesh Katoch, Advocate for the
respondent

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S.J. VAZIFDAR, ACTING CHIEF JUSTICE :

This is an appeal against the order of the Income Tax Appellate Tribunal dated 07.08.2012 in so far as it allowed the appeal filed by the revenue against the order of the Commissioner of Income Tax (Appeals) deleting an addition of Rs.1,31,24,332/- made by the Assessing Officer on account of disallowance of interest paid to the bank on the ground that the appellant/assesse had advanced an interest free loan to its sister concern although the appellant had no business dealings with the sister concern. The matter pertains to the assessment year 2005-06.

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

> "Whether under the facts and circumstances of the case, while arising at the 'chargeable income' u/s 29 considering the provisions of Section 36(1)(iii), the disallowance of interest paid to banks is mandatory on the true and correct interpretation of the words 'for the purpose of business?"

3. Section 36(1)(iii) reads as under:-

> "36. Other deductions.—(1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in Section 28—
>
> …… …….. …….. ……
>
> (iii) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession:
>
> Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.
>
> *Explanation.—Recurring subscriptions paid periodically by shareholders or subscribers in Mutual Benefit Societies which fulfil such conditions as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause;"*

4. As noted in the assessment order, the Assessing Officer found from the sundry advances that the assessee had advanced an amount of Rs.14,08,25,185/- as project advance to various parties, out of which an amount of Rs.10,29,17,301/- was advanced to the appellant's sister concern M/s Kolkatta Hotels Private Limited. The Assessing Officer disallowed the interest paid by the appellant to the bank amounting to Rs.1,31,24,332/- and added the same back to the appellant's income observing that the advance to the appellant's sister concern "does not appear to be for business purposes as the assesse-company has no business dealing with the company M/s Kolkata Hotel". The Assessing Officer observed that no interest was charged from M/s Kolkatta Hotels Private Limited on the advance of Rs.10,29,17,301/- whereas the appellant had paid the interest amounting to Rs.1,31,24,332/- on the loans taken from various banks. He observed that had the appellant not advanced the

said sum to its sister concern without charging interest, it would have been left with sufficient funds to refund the bank loan and the appellant would not have had to pay interest to the bank. In arriving at this conclusion, the Assessing Officer relied upon the judgment of this Court in the case of *Commissioner of Income Tax-I, Ludhiana vs. M/s Abhishek Industries, Ludhiana,* [*2006] 286 ITR 1 (P&H).* The Assessing Officer also initiated penalty proceedings under Section 271(1)(c).

5. The CIT (Appeals) allowed the appellant's appeal. The order records findings of fact which we find are established. They have not been shown to be incorrect. We have also held the inferences of fact and law to be well established. In fact, we have referred to additional facts which reinforce the findings.

The findings of the CIT (Appeals) are as follows. The appellant and its sister concern were in the hotel business and the advance was as a measure of commercial expediency and only for the purpose of the business of the sister concern. The funds advanced had been used for the purpose of the business of the sister concern. This plea had been raised by the appellant along with a copy of the balance sheet of the sister concern and the Assessing Officer had not commented adversely on the appellant's contention that the funds were used by the sister concern for the purpose of its business. The CIT (Appeals) also rightly held that the judgment of the Supreme Court in *S.A. Builders Ltd. vs. Commissioner of Income-Tax (Appeals) and another, (2007) 288 ITR 1 (SC)* supported the appellant's case. The only adverse finding by the Assessing Officer was that the advance does not appear to be for business purposes "as the assessee company has no business dealing with the company M/s Kolkata Hotel". This view as we will

demonstrate is not sustainable. The CIT (Appeals), therefore, rightly came to the conclusion that the appellant advanced the amount to its sister concern on account of commercial expediency and that the sister concern used the same for the purpose of its business.

It was also found that the advance of about Rs.10.29 crores to the appellant's sister concern was covered by the capital and interest free reserve available with the appellant. Accordingly, supported by precedent, the CIT (Appeals) justifiably presumed that the investment would be out of the interest free funds generated or available with the appellant.

6. The Tribunal rejected the appellant's case and set aside the order of the CIT (Appeals) in this regard only on the following basis:-

> "8. We have heard the rival contentions and perused the facts of the case. We are convinced with the arguments made by the Ld. DCIT(DR) Mr. Tarsem Lal that the Ld. CIT(A) has not taken the decision of the Hon'ble Supreme Court in the case of S.A. Builders Ltd. vs. CIT 288 ITR 1 (SC), in right spirit. No where the assessee has established the measure of commercial expediency either before the AO or before the ld. CIT(A) and not even before us. There is nothing on record that the money so advanced by the assessee to the sister concern had been used as a measure of commercial expediency. In the facts and circumstances of the case, the ld. CIT(A) has wrongly interpreted and relied upon the decision of Hon'ble Supreme Court in the case of S.A. Builders Ltd. Vs. CIT (supra), which in fact goes against the assessee. In the facts and circumstances, the order of the Ld. CIT(A) is reversed and that of the A.O. is restored. Thus, all the grounds of the Revenue are allowed."

7. With a view not to leave any room for doubt and to satisfy ourselves about the correctness of the appellant's claim, we directed Mr. Pankaj Jain, the learned senior counsel appearing on behalf of the appellant, to produce the agreement under which

it purchased the shares of M/s Kolkatta Hotels Private Limited. Mr. Jain produced a share purchase agreement dated 08.07.2002 between the President of India, the appellant and Modern Publisher, who were referred to in the agreement as the purchaser and M/s Kolkatta Hotels Private Limited referred to in the agreement as the Company. The agreement stated that the government owned about 89.97% of the paid up equity share capital of M/s Kolkatta Hotels Private Limited, the Indian Hotels Company Limited (IHCL) owned about 10% of the equity share capital and the balance 0.03% was held by other shareholders referred to in the agreement as residual shareholders. The agreement recites that a unit of Indian Tourism Development Corporation of India (ITDC) had been transferred to the sister concern pursuant to a scheme of demerger. The agreement also notes that the Government had invited bids from prospective bidders to purchase the equity shares held by the Government; that the Government had agreed to sell the shares to the purchasers mentioned therein which included the appellant and that by a separate agreement the IHCL had also agreed to sell its 10% share holding to the said purchaser. Further, the purchasers had agreed to make an offer to the residual share holders to purchase their shares.

The term “business” was defined in Article-1 to include the entire business of the said unit of ITDC including not merely the various assets but all liabilities and debts as well. Article-3 reads as follows:-

> “Article 3
> Closing date mechanism
>
> 3.1 Deposit Amount
>
> (a) The Parties recognize that the Purchaser has furnished to the Government a bank guarantee (“Bank Guarantee”) in the form and substance

acceptable to the Government covering an amount of Rs.5 Crores (Rupees Five Crores only) (the "Earnest Amount").

…… …….…… ……... ……..….

3.3 On the Closing Date, the following actions shall be taken.

b) Simultaneous with the actions envisaged at 3.3(a) above, the Purchaser shall pay the Consideration after due adjustment with the Earnest Amount in the following manner:

(i) Rs.9,33,42,000/- (Rupees Nine Crores Thirty Three Lakhs Forty Two Thousand Only) by way of demand draft drawn in favour of India Tourism Development Corporation Limited toward dues payable under the voluntary retirement scheme under implementation by ITDC to VRS Employees as defined in Article 6.10.

(ii) Rs.94,15,040/- (Rupees Ninety Four Lakhs Fifteen Thousand Forty only) by way of demand draft drawn in favour of Dum Dum Municipality towards outstanding property taxes.

(iii) Rs.1,44,13,817/- (Rupees One Crore Forty Four Lakhs Thirteen Thousand Eight Hundred Seventeen Only) by way of demand draft in favour of Airports Authority of India towards outstanding electricity charges.

(iv) Rs.2,02,32,000/- (Rupees Two Crores Two Lakhs Thirty Two Thousand Only) by way of demand draft in favour of Airports Authority of India towards outstanding dues in respect of lease of land/Airport Restaurant.

The Government shall make best efforts to procure a No Dues Certificate from the relevant authorities as soon as practicable.

(v) Rs.5,64,73,145/- by way of Demand Draft or Bankers Cheque in favour of the Government towards share consideration for purchase Shares calculated on the basis of the Price Per Share as defined in this Agreement."

Admittedly, the appellant ultimately acquired 88.75% of the equity shares of M/s Kolkatta Hotels Private Limited and one Ashok Malhotra, a Director of the appellant acquired the balance

shares. The other consortium member under the share purchase agreement, namely, Modern Publishers did not acquire any share.

8. The following facts, therefore, stand established. M/s Kolkatta Hotels Private Limited is a sister concern of the appellant by virtue of the appellant holding 88.75% of its equity shares. The appellant invested a huge amount of about Rs.18 crores in the sister concern. The appellant and its sister concern are in the same business. For the point under consideration, it may not have made any difference even if they were not in the same business. However, the fact that they are in the same business is a further aspect in the appellant's favour. The parties admit that the appellant advanced the said sum of about Rs.10.29 crores to the appellant's sister concern free of interest. The share purchase agreement and in particular Article-3, clause 3.3(b) indicates that the appellant had to pay various amounts towards discharging the liabilities of the sister concern including towards voluntary retirement scheme under implementation by ITDC to its employees, dues of the municipality, electricity charges and lease rent.

9. Whether the amount of Rs.10.29 crores was debited to the account of the sister concern in respect of the payment made under Clause 3.3(b) of Article 3.1 of the share purchase agreement or whether the amount was actually paid to the sister concern and used by it for the purpose of business, is immaterial. Either way the amount was used for the business of the sister concern. It is not even suggested that the advance was used by the sister concern for any purpose other than for the purposes of its business. Nor was such a case raised before us.

The doubt, if any, is set at rest by the memorandum of appeal and the written submissions filed by the appellant before the CIT (Appeals). As Mr. Jain rightly pointed out, in the memorandum of appeal, the appellant expressly stated that it had advanced the amount of about Rs.10.29 crores to its sister concern as a measure of commercial expediency for the purpose of business. In the written submissions, the appellant *inter alia* stated that the appellant and the sister company were in the hotel business; that the Board of Directors of the two companies was the same; that the appellant purchased the shares of the sister company as an investment and that the investment and advances were made for the purposes of business. From the order of the CIT (Appeals), it is evident that the department never contended that the amounts were not advanced for commercial expediency. Nor was it contended that the amounts advanced were used by the sister company for any purpose other than for the purpose of its business. Indeed, such a case was not even advanced before the Tribunal.

10. The CIT (Appeals) was, therefore, entirely justified in coming to the conclusion that the amount was advanced by the appellant to its sister concern on account of commercial expediency and that the advance was used by its sister concern for the purposes of its business. The additional facts further establish the findings.

11. The Tribunal’s observation that there is nothing on record that the money advanced by the appellant to its sister company had been used as a measure of commercial expediency, was not justified. The appellant furnished all the documents in this regard. The appellant expressly stated that the amounts had been utilized for commercial activity. This assertion was never denied.

The appellant was not required to do anything further to establish its assertion that its sister company had utilized the amounts for the purposes of its business. The finding of the Tribunal is not based on any material. It is important to note that the Tribunal had not even suggested that such a case was put to the appellant or its authorized representative and that despite the same the appellant failed to establish the same.

12. The view of the Tribunal that the CIT (Appeals) had not considered the decision of the Supreme Court in *S.A. Builders Ltd. vs. Commissioner of Income-Tax (Appeals) and another (supra)* in "right spirits" and that the CIT had wrongly interpreted the judgment is not well-founded. In *S.A Builder vs. CIT (supra)*, the Supreme Court observed:-

> "It is true that the borrowed amount in question was not utilized 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." (*emphasis supplied*)

It is precisely this test that was applied by the CIT (Appeals).

13. The commercial expediency in advancing the amount is established beyond doubt. The appellant owns about 89% of the equity capital. A Division Bench of this Court in *CIT vs. Marudhar Chemicals & Pharmaceuticals (P) Ltd., (2009) 319 ITR 75 (P&H)* held:-

> "15. Section 36(1)(iii) of the Act provides that "the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession" has to be allowed as a deduction in computing the income under section 28 of the Act. The expression "for the purpose of business" has been held to be wider in scope than the expression "for the purpose of earning income, profits or gains". It has been held in *S.A. Builders Ltd.'s case* (supra) that

> when the assessee borrowed the fund from the bank and lent some of it to its sister concern as an interest free loan, then the real test to allow the interest as deduction under section 36(1)(iii) of the Act is whether this was done as a measure of commercial expediency. It has been held that in order to claim a deduction, it is enough to show that the money is expended, not on necessity and with a view to direct and immediate benefit, but voluntarily and on account of commercial expediency and in order to indirectly to facilitate the carrying on the business. 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. In *S.A. Builders Ltd.'s case* (supra), it was held that in order to decide whether it was for commercial expediency, the authorities and the courts should have examined the purpose for which the assessee advanced money to its sister concern and what the sister concern did with the money. It was further held that it is not relevant whether the assessee has utilized the borrowed amount in its own business or has advanced the same as interest free loan to its sister concern. What is relevant is whether the amount, so advanced was as a measure of commercial expediency or not. It is not necessary that the amount so advanced is earning profit or not but there must be some nexus between expenses and the purpose of business."

It is important to note that the Division Bench in arriving at its conclusion followed the judgment of the Supreme Court in *S.A. Builders Ltd. vs. Commissioner of Income-Tax (Appeals) and another (supra).* The Division Bench, in fact, after remanding the matter, expressly directed the Tribunal to consider the matter in the light of the principles laid down by the Supreme Court in *S.A. Builders Ltd. vs. Commissioner of Income-Tax (Appeals) and another (supra).*

14. The appellant's case meets each of the tests stipulated by the Division Bench. In fact, it meets a higher test. When a holding company invests amounts for the purpose of the business of its subsidiary, it must of necessity be held to be an expense on account of commercial expediency. A financial benefit of any

nature derived by the subsidiary on account of the amounts advanced to it by the holding company would not merely indirectly but directly benefit its holding company. In the case before us, the subsidiary had to be funded to a large extent for otherwise it would not have survived. If it had not survived and had gone into liquidation, the appellant would have suffered directly on account of an erosion of its entire investment in the subsidiary. In this case, the financial assistance was not only prudent but of utmost necessity for without it the subsidiary would have suffered grave financial prejudice.

15. The Tribunal, therefore, erred in coming to the conclusion that the CIT (Appeals) had not considered the judgment of the Supreme Court in the correct perspective. With respect, we find that the Tribunal has not even analyzed the judgment of the Supreme Court in *S.A. Builders Ltd. vs. Commissioner of Income-Tax (Appeals) and another (supra).*

16. As we noted earlier, the funds/reserves of the appellant were sufficient to cover the interest free advances made by it of Rs.10.29 crores to its sister company. We are entirely in agreement with the judgment of the Bombay High Court in *Commissioner of Income Tax vs. Reliance Utilities & Power Ltd., (2009) 313 ITR 340*, para-10, that if there are interest free funds available a presumption would arise that investment would be out of the interest free funds generated or available with the company if the interest free funds were sufficient to meet the investment.

17. The Assessing Officer’s view that the advance was not for business purposes as the appellant had no business dealings with the sister company is erroneous. Commercial expediency in

advancing loans does not arise only on account of there being transactions directly between the holding company and the subsidiary company or between the group companies *inter se*. The two companies may even be in a different line of business. It would make no difference. It would still be commercially expedient for one group company to advance amounts to another group company, if, for instance, as a result thereof the former benefits. In the present case, as we have already demonstrated, there would be a direct benefit on account of the advance made by the appellant to its sister company if the same improves the financial health of the sister company and makes it a viable enterprise. We hasten to add that it is not necessary that the advance results in a positive tangible benefit. So long as the amount is advanced with that view in mind or with any other commercially expedient view in mind that is sufficient.

18. In the circumstances, the question of law is answered in favour of the appellant and against the department. The order of the Tribunal is set aside. The appellant shall be entitled to the deduction under Section 36(1)(iii). There shall, however, be no order as to costs.

(S.J. VAZIFDAR)
ACTING CHIEF JUSTICE

24.07.2015
parkash*

(G.S. SANDHAWALIA)
JUDGE

NOTE:- Whether reportable: YES