

Gauhati High Court

Highways Construction Co. Pvt. ... vs Commissioner Of Income-Tax on 13 November, 1992

Equivalent citations: 1993 199 ITR 702 Gauhati

Author: U Bhat

Bench: U Bhat, N Das

JUDGMENT U.L. Bhat, C.J.

1. At the instance of the assessee, the Income-tax Appellate Tribunal, Gauhati Bench, has referred the following questions under Section 256(1) of the Income-tax Act, 1961 :

" (i) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the disallowance of interest was made on valid grounds for the assessment years 1973-74 and 1974-75?

(ii) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in upholding the action of the Inspecting Assistant Commissioner (Assessment) in including the interest on notional basis on interest-free advances made by the assessee to the managing director and others for the assessment years 1978-79 and 1979-80 ?"

2. Question No. (i) refers to a dispute in regard to the assessment years 1973-74 and 1974-75. Question No. (ii) refers to a dispute regarding assessment years 1978-79 and 1979-80.

3. The assessee, a private limited company, was engaged in the business of building construction as a contractor under M. E. S. The Income-tax Officer, in his assessment orders for the assessment years 1973-74 and 1974-75, disallowed the assessee's claim for deduction of interest of Rs. 32,934 and Rs. 44,783, respectively, on the ground that the same did not represent genuine business expenditure. The Income-tax Officer found from the balance-sheet that the assessee had raised loans from eight different parties to the extent of Rs. 1,78,020 during the accounting year 1972-73 and had repaid the same with interest on March 31, 1972, borrowed from the same parties a total amount of Rs. 1,80,000 on May 1, 1972, that is, in the assessment year 1973-74 and had raised credit from ten different parties to the total extent of Rs. 2,75,000 on various dates during the period from November 25, 1972, to August 17, 1973, and interest was payable on these loans. Thus, the total amount borrowed during the assessment year 1973-74 was Rs. 4,55,000. The Income-tax Officer further found that, on April 5, 1972, the assessee made an interest-free advance of Rs. 5,00,000 to its managing director for enabling him to liquidate his personal overdraft taken from the United Commercial Bank. The Income-tax Officer found that the transactions under which the loans taken during the accounting year 1972-73 were repaid on March 31, 1972, and fresh loans taken on May 1, 1972, constituted only rotation of loans and this and the subsequent loan taken were to grant loan to the managing director free of interest. The Income-tax Officer came to the conclusion that the assessee had thus diverted the fund raised by loans to its managing director during the year without interest. The order of the Income-tax Officer shows that the assessee explained that the borrowing had to be made on different dates, considering the voluminous contracts in hand and the probable financial requirements for the business purposes of the company. The Income-tax Officer rejected this explanation and disallowed the interest paid. The Income-tax Officer, under similar

circumstances, disallowed the interest paid during the next assessment year.

4. On appeal by the assessee, the Commissioner of Income-tax, considering that the amount of Rs. 5,00,000 was advanced to the managing director on April 5, 1972, while the borrowings were made during the period between May 1, 1972, and March 17, 1973, came to the conclusion that the borrowings had not been utilised in making advance to the managing director and the company appears to have advanced its own fund received from the allotment of further shares in March, 1972. The Commissioner further pointed out that, on the insistence of M. E. S., the paid-up share capital of the company was raised and, for this purpose, the managing director had taken a loan from his personal bankers and the loan of Rs. 5,00,000 granted to the managing director was to enable him to pay off his loans to the bankers and came to the conclusion that it appears to be a paper transaction with the help of the bankers' accommodation for a few days and struck down the disallowance of interest for the two assessment years, namely, 1973-74 and 1974-75. On appeal at the instance of the Revenue, the Tribunal, on the facts available and the materials placed before it, came to the conclusion that the Income-tax Officer had disallowed the interest payment on valid grounds and the Commissioner of Income-tax (Appeals) was not justified in deleting the same for the reasons recorded by him and restored the addition made by the Income-tax Officer.

5. In regard to the assessment years 1978-79 and 1979-80, dealing with the question of interest the Income-tax Officer referred to the unsecured loans and advances at the close of the accounting year 1977-78 standing at Rs. 7,82,829, out of which Rs. 4,21,231 was in the account of the managing director, to the fact that no interest had been charged by the assessee on the amounts loaned to the managing director as also certain other parties and, having regard to the facts and circumstances of the case as discussed in the assessment order for the earlier year, "added back Rs. 50,000 only as before, being the amount of interest the assessee-company ought to have charged in its business interest". On appeal by the assessee, the Commissioner of Income-tax (Appeals) referred to the argument of the assessee that it cannot be forced to earn and, in view of the fact that borrowed funds had not been diverted for non-business purposes, the Assessing Officer was not justified in charging notional interest, and also to his own order in the appeal for the assessment year 1977-78 that the Assessing Officer should not charge deemed interest, deleted the addition of Rs. 50,000. The Tribunal, in the appeal at the instance of the Revenue, held, " In view of what we have decided for the earlier years, the interest added by the Income-tax Officer is restored ".

6. Question No. (i).--Regarding interest payable on loan amounts, the claim of the assessee for deduction is based on Section 36(l)(iii) of the Act. Section 36 enumerates the deductions which shall be allowed in respect of the matters dealt with therein, in computing the income referred to in Section 28. Under Clause (iii), the amount of the interest paid in respect of capital borrowed for the purposes of business or profession is deductible. The Income-tax Officer and the Tribunal held that the amounts shown as interest paid during the two assessment years 1973-74 and 1974-75 are not deductible under the above provision. The question is whether, on the facts arid in the circumstances of the case, the Tribunal was justified in holding that the disallowance of interest was made on valid grounds for these assessment years. The Tribunal found that, on the facts available and on the materials before it, it is satisfied that the Income-tax Officer disallowed the interest payment on valid grounds and the Commissioner of Income-tax (Appeals) was not justified in

deleting the same for the reasons recorded by him. It is thus clear that the Tribunal accepted the findings of fact arrived at by the Income-tax Officer on the facts and materials before it. The findings of fact arrived at by the Income-tax Officer are that there were rotational loans and fresh loans were taken for the purpose of granting loan free of interest to the managing director. The Income-tax Officer also rejected the explanation that borrowing had to be made considering the voluminous contracts in hand and the probable financial requirements for the purpose of business. It is on the basis of these findings of fact that the Income-tax Officer arrived at a negative decision on the question of law whether capital was borrowed for the purpose of business. The assessee sought reference only on the question of law whether disallowance of interest was on any valid ground. He did not seek reference of the question whether the findings of fact are unreasonable or vitiated or were arrived at without considering relevant materials. We are referring to this aspect since learned counsel for the assessee contended that the fact that new loans were taken on several occasions over a long period and the loan to the managing director was made much later was not taken into consideration by the Tribunal which accepted the reasoning and conclusion of the Income-tax Officer. If the assessee wanted to contend that the finding of fact was vitiated on account of any good ground, he could have sought a reference of this question to this court. On the facts found, namely, that the loans were obtained to grant loan to the managing director free of interest, that the borrowing was not made considering the voluminous contracts in hand and the probable financial requirements for the business purpose of the company, the conclusion could only be that the loan was not borrowed for the purpose of business. We, therefore, answer the first question in the affirmative, that is, against the assessee and in favour of the Revenue.

7. While the accounts reflected grant of interest-free loan to the managing director and others, the Income-tax Officer added Rs. 50,000, being the amount of interest the assessee ought to have charged in his business interest. The amount represents the interest on the interest-free loans granted to the managing director and others. The Tribunal upheld this in view of what it had decided for the earlier years. There is a controversy as to whether the reference to earlier years in the order is a reference to the assessment years 1975-76 to 1-977-78, or to the assessment years 1973-74 and 1974-75. Paragraph 8 of the statement of facts specifically refers to paragraphs 16 and 19 of the order of the Tribunal. In paragraph 16, the Tribunal confirmed the decision of the Income tax Officer disallowing interest and, in paragraph 19, the Tribunal confirmed the decision of the Income-tax Officer adding interest. It is, therefore, clear that the reference in paragraph 19 to "what we have decided for the earlier years" is to the decision in paragraph 16 regarding the deletion of interest for the years 1973-74 and 1974-75. In other words, the Tribunal confirmed the action of the Income-tax Officer in adding interest on loans granted to the managing director and others only because it confirmed the decision of the Income-tax Officer that the loans borrowed were not for business purposes. There is no finding of fact to the effect that actually the loan had been granted to the managing director or any other person on interest, or that interest had actually been collected and the collection of the interest was not reflected in the accounts. The finding of the Income-tax Officer is that the assessee ought to have collected interest. In other words, the view of the Income-tax Officer, which has been accepted by the Tribunal, was that the assessee, as a good business concern, should not have granted interest-free loan, or should have insisted on payment of interest. If the assessee had not bargained for interest, or had not collected interest, we fail to see how the income-tax authorities can fix a notional interest as due, or collected by the assessee. Our

attention has not been invited to any provision of the Income-tax Act empowering the income-tax authorities to include in the income interest which was not due or not collected. In the view, we answer question No. (ii) in the negative, that is, in favour of the assessee and against the Revenue.

8. In the result, we answer question No. (i) in the affirmative, that is, against the assessee and in favour of the Revenue, and question No. (ii) in the negative, that is, in favour of the assessee and against the Revenue. There will be no direction as to costs.

9. A copy of the judgment under the signature of the Registrar and bearing the seal of the High Court will be transmitted to the Income-tax Appellate Tribunal, Gauhati Bench, Gauhati.