CASE NO.:
Appeal (civil) 5811 of 2006

PETITIONER:
S. A. Builders Ltd. .. Petitioner

RESPONDENT:
Commissioner of Income Tax (Appeals) Chandigarh & Anr. .. Respondents

DATE OF JUDGMENT: 14/12/2006

BENCH:
S. B. SINHA & MARKANDEY KATJU

JUDGMENT:
J U D G M E N T
(Arising out of Special Leave Petition Nos. 21707-21710/2004)

[with CA Nos. 5812 /2006 @ SLP(Civil) Nos. 1300-1301/2005]

MARKANDEY KATJU, J.

Leave granted.

These two appeals involve common questions of law and fact and hence are being disposed of by a common judgment.

Since the leading case is that of S.A. Builders [SLP(C) 21707-21710/2004], we shall be taking note of the facts of this case.

These appeals have been filed against the impugned judgment of the Punjab and Haryana High Court dated 13.5.2004 in Income Tax Appeal Nos. 6, 7, 119 and 120 of 2003, and the judgment dated 21.5.2004 in ITA No. 117/118 of 2003.

Heard learned counsel for the parties and perused the record.

During the course of the proceeding for the relevant assessment year(s), the Assessing Officer under the Income Tax Act observed that the assessee had transferred a huge amount of Rs. 82 lakhs to its subsidiary company M/s. SAB Credits Limited out of the cash credit account of the assessee in which there was a huge debit balance. He, therefore, held that since the assessee had diverted its borrowed funds to a sister concern without charging any interest, proportionate interest relating to the said amount out of the total interest paid to the bank deserved to be disallowed. Accordingly, he disallowed a sum of Rs. 5, 66, 729/- .

The assessee preferred an appeal to the Commissioner of Income Tax (Appeals) Chandigarh [for short hereinafter referred to as the CIT(A)], who vide his order dated 15.4.1993 partially accepted the claim of the assessee. According to the CIT (A), out of the total amount of Rs. 82 lacs advanced by the assessee in the relevant assessment year to M/s. SAB Credit Limited, only a sum of Rs. 18 lacs had a clear nexus with the borrowed funds, as the balance amount had been paid out of the receipts from other parties to whom no interest had been paid. Accordingly, the CIT(A) directed the Assessing Officer to calculate disallowance of interest only relating to the sum of Rs. 18 lacs, and the disallowance was reduced accordingly.

Both the assessee as well as the Revenue filed appeals before the Income Tax Appellate Tribunal (hereinafter referred to as the 'Tribunal'). The Tribunal by its order dated 20.6.2002 allowed the appeal of the Revenue, and held that the entire amount of Rs. 82 lacs had been advanced by the assessee by utilizing the overdraft account, and hence it was of the view that disallowance made by the Assessing Officer was justified. Accordingly, the appeal filed by the Revenue was allowed and the appeal field by the assessee was dismissed.

Against the order of the Tribunal, the assessee filed appeals in the High Court which were dismissed by the impugned judgment.

In the assessment year 1991-92, the Assessing Officer noticed that in addition to the sum of Rs. 82 lacs advanced in the assessment year 1990-91, a further sum of Rs. 37,85,000/- had been advanced to M/s. SAB Credits Ltd which also had a clear nexus with the amounts borrowed by the assessee on payment of interest. Accordingly, the Assessing Officer disallowed proportionate interest relatable to these amounts amounting to Rs. 20,08,836/-.

On appeal by the assessee, the CIT(A) upheld the finding of the Assessing Officer that the sum of Rs. 37,85,000/- advanced during assessment year 1990-91, was relatable to the borrowed funds. However, in view of the findings of her predecessor in assessment year 1990-91, that out of Rs. 82 lacs advanced during that year, advance of Rs. 64 lacs had no nexus with the borrowed funds, she reduced the disallowance from Rs. 20,08,836 to Rs. 10,03,538/- vide her order dated 28.7.1994. The assessee was granted further relief of Rs. 1,48,464/- by the CIT(A) vide order dated 6.9.1995 under Section 154 of the Act. On the cross-appeals filed by the assessee as well as the Revenue, the Tribunal following its order for assessment year 1990-91, upheld the disallowance as made by the Assessing Officer. Accordingly, the appeal of the revenue on this issue was allowed and that of the assessee dismissed.

Against this decision also, the assessee filed an appeal before the High Court.

In the impugned judgment dated 13.5.2004, the High Court held that the Tribunal had recorded a categorical finding of fact that the amount advanced by the assessee to M/s. SAB Credits Limited by utilizing the overdraft account and that on the date on which the amount was advanced there was no credit balance in the bank account of the assessee. The Tribunal further observed that the assessee has not been able to explain the purpose for which the amount had been advanced to its sister concern without charging any interest and there was no material on record to show that the assessee had derived any business benefit by advancing the interest free amounts to its sister concern.

The High Court held that since it stands established that the amount of Rs. 82 lacs and Rs. 37.85 lacs had been advanced by the assessee to its sister concern from out of the overdraft account with the bank in which there was already a debit balance, the order of the Tribunal does not suffer from any factual or legal infirmity. Accordingly, the High Court dismissed the appeal.

Learned counsel for the appellant-assessee submitted that the High Court has erred in failing to consider the fact that the appellant had made the advances to its sister concern by withdrawals from its bank accounts in which there was sufficient credit balance as the appellant had received payments from its clients. It is an admitted fact that the appellant had received these payments from its clients and had deposited these in the account out of which advances were subsequently made to the sister concern. These deposits/payments/advances of Rs. 82 lacs as and when received and made by the appellant to its sister concern, namely, SAB

Credits Ltd in the Assessment Year 1990-91 are reproduced hereunder in a tabular form:

Date	Ch. No.	Amount	Name of Bank	Course of funds
16.9.1989	683366	24.00 lacs	State Bank of Patiala, CC Account	Amount received from R.C.I., Hyderabad, a client
25.9.1989	684404	18.00 lacs	-do-	From cash credit account (Debit balance account)
27.12.1989	676546	20.00 lacs	-do-	From Indian Acrylics Ltd., a client
12.01.1990	476582	20.00 lacs	-do-	-do-
		Rs. 82.00 lacs		

Learned counsel for the appellant submitted that a perusal of the above tabular statement makes it apparent that such payments as claimed were in fact received and deposited. Thus, there is no direct nexus between the amount borrowed by the appellant-assessee from the bank and the loans advanced by the appellant-assessee to its sister concern, as no amount was so advanced by raising an interest bearing loan.

Learned counsel submitted that the High Court has erred in not considering the categorical finding of the CIT(A) in this regard. He further stated that the CIT(A) in its order dated 15.4.1993 had given a clear finding of fact that except a sum of Rs. 18 lacs there was no clear nexus between the amount received on interest and the interest free advance made to M/s. SAB Credits Limited. He further stated that the amount of Rs. 24 lacs, 20 lacs and 20 lacs respectively, were not paid out of the cash credit account but were paid out of the receipts from other parties to whom no interest had been paid. The amount of Rs. 18 lacs was paid out of the cash credit account because there was a debit balance of Rs. 18 lacs on that date and, therefore, a clear nexus is proved in respect of the amount of Rs. 18 lacs in the interest bearing loans and interest free advances. On this view, the CIT(A) held that the Assessing Officer should have only disallowed interest relatable to Rs. 18 lacs and not the entire amount of Rs. 82 lacs.

Learned counsel for the appellant submitted that even this disallowance of Rs. 18 lacs by the CIT(A) was erroneous and the entire sum of Rs. 82 lacs should have been allowed.

In paragraph 35-41 of its order the Tribunal has considered in detail the question of allowability of the interest amount on the borrowed funds. The Tribunal was of the view that the assessee had given an advance of Rs. 82 lacs to its sister concern without charging any interest. The Tribunal further observed that there was no material on record to show that the assessee derived any business advantage by advancing an interest free amount of Rs. 82 lacs to its sister concern. It referred to several decisions in support of the view which it took.

We have considered the submission of the respective parties. The question involved in this case is only about the allowability of the interest on borrowed funds and hence we are dealing only with that question. In our opinion, the approach of the High Court as well as the authorities below on the aforesaid question was not correct.

In this connection we may refer to Section 36(1)(iii) of the Income Tax Act, 1961 (hereinafter referred to as the 'Act') which states 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 tax under Section 28 of the Act.

In Madhav Prasad Jantia vs. Commissioner of Income Tax U.P. AIR 1979 SC 1291, this Court held that the expression "for the purpose of business" occurring under the provision is wider in scope than the expression "for the purpose of earning income, profits or gains", and this has been the consistent view of this Court.

In our opinion, the High Court in the impugned judgment, as well as the Tribunal and the Income Tax authorities have approached the matter from an erroneous angle. In the present case, the assessee borrowed the fund from the bank and lent some of it to its sister concern (a subsidiary) on interest free loan. The test, in our opinion, in such a case is really whether this was done as a measure of commercial expediency.

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.

Thus in Atherton vs. British Insulated & Helsby Cables Ltd (1925)10 TC 155 (HL), it was held by the House of Lords that in order to claim a deduction, it is enough to show that the money is expended, not of necessity and with a view to direct and immediate benefit, but voluntarily and on grounds of commercial expediency and in order to indirectly to facilitate the carrying on the business. The above test in Atherton's case (supra) has been approved by this Court in several decisions e.g. Eastern Investments Ltd. vs. CIT (1951) 20 ITR 1, CIT vs. Chandulal Keshavlal & Co. (1960) 38 ITR 601 etc.

In our opinion, the High Court as well as the Tribunal and other Income Tax authorities should have approached the question of allowability of interest on the borrowed funds from the above angle. In other words, the High Court and other authorities should have enquired as to whether the interest free loan was given to the sister company (which is a subsidiary of the assessee) as a measure of commercial expediency, and if it was, it should have been allowed.

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.

No doubt, as held in Madhav Prasad Jantia vs. CIT (supra), if the borrowed amount was donated for some sentimental or personal reasons and not on the ground of commercial expediency, the interest thereon could not have been allowed under Section 36(1)(iii) of the Act. In Madhav Prasad's case (supra), the borrowed amount was donated to a college with a view to commemorate the memory of the assessee's deceased husband after whom the college was to be named. It was held by this Court that the interest on the borrowed fund in such a case could not be allowed, as it could not be said that it was for commercial expediency.

Thus, the ratio of Madhav Prasad Jantia's case (supra) is that the borrowed fund advanced to a third party should be for commercial expediency if it is sought to be allowed under Section 36(1)(iii) of the Act.

In the present case, neither the High Court nor the Tribunal nor other authorities have examined whether the amount advanced to the sister concern was by way of commercial expediency.

It has been repeatedly held by this Court that the expression "for the purpose of business" is wider in scope than the expression " for the purpose of earning profits" vide CIT vs. Malayalam Plantations Ltd. (1964) 53 ITR 140, CIT vs. Birla Cotton Spinning & Weaving Mills Ltd (1971) 82 ITR 166 etc.

The High Court and the other authorities should have examined the purpose for which the assessee advanced the money to its sister concern, and what the sister concern did with this money, in order to decide whether it was for commercial expediency, but that has not been done.

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.
Learned counsel for the Revenue relied on a Bombay High Court decision in Phaltan Sugar Works Ltd. Vs. Commissioner of Wealth-Tax (1994) 208 ITR 989 in which it was held that deduction under Section 36(1)(iii) can only be allowed on the interest if the assessee borrows capital for its own business. Hence, it was held that interest on the borrowed amount could not be allowed if such amount had been advanced to a subsidiary company of the assessee. With respect, we are of the opinion that the view taken by the Bombay High Court was not correct. The correct view in our opinion was whether the amount advanced to the subsidiary or associated company or any other party was advanced as a measure of commercial expediency. We are of the opinion that the view taken by the Tribunal in Phaltan Sugar Works Ltd (supra) that the interest was deductible as the amount was advanced to the subsidiary company as a measure of commercial expediency is the correct view, and the view taken by the Bombay High Court which set aside the aforesaid decision is not correct.

Similarly, the view taken by the Bombay High Court in Phaltan Sugar Works Ltd. vs. Commissioner of Wealth-Tax (1995) 215 ITR 582 also does not appear to be correct.

We agree with the view taken by the Delhi High Court in CIT vs. Dalmia Cement (Bhart) Ltd. (2002) 254 ITR 377 that once it is established that there was nexus between the expenditure and the purpose of the business (which need not necessarily be the business of the assessee itself), the Revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the board of directors and assume the role to decide how much is reasonable expenditure having regard to the circumstances of the case. No businessman can be compelled to maximize its profit. The income tax authorities must put themselves in the shoes of the

assessee and see how a prudent businessman would act. The authorities must not look at the matter from their own view point but that of a prudent businessman. As already stated above, we have to see the transfer of the borrowed funds to a sister concern from the point of view of commercial expediency and not from the point of view whether the amount was advanced for earning profits.

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.

In view of the above, we allow these appeals and set aside the impugned judgments of the High Court, the Tribunals and other authorities and remand the matter to the Tribunal for a fresh decision, in accordance with law and in the light of the observations made above.

We also make it clear that we are not setting aside the order of the Tribunal or other Income Tax authorities in relation to the other points dealt with by these authorities, except the point of deduction of interest on the borrowed funds.