

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

BEFORE SHRI G.S.PANNU, ACCOUNTANT MEMBER
AND MS SUSHMA CHOWLA, JUDICIAL MEMBER

ITA No. 915/Chd/2008
Assessment Year: 2005-06

M/s C.R. Auluck & Sons Pvt. Ltd.,
Ludhiana

Vs. ACIT, Circle VII,
Ludhiana

PAN No. AAACC675F

(Appellant)

(Respondent)

Appellant By : Shri Sudhir Sehgal & Shri Ashok Goyal
Respondent By: Smt. Inoshi Sharma

ORDER

PER SUSHMA CHOWLA, JM

The appeal by the assessee is against the order of CIT(A)-II, Ludhiana dated 29.8.2008 relating to assessment year 2005-06 against the order passed under section 143(3) of the I.T. Act.

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

- 1. That the worthy CIT-II Ludhiana has erred in confirming the action of the Assessing Officer in disallowance of interest to the tune of Rs. 14,82,695/- u/s 36(1) (iii) being the proportionate interest which works on interest free loan given to sister concern M/s Luxmi Engg. Works out of borrowed funds*
- 2. That the worthy CIT(A) has not appreciated the fact that the interest free loan advanced to the sister concern M/s Luxmi Engg. Works was as a measure of commercial expediency. As such, there was nexus of use of borrowed funds for the purpose of business to claim deduction u/S 36 (i)(iii) of Income Tax Act.*

3. *That the CIT(A) has not considered our submissions properly in which it was explained in detail about the loan advanced to sister concern for the commercial expediency and nexus of use of borrowed funds for the purpose of business.*

3. The only issue in the present appeal is against the disallowance of interest u/s 36(1)(iii) of the Act amounting to Rs. 14,82,695/- . The brief facts of the case are that on the perusal of the balance sheet, the Assessing Officer noted the assessee had made advances to its sister concern and others totaling Rs. 2,31,23,236/- . The learned AR for the assessee was asked to furnish the details of loans and advances made and whether any of the same had been given interest free to the sister concerns for non business purposes. In reply, the assessee furnished the details of loans and advances given. A sum of Rs. 1,23,65,787/- was given to M/s Luxmi Engg. Works, a sister concern of the assessee. As the assessee had paid interest at the rate of 12% on its borrowings, it was asked to explain why proportionate disallowance may not be made u/s 36(1)(iii) of the Act. In reply, it was submitted that the assessee had taken a mortgage loan of Rs. 100 lacs from the bank and the same was advanced to the sister concern M/s Luxmi Engg Works in the last week of March, 2004. Further submission was that the said firm had overdrawn its credit limits with the bank and the account was in the danger of being declared NPA (Non Productive Asset) by the bank on 31.3.2004. The assessee had also stood guarantee to the credit limits advanced by the bank to M/s Luxmi Engineering Works. Hence, in order to save the firm from being declared as NPA, and to ensure the survival of the said firm, the assessee had advanced sum of Rs. 100 lacs during the year free of interest to its sister concern. The said advance was claimed to be for commercial expediency. The Assessing Officer rejected the plea of the assessee

regarding commercial expediency. He further observed that apart from the assessee, two other companies were also guarantors in the loan taken by M./s Luxmi Engineering Works from the bank and none of the said two concerns had given any loans to save their sister concern. The Assessing Officer noted that the two investment companies who had stood guarantee were not making profits and the assessee before us was making profits, hence, funds were transferred for reducing the tax liability of the profit making concern. Applying the ratio laid down by the Hon'ble Punjab & Haryana High Court in CIT Vs. Abhishek Industries [286 ITR 1 (P&H)], the Assessing Officer disallowed a sum of Rs. 14,82,695/- being 12% interest on the said advances. The Assessing Officer also held that the ratio of commercial expediency quoted by the Hon'ble Supreme Court in M/s S.A. Builders [288 ITR 1 (SC)] was not applicable in view of no business expediency. Another plea of the assessee that both the assessee and its sister concern were supplying their goods to one concern was held by the Assessing Officer not to be a case of business expediency in relation to the assessee. The CIT(A) upheld the order of Assessing Officer on all counts and also agreed with the Assessing Officer that the commercial expediency for the purpose of examining and applicability of the ratio laid down in M/s S.A. Builders Ltd (Supra) had to be seen with reference to the loan given and not to the loan receiver. The CIT(A) thus held that in view of the ratio laid down in CIT Vs. Abhishek Industries Ltd (Supra), the disallowance of interest u/s 36(1)(iii) of the Act is upheld. The assessee is in appeal against the aforesaid order of CIT(A).

4. The learned AR for the assessee pointed out that the advances to the sister concern were made on account of commercial expediency. It was pointed out that assessee was supplying sewing machines to M/s Usha

International and the sister concern was supplying fans to the said concerns. The assessee in order to save its reputation and goodwill in the market had advanced Rs. 1 Cr interest free to its sister concern. It was further pointed by the learned AR that both the concerns had raised bank loans and the assessee was a guarantor of loan advanced to M/s Luxmi. In case, the assessee was declared NPA, the creditability of the assessee also gets affected. Reliance was placed on the ratio laid down by the Hon'ble Supreme Court S.A. Builder Ltd Vs. CIT (Supra) for the proposition that no disallowance is warranted u/s 36(1) (iii) of the Act where the amounts are advanced, interest free to the sister concern for commercial expediency. Further reliance was placed on the ratio laid down in CIT Vs. Delhi Safe Deposit Company [133 ITR 756 (SC)]. Payments being made for saving business reputation and its allowability as business expenditure was the next plea of the learned AR for the assessee. The learned AR relied upon CIT Vs. Georgepolous [146 ITR 380 (Mad)] and Surat Electricity Co Ltd Vs. CIT [35 DTR (Ahd)(Trib) 272]. The learned AR also pointed out that the ratio laid down in CIT Vs. Abhishek Industries Ltd (supra) was not applicable as the amount was advanced for business purposes. The learned DR pointed out that both the concerns were making different products and were supplying to M/s Usha Enterprises and there was no connection between the two. The Learned DR further stated that the expenditure incurred on the loan taken and advanced interest free to the sister concern were not in the course of business and hence not allowable. The learned DR pointed that there should be nexus between the expenditure incurred and the business carried on in order to establish commercial expediency. The learned AR for the assessee in rejoinder stated that the different products supplied by the two concerns, i.e. the assessee and its sister concern would not make any

differences as in S.A. Builders vs CIT (supra), the Hon'ble Supreme court has recognized that in order to establish nexus between the expenditures and the purposes of business, the business of sister concern need not necessarily be the business of the assessee itself.

5. We have heard the rival contentions and perused the records. The issue arises in the present appeal with regard to the allowability of deduction u/s 36(1)(iii) of the Act. The assessee during the year under consideration had raised loan of Rs. 100 lacs from its banks, which was advanced interest free to the sister concern of the assessee M/s Luxmi Engineering Works. The loan was borrowed from the bank at interest cost of 12% and the same was advanced interest free to the sister concern. The plea of the assessee for making the said advance to its sister concern is that the same has been advanced for commercial expediency. The assessee and the sister concern had individually overdrawn credit limits from banks. The assessee had stood guarantee to the credit facilities availed by the sister concern. Because of non payment, the said overdraft account available by the sister concern was in danger of being declared as NPA by the bank. In order to ensure the firm not being declared as NPA, the assessee before us had made the said advances to its sister concern. The second plea of the assessee was that both the concerns were supplying its products to M/s Usha International and hence the business expediency.

6. The allowability of interest on borrowed capital wherein interest bearing funds have been advanced interest free to the sister concern was deliberated upon by the Hon'ble Supreme Court in S.A. Builders Vs. CIT (Supra). The ratio laid down by the Hon'ble Supreme Court is as under:-

“In order to decide whether interest on funds borrowed by the assessee to give an interest free loan to a sister concern (e.g. a subsidiary of the assessee) should be allowed as a deduction under section 36 (1)(iii) of the Income Tax Act, 1961, one has to enquire whether the loan was given by the assessee as a measure of commercial expediency.”

7. Their lordships further held that for allowing the deduction u/s 36(1)(iii) of the Act of interest paid on amounts borrowed for advancing loans to a sister concern, the authorities *“should examine the purpose for which the assessee advance the money and what the sister concern did with the money”*. The test of commercial expediency is to be satisfied before allowing of claim of expenditure on account of interest on borrowed capital u/s 36(1)(iii) of the Act. The Hon'ble Supreme Court further observed as under:-

“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 business expenditure if it was incurred on grounds of commercial expediency.”

8. It was concluded as under:-

“We wish to make it clear that it is 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 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.”

9. Coming to the facts of the present case before us, we find that the share holding of the directors in the assessee company and the partners in the sister concern M/s Luxmi Engineering Works are common. The two concerns are family concerns having different lines of manufacturing. The assessee is manufacturing sewing machines under the brand name of ‘Luxmi’ and as per the assessee major portion of the sales are being made to M/s Usha International Ltd. The sister concern is engaged in the manufacturing of fans under the brand name ‘Luxmi’ and 90% of the sales are being made to M/s Usha International Ltd. Both the concerns had taken independent credits limits from Punjab National Bank and the assessee had stood guarantor to the credit limits advanced to the sister concern. However, M/s Luxmi Engineering works had gone into huge losses and the bank account was proposed to be declared NPA by the bank. The fear of the assessee was that the amount could have been recovered from its being the guarantor which in turn would have affected its working and in turn its goodwill and reputation in business. In order to safeguard its business interest, the assessee claims to have raised a loan of Rs. 100 lacs from bank and advanced the same to its sister concern

10. The basis for allowing an expenditure in the hands of the assessee is an expenditure incurred for the purpose of business. Applying the ratio of commercial expediency propounded by the Hon'ble Supreme Court in S.A. Builders Vs. CIT (Supra), we find that the intention of the assessee in advancing the said loan interest free to its sister concern is not for the purpose of business. The two concerns were carrying on independent lines of manufacturing and the products manufactured were different by each of the concern. The end products were being supplied to one concern i.e M/s Usha International Ltd. The plea of the assessee in this regard is that the products were being supplied under the same brand name 'Luxmi' by the two concerns does not establish the stand of the assessee that its reputation will be affected specially in the facts and circumstances of the case where both the concerns were supplying different items to M/s Usha International Ltd. No evidence has been brought on record to show how the non supply by the sister concern M/s Luxmi Engineering Works would affect the business of the assessee. Further, the availing of independent loans from the banks and its non payment by the sister concern or the sister concern being declared NPA has no relation with the business being carried on by the assessee. The fear of the amount being recovered from the assessee because of the guarantees given, does not mean that the advancing of interest free loans to the sister concern is being in the course of carrying on the business by the assessee. The plea of the loss of reputation and goodwill of the assessee in view of sister concern being declared NPA does not justify the advancing of interest free loan out of borrowed funds, as the same is not for the purpose of business of assessee.

11. We find support from the ratio laid down by the Chandigarh Bench of the Tribunal in M/s Hero Cycles Ltd Vs. ACIT (ITA No. 768/Chandi/2005) relating to Assessment Year 2001-02 wherein while allowing the claim of deduction u/s 37(1) of the Act, the expression 'for the purpose of business' has been considered in the light of the ratio laid down in various judgments by the Hon'ble Apex Court. A reference has been made to the ratio laid down by Apex Court in CIT Vs. Chandu Lal Keshav Lal & Company [38 ITR 601], which reads as under:-

“11.3 Infact, a gainful reference can be made to the judgement of the Hon'ble Apex Court in the case of CIT v. Chandulal Keshavlal and Co. reported in 38 ITR 601. In the said case, assessee was a managing agent of a company and commission of Rs 309114/- accrued to it. The financial position of the managed company was not good and as such it gave up full amount of claim of commission and agreed to take only Rs 100000/- only. The AO taxed the entire amount of Rs 309114/- as income of the assessee. The ITAT held that the amount of Rs 209114/- given up was for the purposes of business and hence allowable as business expenditure. It held that the assessee's business prosperity is linked up with managed company, if the managed company grew assessee's commission would also grow and consequently the amount given up was a justified expenditure. The Hon'ble High Court and Supreme Court upheld the findings of the ITAT. The Hon'ble Apex Court while approving the order of ITAT made the under mentioned observations:-

“Another fact that emerges from these cases is that if the expense is incurred for fostering the business of another only or was made by way of distribution of profits or was wholly gratuitous or for some improper or oblique purpose outside the course of business then the expense is not deductible. In deciding whether a payment of money is a deductible expenditure one has to take into consideration questions of commercial expediency and the principles of ordinary commercial trading. if the payment or expenditure is incurred for the purpose of the trade of the assessee it does not matter that the payment may inure to the benefit of a third party (Usher's Wiltshire Brewery Limited v. Bruce). Another test

is whether the transaction is properly entered into as a part of the assessee's legitimate commercial undertaking in order to facilitate the carrying on of its business; and it is immaterial that a third party also benefits thereby (Eastern Investments Ltd. v. Commissioner of Income-tax). But in every case it is a question of fact whether the expenditure was expended wholly and exclusively for the purpose of trade or business of the assessee. In the present case the finding is that it was laid out for the purpose of the assessee's business and there is evidence to support this finding. Mr. Palkhivala referred in this connection to Atherton v. British Insulated & Helsby Cables Limited where at page 191 Viscount Cave L.C., observed:

" It was made clear in the above cited cases of Usher's Wiltshire Brewery v. Bruce and Smith v. Incorporated Council of Law Reporting that a sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency and in order indirectly to facilitate the carrying on of the business may yet be expended wholly and exclusively for the purposes of the trade; and it appears to me that the findings of the Commissioners in the present case bring the payment in question within that description. They found (in words which I have already quoted) that the payment was made for the sound commercial purpose of enabling the company to retain the services of existing and future members of their staff and of increasing the efficiency of the staff; and after referring to the contention of the Crown that the sum of pound 31,784 was not money wholly and exclusively laid out for the purposes of the trade under the rule above referred to, they found that the deduction was admissible--thus in effect, although not in terms, negating the Crown's contention. I think that there was ample material to, support the findings of the Commissioners, and accordingly that this prohibition does not apply." (Underlined for emphasis by us)"

12. Applying the test of commercial expediency propounded by the Apex Court in S.A. Builders Ltd (Supra), the Tribunal in Hero Cycles Ltd Vs. ACIT held as under:-

".....In fact, learned counsel for the assessee had relied upon the judgement of the Hon'ble Apex

Court in the case of S.A.Builders Ltd. (supra) for the proposition that the purpose of the business need not necessarily be the business of the assessee itself. In the said judgement, the Hon'ble Apex Court has noted that where it is obvious that a holding company has a deep interest in a subsidiary and if the holding company advanced borrowed money to a subsidiary and the same is used by the subsidiary for some business purpose, the assessee would be entitled to deduction of interest on its borrowed loans. On the basis of the aforesaid, it is argued by the learned counsel that in this case, subsidy has been provided to MAL to recoup its losses and even if it is said that the subsidy is not for assessee's own business purpose, but it can be said to be for the purposes of MAL's business purposes and thus, the said expenditure would be allowable for deduction u/s 37(1) of the Act because the assessee has deep interest in MAL. We have carefully considered this plea and in our opinion, the case of the assessee has to fail. We are unable to appreciate and nor is there any evidence or pleading set up as to how the money provided to MAL as subsidy has been used by it for its business purposes. As noted earlier, in terms of the judgement of the Hon'ble Apex Court in the case of Chandu Lal Keshav Lal & Co. (supra) where the expenditure is incurred for only fostering the business of another concern or the payment is wholly gratuitous or is for some oblique purpose outside the course of business, such expenditure is not deductible. The instant is a case where the business of the other concern has been sought to be fostered by way of a gratuitous disbursement and hence, the reasoning enunciated by the Hon'ble Apex Court in the case of S.A.Builders Limited (supra) does not help the case of the assessee.....”.

13. We find that the assessee has failed to establish its case of commercial expediency. That in the circumstances where interest bearing borrowed loans have been advanced for non business purposes, the ratio laid down by the Hon'ble Punjab & Haryana High Court in CIT Vs. Abhishek Industries (Supra) is applicable. Accordingly, we uphold the disallowance of Rs. 14,82,695/- being interest attributable to the interest free advances made by the assessee to its sister concern out of interest

bearing borrowed funds. The order of the CIT(A) is upheld. Thus, the grounds of appeal raised by the assessee are dismissed.

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

Order Pronounced in the Open Court on this 30th day of June, 2010.

Sd/-
(G.S.PANNU)
ACCOUNTANT MEMBER
Dated : 30th June, 2010
Rkk

Sd/-
(SUSHMA CHOWLA)
JUDICIAL MEMBER

Copy to:

1. *The Appellant*
2. *The Respondent*
3. *The CIT*
4. *The CIT(A)*
5. *The DR*