

**IN THE INCOME TAX APPELLATE TRIBUNAL
CHANDIGARH BENCHES 'SMC' CHANDIGARH**

BEFORE SHRI H.L.KARWA, HON'BLE VICE PRESIDENT

ITA No. 327 /Chd/2012
(Assessment Year: 2007-08)

Late Sh.Jagat Singh Vs. The Income Tax Officer,
Through L/H Gurjit Singh Ward 1 (2),
S/o Sh.Jagat Singh, Chandigarh.
179, Industrial Area, Phase II,
Chandigarh.
PAN No. ACEPS9772K

And

ITA No. 326 /Chd/2012
(Assessment Year: 2007-08)

Fenzer Shoe Industries, Vs. The Income Tax Officer,
179, Industrial Area, Phase II, Ward 4(1),
Chandigarh. Chandigarh.
PAN No. ACEPS9772K

(Appellant)

(Respondent)

Appellant by : Shri Gurjit Singh
Respondent by : Shri Jitender Kumar, DR

Date of hearing : 24.07.2015

Date of Pronouncement : 10.08.2015

ORDER

PER H.L.KARWA, VP :

These two appeals involving common issue were heard together and are being disposed off by this common order for the sake of convenience.

2. Firstly, I will take up ITA No.327/Chd/2012. In this appeal, the assessee has raised the following grounds :

- “1. *Treatment of advances amounting Rs.25,00,000/-, during previous year i.e. AY 2006-07, to son for acquiring assets for firm's own business & Rs.9,00,000/- to son, for few days, for Disawar Account (day to day requirements of the firm) as loan to disallow proportionate interest amounting Rs.1,49,941/- under section 36(l)(iii) of the Income-Tax Act, 1961 is arbitrary.*
2. *Disallowance of proportionate interest amounting Rs.1,49,941/- under section 36(l)(iii) of the Income-Tax Act, 1961 is not proper, as the relevant amounts has been used for acquiring assets for firm's own use. It is pertinent to mention here that with the help of the finances in question, the firm owned it's Retail Outlet in Bay Shop 44-45, Sector 22-B, Chandigarh.*
3. *The amount of Rs.25,00,000/- can not be questioned beyond it's relevant year i.e. A.Y. 2006-07. This amount was advanced by it's erstwhile proprietor of the firm during A.Y. 2006-07.”*

3. Briefly stated, the facts are that the assessee was proprietor of a firm dealing in manufacturing and trading of shoes. The return for the assessment year 2007-08 was filed on 29.10.2007 declaring an income of Rs.1,96,650/-. During assessment proceedings, the Assessing Officer noticed that the assessee had advanced an interest free amount of Rs.25,00,000/- to Shri Gurjit Singh on 7.10.2015. It was also noticed that the assessee was paying interest to Bank amounting to Rs.1,49,941/-. It was explained to the Assessing Officer that the amount was utilized for purchasing

immovable property, but the Assessing Officer noticed that this advance was never utilized for the purpose of business and therefore he disallowed interest parallel to bank interest @ 12.25%, on the above said interest free advances, following the judgment of the Hon'ble Punjab & Haryana High Court in the case of CIT Vs. Abhishek Industries Ltd. 286 ITR 1 (P&H).

4. The learned CIT (Appeals) vide his order dated 9.12.2011 upheld the disallowance by stating that the assessee had not explained as to how it was commercially expedient to advance such a large amount. The learned CIT (Appeals) held that since it was borne out from records that the assessee had borrowed certain funds on which liability to pay interest was being incurred and on the other hand, certain amounts had been advanced to sister concerns or others without carrying any interest and without any business purpose, interest to the extent the advance has been made without carrying any interest had to be disallowed under section 36(i)(iii) of the Income Tax Act, 1961 (in short 'the Act').

5. Aggrieved by the order of the learned CIT (Appeals), the assessee has filed the present appeal before the Tribunal.

6. Shri Gurjit Singh, legal heir of late Shri Jagat Singh appeared before this Bench of the Tribunal and submitted that commercial expediency had been clearly established in this case. He argued that the sum of Rs.25 lacs advanced by

the assessee to his son Mr. Gurjit Singh, had been utilized to acquire commercial properties. The legal heir of the assessee stated that these commercial properties were used to expand the family business, by opening more shops in them. This, as per the learned counsel for the assessee, resulted in tremendous increase in volumes of the family business.

7. As per Shri Gurjit Singh, commercial expediency, was established by the fact that the advance was utilized for the expansion/securing of business of the family. He emphasized that it is not relevant for establishing commercial expediency, to whom the advance has been made. He further relied upon the decision of the I.T.A.T., Chandigarh Bench in the case of Thukral Regal Shoes Vs. ACIT, Circle 2(1), Chandigarh in ITA No. 650/Chd/2011, wherein it has been held with respect to investments in the same properties, that the investments and conduct of business in these properties was out of commercial expediency.

8. Shri Jitender Kumar, the learned D.R. relying upon the order of the learned CIT (Appeals), contended that since no commercial expediency of the advance had been established by the assessee, interest relating to the advance was rightly disallowed under section 36(i)(iii) of the Act. The learned D.R placed reliance on the judgment of the Hon'ble Apex Court in the case of SA Builders Ltd. 288 ITR 1 (SC) and on the decision of the Hon'ble Punjab & Haryana High Court in the case of Abhishek Industries 286 ITR 1 (P&H) in support of his contention.

9. I have heard the rival submissions and perused the record. The facts emerging therefrom are that on 7.10.2005, an interest free advance of Rs.25,00,000/- was given by the assessee to his son Mr. Gurjeet Singh. Out of this amount, Rs.10,00,000/- was utilized by Mr. Gurjit Singh, vide Bankers Cheque No.176420, for making payment to HUDA for purchase of commercial property SCO No. 259, Sector-14, Panchkula on 17.11.2005 in the name of Shri Gurjeet Singh and his brother Sh. Harinder Singh. Interestingly, the said property has not been purchased in the name of late Shri Jagat Singh, who has advanced the amount in question. According to the Assessing Officer, the argument put-forth by the assessee firm is only on the account that the amount of Rs.25 lacs was advanced to expand the business of late Shri Jagat Singh. Balance amount of Rs.15,00,000/- was credited into the account of M/s Thukral Regal Shoes, in which Mr. Gurjit Singh is a partner. SCO No. 259, Sector-14, Panchkula was sold on 27.11.2006. The assessee claimed that at present their family members are having two showrooms, one in Sector 22, Chandigarh and other (SCF No.3) in Sector 11-D, Chandigarh), which was purchased vide Sale Deed dated 29.8.2008 in the name of Smt.Pritpal Kaur, Smt. Gurminder Kaur and Smt. Paramdeep Kaur, who were partners in the firm Fenzer Shoes. The Assessing Officer observed that the said advance of Rs.25 lacs was never utilized for the purpose of erstwhile proprietor of the firm late Shri Jagat Singh as well as by the partners of M/s Fenzer Shoe Industries in any way during the financial year 2006-07.

10. The issue in the present appeal is against the disallowance of interest under section 36(i)(iii) of the Act, on the interest free advance made by the assessee to his son.

11. It is important to understand the provision of section 36(1)(iii) of the Act, with respect to its scope and implications before adjudicating on the issue at hand. For the same, the section is reproduced hereunder:

36 (i) 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 capitalized 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.

12. A bare reading of the section shows that for claiming deduction of interest under section 36(i)(iii) of the Act, the following conditions have to be satisfied :

1. *There should be borrowed capital.*
2. *interest must be paid on the borrowed capital and,*

3. *The borrowed capital must be for the purpose of business and profession.*

13. In the instant case, it is not in dispute that the assessee has borrowed capital, on which interest has been paid. The only dispute is regarding the fact, whether the borrowed capital has been used for the purpose of the business.

14. In the case of S.A. Builders Ltd. (supra), the Hon'ble Supreme Court has dealt with the expression "for the purpose of business" occurring in section 36(i)(iii) of the Act and has held at Para 23 and 32 of the order as under :

23. *" In our opinion, the decisions relating to Section 37 of the Act will also be applicable to Section 36(1) (iii) because in Section 37 also the expression used is "for the purpose of business". It has been consistently held in decisions relating to Section 37 that the **expression "for the purpose of business" includes expenditure voluntarily incurred for commercial expediency, and it is immaterial if a third party also benefits thereby.**"*

32. *" 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.** "*

Clearly, commercial expediency of the advance has to be established, to prove that the money was borrowed for the purpose of business.

15. In this case, it emerges from the facts, that the advance of Rs.25 lacs given to Shri Gurjit Singh by the assessee was partly utilized to purchase a property SCO 259 Sector-14, Panchkula in the name of Shri Gurjit Singh and his brother Shri Harinder Singh. Balance amount was utilized by Shri Gurjit Singh, by infusing capital in his partnership concern, namely Thukral Regal Shoes. None of the investments were made in the name of the assessee, nor was it demonstrated before me as to how these investments benefited the assessee. Clearly the aforesaid investments did not in any way contribute to the assessee's business. It is only Shri Gurjit Singh, who happened to benefit by these investments. What emerges therefore from the facts is that the interest free advance given by the assessee to his son, was solely for the personal benefit of his son. Clearly such an advance does not qualify as advance for commercial expediency of the assessee. In fact, the Hon'ble Apex court in the case of S.A. Builders (supra) at para 36 of the order has clearly given a similar example stating that such advances do not qualify as a measure of commercial expediency.

“36. “We wish to make it clear that it is not our opinion that in every case interest on borrowed loan has to be allowed if the assessee advances it to a sister concern. It all depends on the facts and circumstances of the respective case. For

instance, if the Directors of the sister concern utilize the amount advanced to it by the assessee for their personal benefit, obviously it cannot be said that such money was advanced as a measure of commercial expediency. However, money can be said to be advanced to a sister concern for commercial expediency in many other circumstances (which need not be enumerated here). However, where it is obvious that a holding company has a deep interest in its subsidiary, and hence if the holding company advances borrowed money to a subsidiary and the same is used by the subsidiary for some business purposes, the assessee would, in our opinion, ordinarily be entitled to deduction of interest on its borrowed loans.”

The Hon'ble Madras High Court in CIT Vs. M.S. Venkateswaran (1996) 222 ITR 163 (Mad) has observed as under :

“Interest paid on borrowed capital will be allowed as a deduction only if the capital was borrowed and used for the purposes of business. If it is used for a purpose other than business then interest to the extent to which the capital was so used will not be allowed as a permissible deduction under the provisions of section 36(1)(iii) of the Act. “

In the above judgment, the Hon'ble Madras High Court has held as under :

“We have heard learned standing counsel for the Department and Perused the records carefully. The fact remains that the assessee's father Died on July 10, 1970. The first assessment year after the father's death was the assessment for the accounting year relevant to the year ending March 31, 1970. In the balance-sheet as on March 31, 1972, on the credit side, the assessee's capital account was shown at Rs. 1,58,675 and the advance against contracts was shown at Rs. 1,53,392.68. The total comes to Rs.3 lakhs. On the debit side, the old proprietor's account in respect of which the case of diversion for non-business purposes is made, amounts to Rs.22,20,590.96 (?). According to the Department, they have clearly established that a portion of the borrowed capital was utilised by the father of the assessee for non-business purposes and, therefore, the interest paid thereon cannot be allowed as a deduction under section 36(l)(iii). According to the Tribunal, when an assessee had invested his own capital In his business and also borrowed monies for the purpose of his business, Any subsequent withdrawal for his personal use would be presumed to Be out of his capital and would not entitle the Department to disallow a Part of the interest paid. But the Department pointed out that this is subject to the proof given by the Department that a particular portion of the borrowed capital was utilised by the assessee for non-business purposes. According to the Department, it was clearly established that the father of the assessee had utilised a portion of the borrowed capital for non-business purposes, in such a case it was submitted that interest cannot be allowed on such borrowed capital, which was utilised for non-business purposes. In the order, the Tribunal failed to consider the submission made by the Department that they have established that a portion

of the borrowed capital was utilised by the father of the assessee for non-business purposes. The facts on record would clearly go to show that the father of the assessee had definitely diverted a portion of the borrowed capital for his own purposes and not for business purposes. In such a case, it cannot be said that there can be a presumption that a part of the capital would have been diverted for non-business purposes not from the borrowed capital but from the capital contributed by the assessee. In the absence of such an element in the facts arising in the present case, we are unable to subscribe to the view of the Tribunal that the assessee is entitled to deduction under section 36(l)(iii) with regard to the interest paid on borrowed capital, which was utilised by the assessee's father for non-business purposes. In that view of the matter, we answer the question referred to us in the negative and in favour of the Department. There will be no order as to costs."

In CIT Vs. V.I. Baby and Co. [2002] 254 ITR 248, the Kerala High Court, while reversing the order of the Tribunal, held as under:

*"We are inclined to accept the argument raised by counsel for the Revenue, because the advances to the partners, their relatives and the sister concerns are not for business purposes and the assessee has not derived any benefit out of the same. Admittedly, no interest was charged on these advances. The Tribunal appears to have placed reliance on the fact that the partners and their relatives have utilised the amounts for business purposes, such as construction of a shop building etc. **So long as the assessee firm is not the beneficiary of such investments, the nature of investment***

or the utilization of such advances has no relevance.

16. In view of the above decisions, and also considering the facts of the present case, in my opinion, the advance given to Shri Gurjit Singh is not for the purpose of business and interest relating to the same does not qualify for deduction under section 36(i)(iii) of the Act.

17. Further, even, if the aforesaid advance is treated as being given for the purpose of business, though it has already been decided otherwise above, the interest relating thereto still does not qualify for deduction under section 36(i)(iii) of the Act, due to the proviso to section 36(i)(iii) of the Act.

18. As per the proviso interest pertaining to capital borrowed for acquiring an asset, shall not be allowed as deduction upto the period till the asset is first put to use.

19. In the case before me, even if the acquisition of SCO 259, Sec-14, Panchkula is treated as for the purpose of business, it emerges from the facts, that the asset was not put to use in the year at all. No evidence has been brought on record to prove that, SCO 259, Sec-14, Panchkula was put to use in the business of the assessee during the impugned year. In fact, SCO-259, Sector-14, was sold on 27.11.2006. Hence also, by virtue of the proviso to section 36(i)(iii) of the Act, the interest paid on borrowed capital does not qualify for deduction under section 36(i)(iii) of the Act.

20. Coming to the arguments of the legal heir of the assessee, it appears that he has incorrectly interpreted the meaning of commercial expediency. As has been explained above, commercial expediency includes such expenditure as a prudent business man incurs for the purpose of business. Some benefit direct or indirect must accrue to the assessee. In the present case, it has not been established as to what benefit accrued to the assessee by virtue of this advance. In fact, benefit if any, seems to be accrued to the son of the assessee Mr. Gurjit, who has bought a commercial property in SCO 259, Sec-14, Panchkula in his name. Balance amount of Rs.15 lacs has been credited in to the account of M/s Thukral Regal Shoes, in which Shri Gurjit Singh is a partner. This amount has been introduced as capital of Shri Gurjit Singh in the said partnership /firm. The reliance placed by the legal heir of the assessee on the judgment of the I.T.A.T., Chandigarh Bench in the case of Thukral Regal Shoes, also seems to be misplaced. The facts in the case of Thukral Regal Shoes are distinguishable from the facts of the present case. In the case of Thukral Regal Shoes, the firm i.e. Thukral Regal Shoes, had advanced sums to its partners, who had utilized the same to acquire commercial properties, in one of which the business of the firm was continued. Since, in that case, the firm had benefited by the advance made to the partners, commercial expediency had been established and no disallowance of interest was therefore held to be warranted under section 36(i)(iii) of the Act, by the Tribunal. In this case, as stated above, it has not been established as to how

the advance made by the assessee to his son had benefited the assessee. Even the facts prove otherwise. Thus, the decision in the case of Thukral Regal Shoes does not apply to the facts of the present case.

21. I, therefore, hold that the disallowance of interest of Rs.1,49,941/- under section 36(1)(iii) of the Act, has been correctly upheld by the learned CIT (Appeals).

22. In the result the appeal of the assessee is dismissed.

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23. The facts in the present case are that, Fenzer Shoes Industries is a partnership firm, formed on 1.12.2006, by the takeover of the business of late Shri Jagat Singh on as is where is basis. The firm comprised of the daughter in laws of late Shri Jagat Singh as partner, namely Smt.Pritpal Kaur, Smt.Gurminder Kaur and Smt.Paramdeep Kaur .

24. The advance of Rs.25 Lacs given by late Shri Jagat Singh to his son Shri Gurjit Singh from his proprietorship concern before takeover, continued to appear in the books of Fenzer Shoes Industries, as such. The Assessing Officer disallowed interest relating to the same amounting to Rs.1,00,000/- under section 36(1)(iii) of the Act, following the same reasoning as given in the case of late Shri Jagat Singh. The learned CIT (Appeals) upheld the same, against which the assessee has come up in appeal before the Tribunal.

25. The arguments advanced in the case of late Shri Jagat Singh, were adopted in the present case also by the respective parties.

26. I find that the facts in the case of Fenzer Shoes Industries are similar to the case of late Shri Jagat Singh through his legal heir Shri Gurjit Singh in ITA No.327/Chd/2012. The nature of the advance has not changed by virtue of the takeover of the business. The findings in that case that the advance was not for business purpose, therefore, also applies to the present case.

27. I, therefore, hold that the disallowance of interest of Rs.1,00,000/- under section 36(1)(iii) of the Act, has been correctly upheld by the learned CIT (Appeals).

28. In the result both the appeals of the assesses are dismissed.

Order pronounced in the open court on this 10th day of August, 2015.

Sd/-
(H.L.KARWA)
VICE PRESIDENT

Dated : 10th August, 2015

Rati/AG

Copy to: The Appellant/The Respondent/The CIT(A)/The CIT/The DR.

Assistant Registrar,
ITAT, Chandigarh

