

**IN THE INCOME TAX APPELLATE TRIBUNAL
"E" Bench, Mumbai**

**Before Shri R.C. Sharma, Accountant Member
and Ms. Sushma Chowla, Judicial Member**

ITA No. 7758/Mum/2010

ITA No. 1364/Mum/2011

ITA No. 5088/Mum/2012

(Assessment Years: 2006-07, 2007-08 & 2009-10)

ACIT, Range 9(1)/ITO-9(1)(3)
Room No. 223, Aayakar Bhavan
M.K. Road, Mumbai 400020

M/s. Edicon Mining Equipment
Pvt. Limited
Vs. 11/12, Guru Govindsingh Indl.
Estate, Off W.E. Highway,
Goregaon (W), Mumbai 400060

PAN - AAACE1388C

Appellant

Respondent

Appellant by: Shri Neil Philip
Respondent by: Shri B.P. Agarwal

Date of Hearing: 03.06.2015
Date of Pronouncement: 10.06.2015

ORDER

Per Sushma Chowla, J.M.

Out of this bunch of three appeals filed by Revenue the appeal in ITA No. 7758/Mum/2010 is filed against the order of CIT(A)-19 Mumbai dated 07.09.2010 relating to A.Y. 2006-07 passed under section 143(3) of the Act. Revenue is also in appeal against separate orders of the CIT(A) dated 22.11.2010 and 25.06.2012 relating to assessment years 2007-08 and 2009-10 respectively against orders passed under section 143(3) of the Act.

2. All the three appeals relating to the same assessee on similar issue were heard together and are being disposed of by this consolidated order for the sake of convenience.

3. The Revenue, in ITA No. 7758/Mum/2010 & ITA No. 1364/Mum/2011, has raised the following grounds of appeal: -

"1. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition of Rs.18,50,000/- being*

interest disallowed u/s. 36(1)(iii) of the I.T. Act, 1961, overlooking the failure of the assessee to substantiate that the amounts borrowed were for the purpose of the assessee's business.

2. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in placing reliance on the case of M/s. S.A. Builders Ltd. [288 ITR 21 (SC)] despite the fact that the assessee's case is distinguishable on facts in so far as commercial expediency has not been proved to be the motive behind diversion of interest-bearing borrowed funds to sister concern by the assessee."*

4. The issue arising out of ground Nos. 1 & 2 is against the deletion of addition made on account of disallowance of interest under section 36(1)(iii) of the Act. The facts and issue in the present appeals are similar, however, reference is being made to the facts in ITA No. 7758/Mum/2010 to adjudicate the issue.

5. Briefly in the facts of the case, assessee is engaged in the business of manufacturing of Pneumatic Tools. During the course of assessment proceedings the AO noticed that assessee had made investment of ₹110 lakhs in the shares of its subsidiary company, i.e. Edicon Pneumatic Tools Co. Pvt. Ltd., which included advance against shares of ₹109 lakhs. During the year under consideration assessee had further advanced loan of ₹75 lakhs to Edicon Pneumatic Tools Co. Pvt. Ltd. The AO was of the view that assessee had made interest free advances to its subsidiary company of ₹185 lakhs for non business purposes although assessee had paid interest of ₹19,43,204/- and finance charges to secured/unsecured loans of ₹6,82,252/-. Assessee was asked to explain as to why proportionate interest relating to interest free loans & advances and investment made for non business purposes should not be disallowed under section 36(1)(iii) of the Act. In reply assessee stated that the said investment was made in 100% subsidiary company by way of share capital of ₹1 lakh and share application money of ₹109 lakhs and advance of ₹75 lakhs. The said investment was claimed to have been made out of Capital & Reserves and surplus of the company and it was claimed that no disallowance under section 36(1)(iii) of the Act was warranted. The AO noted that the share capital of assessee was ₹20 lakhs, which was with the company for the past several years and the same had already been utilised in application of funds in the earlier years.

The AO also noted that in A.Y. 2005-06 similar disallowance was made in the hands of the assessee. The AO further held that where the amounts borrowed by the assessee were advanced to its subsidiary without interest then the same cannot be said to have been borrowed for the purpose of assessee's own business. Further, the claim of the assessee that investment was made for the purpose of business was also not accepted, since the subsidiary company was an altogether different entity. The AO thus held that disallowance of ₹18,50,000/- was warranted under section 36(1)(iii) of the Act.

6. The CIT(A) noted that the loans and advances have been advanced to 100% subsidiary of the assessee, which was also carrying on the same business as the assessee. Further, the finding of the CIT(A) was that the money had been utilised by the said subsidiary company for business purposes. Hence, as per the CIT(A) the advances were made in furtherance of the business requirements of the assessee and it cannot be held that the same were utilised for non business purposes, where the advances were made to 100% subsidiary, which was in the same business as that of the assessee. Since the subsidiary had utilised the said amount for business purposes, the CIT(A) held that no disallowance is warranted under section 36(1)(iii) of the Act.

7. Revenue is in appeal against the said order of the CIT(A). The learned D.R. for the Revenue pointed out that where the assessee had borrowed funds on interest and investment was made in tax free funds, though with the subsidiary, in the absence of any trade between the two and in the absence of any commercial expediency, there was no merit in the plea of the assessee.

8. On the other hand, the learned counsel for the assessee pointed out that the total Capital & Reserve and surplus of the assessee as on the close of the year was ₹3 crores and even the bank loan had reduced to ₹57 lakhs. The first plea of the learned counsel for the assessee was that the said investment with the subsidiary was made out of its own Capital & Reserves and surplus. Another plea raised by the learned counsel was that the

investment was made by the assessee with its own subsidiary, who was in the same line of business with same Directors. The next plea raised by him was that the income earned by the subsidiary goes to the holding company, hence the said investment was made for business purposes. Reliance in this regard was placed upon the ratio laid down by the Hon'ble Supreme Court in the case of S.A. Builders Ltd. vs. CIT 288 ITR 21 (SC).

9. We have heard the rival submissions and perused the record. The issue arising in the present appeal is in relation to computation of disallowance, if any, under the provisions of section 36(1)(iii) of the Act. The assessee had made certain advances to its 100% subsidiary. During the year under consideration assessee had advanced loan of ₹75 lakhs to Edicon Pneumatic Tools Co. Pvt. Ltd. In the earlier year assessee had made investment of ₹110 lakhs in the shares of its subsidiary company. The Directors of the assessee firm were also Directors of the subsidiary company and the business carried on by the subsidiary company was the same as that carried on by the assessee. The claim of assessee before the AO was that the said investment was made for business purposes, hence no disallowance of interest was warranted under section 36(1)(iii) of the Act. The first advance was made by assessee to its subsidiary company vis-a-vis investment in the shares of the said subsidiary company in A.Y. 2005-06. It was claimed by the assessee that the said investment was out of its share capital. However, the AO dismissed the contention of the assessee and made disallowance under section 36(1)(iii) of the Act. The CIT(A) noted that both the assessee and its subsidiary were in the business of manufacturing of mining tools. The advance made by the assessee was utilised for the business of the subsidiary company, hence, in turn, relying upon the ratio laid down by the Hon'ble Supreme Court in the case of S.A. Builders Ltd. (supra) it was held that the said advance was because of commercial expediency and hence no part of interest was disallowable under section 36(1)(iii) of the Act. The addition made by the AO was ₹2,21,731/- and because the small tax effect no appeal was filed before the Revenue against the said order.

10. In the instant year, assessee had further advanced ₹75 lakhs to its subsidiary company. A perusal of the Balance Sheet filed for A.Y. 2006-07 at pages 1 to 5 of the paper book reflects that though the capital of the assessee company remained at ₹20 lakhs but the Reserves and surpluses are at ₹3,27,67,981/- as against ₹3,07,55,969/- declared in the preceding year. The profit declared by assessee for the year under consideration before taxation was ₹34,73,256/-. In the totality of the above said facts and circumstances, where the assessee had established availability of funds of its own and also where the investment was made in 100% subsidiary of the assessee, which in turn was engaged in the same line of business and had utilised the funds for its business, the existence of commercial expediency stands proved. In case the connection between the lender and the borrower is of commercial expediency, then in view of the ratio laid down by the Hon'ble Supreme Court in SA Builders Ltd. (supra), no disallowance is warranted under section 36(1)(iii) of the Act. In view thereof we hold that there is no justification for disallowing interest under section 36(1)(iii) of the Act and uphold the order of the CIT(A). We dismiss the grounds of appeal Nos. 1 & 2 raised by Revenue.

11. The facts and issue in ITA No. 1364/Mum/2011 are identical to the facts and issue in ITA No. 7758/2010 and our decision ITA No. 7758/2010 shall apply mutatis mutandis to ITA No. 1364/Mum/2011.

12. Now coming to the appeal of Revenue for A.Y. 2009-10 the under mentioned grounds have been raised: -

- “1. *Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) was right in deleting the addition of interest expenditure of Rs.13,90,000/-, on the ground that for A.Y. 2005-06, 2006-07 and 2007-08, the department has accepted the CIT(A)'s decision. The disallowance made by the Assessing Officer as interest expenses was on account of interest free advances, which were not used for the purpose of assessee's business. Further, the CIT(A)'s order for A.Y. 2005-06 was not challenged due to low tax effect and appeals on the same issue have been preferred against CIT(A)'s order for A.Y. 2006-07 & 2007-08.*
2. *Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) was right in allowing the excess remuneration of Rs.22,80,000/- paid to directors in assessee company viz-a-viz sister*

company which was disallowed by the Assessing Officer without appreciating the fact that services rendered by the directors were similar in nature. Further the expenditure was considered excessive on the basis of comparisons of two companies having same management and same line of business and assessee's failure to justify the heavy expenses claimed by it as against the expenses claimed by its sister concern which enjoys benefit u/s. 10B.

13. The issue in ground No. 1 raised by Revenue is identical to the ground No. 1 raised in A.Y. 2006-07 and A.Y. 2007-08, which we have adjudicated in the paras hereinabove. Following the same parity of reasoning, we uphold the order of the CIT(A) in deleting the disallowance under section 36(1)(iii) of the Act. Accordingly ground No. 1 raised by Revenue is dismissed.

14. Now coming to ground No. 2 raised by the Revenue, the issue is against the allowance of remuneration paid to the Directors at ₹22,80,000/-. On comparison of the remuneration paid by the assessee company to its Directors and the remuneration paid to the Directors of Edicon Pneumatic Tools Co. Pvt. Ltd, the AO was of the view that there was no justification for huge payment of remuneration of Directors in assessee's case vis-a-vis its sister concern, where the company was in the same line of business and having common Directors. As per the AO it was evident that similar nature of services were rendered by the Directors in both the companies. The only difference between the companies was that assessee company was 36 years old whereas the subsidiary was only 5 years old and in view thereof AO allowed only a remuneration of ₹3,50,000/- and the balance remuneration of ₹22,80,000/- was disallowed.

15. The CIT(A), on consideration of the facts, observed as under: -

“5.3 I have carefully considered the facts of the case, the submissions of the appellant the assessment order and the order of CIT(A) for A.Y. 2008-09. The A.O. has disallowed the remuneration on the ground that much less remuneration was paid in the case of sister concern. Although, this could be a starting point to suspect that excessive remuneration was paid but for effecting an addition the suspicion has to be grounded on fair market value of services rendered. The A.O. however, did not carry out such exercise. On the other hand the appellant has explained that the appellant is a 35 year old company whereas the subsidiary is only in business for last 4 years. It has also been mentioned that the subsidiary is export oriented unit which is mainly automated and located in single building with less overheads.

The A.O. has not indicated as to how the turnover could be a sound basis for comparison of remuneration. Even if it is so, there could be a case for examining the lesser remuneration paid in the case of subsidiary company. The remuneration of around Rs.25 lakhs paid to three directors who were promoters of the company in 35 year old company does not seem to be excessive and thus the disallowance of ₹22,80,000/- is directed to be deleted. Ground No. 2 is allowed.”

16. The learned D.R. for the Revenue could not controvert the findings of the CIT(A). In view thereof we uphold the order of the CIT(A) in allowing the claim of Director’s remuneration. The ground of appeal No. 2 raised by the Revenue is dismissed.

17. In the result, all the three appeals filed by the Revenue are dismissed.

Order pronounced in the open court on 10th June, 2015.

Sd/-
(R.C. Sharma)
Accountant Member

Sd/-
(Sushma Chowla)
Judicial Member

Mumbai, Dated: 10th June, 2015

Copy to:

1. *The Appellant*
2. *The Respondent*
3. *The CIT(A) – 19, Mumbai*
4. *The CIT– V, Mumbai City*
5. *The DR, “E” Bench, ITAT, Mumbai*

By Order

//True Copy//

Assistant Registrar
ITAT, Mumbai Benches, Mumbai

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