statements that the appellant possessed sufficient interest-free funds of Rs. 4,09,791 lakhs as on 31.03.2020 and Rs. 3,24,420 lakhs as on 31.03.2021, which comfortably exceeded the interest-free advances of Rs. 2,98,581 lakhs and Rs. 2,57,218 lakhs respectively. Applying the settled law laid down by the Hon'ble Bombay High Court in *CIT v. Reliance Utilities and Power Ltd.* (313 ITR 340), a presumption arises that such advances were made out of interest-free funds and not out of borrowed funds.

1. The appellant had submitted a detailed tabulated summary in its reply which provides a comprehensive overview of the funds allocated to subsidiaries, detailing both the utilization of these funds by the subsidiaries and the commercial rationale behind such allocations. This summary highlights how the funds were employed and the business justifications supporting the expenditure, offering a clearer understanding of the financial decisions made within the group. It reveals that the advances were made to subsidiaries and associates engaged in the real estate business, with whom the appellant has long-standing business relations and from whom it has derived and expects to derive substantial construction contracts.

1. The AO in the assessment order had relied upon the case of CIT v. H.R. Sugar Factory Pvt. Ltd. (Allahabad HC) in which the assessee borrowed secured loans from banks at 8% interest and advanced them to its directors at 2.25%. The Court held that since the assessee was not in the business of lending, such an arrangement was detrimental to its interest, as borrowed funds were diverted for non-business purposes. The fact of the present case is different. In the appellant's case, funds were advanced to subsidiaries **out of interest-free funds**, not out of borrowed funds. Moreover, such subsidiaries are engaged in the same line of business (real estate), and the advances were commercially expedient. In contrast, the

cited case involved diversion of **interest-bearing loans to directors** at concessional rates, without any nexus to business. Thus, this case laws relied by the AO is not applicable.

1. The AO in the assessment order had relied upon the case Patel Filters Ltd. v. CIT (Gujarat HC) in which the issue was whether expenses incurred for obtaining a loan should be treated as capital or revenue in nature. The Court held that such expenses are revenue as they relate to securing loans, not acquiring assets. Other incidental issues (foreign travel expenses, Section 43B) were also decided. The fact of the present case is different. The case relates to **treatment of loan acquisition expenses** (capital vs. revenue), which is wholly unrelated to the appellant's matter. No parity of facts exists with the issue of interest disallowance on advances to group concerns. Thus, this case laws relied by the AO is not applicable.

1. The AO in the assessment order had relied upon the case CIT v. Vallabh Glass Works Ltd. (Gujarat HC) in which the assessee incurred bank guarantee commission, letter of credit charges, and survey fees while importing machinery. The Court held guarantee commission and LC charges to be capital in nature, forming part of asset cost, whereas survey fees were revenue. The fact of the present case is different. This case pertains to the **capitalization of incidental costs of machinery acquisition**, which is entirely different from the appellant's case involving disallowance of interest under Section 36(1)(iii). Hence, it has no relevance here. Thus, this case laws relied by the AO is not applicable.
2. The AO in the assessment order had relied upon the case Indian Shavings Products Ltd. v. CIT (Rajasthan HC) in which the assessee borrowed funds and advanced them to subsidiaries for acquiring control in another company by way of investment in shares. The Tribunal and Court held that such advances were not for business purposes. The fact of the present case is different. In

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the appellant's case, advances were made to subsidiaries **from interest-free funds** and were used in the same line of real estate business, strengthening commercial ties. In contrast, in the cited case, borrowed funds were advanced to subsidiaries which diverted them for **acquisition of control in an unrelated entity**, without any business nexus. Thus, this case laws relied by the AO is not applicable.

3. The AO in the assessment order had relied upon the case Caldern Pharmaceuticals Pvt. Ltd. v. CIT (Calcutta HC) in which the assessee borrowed funds and appointed a sister concern as a marketing agent. Disallowance of interest was made, but the Court held that Section 36(1)(iii) only requires that borrowings are for business purposes and interest is paid. Since borrowings were used in business, interest was deductible. The fact of the present case is different. This judgment was actually **in favour of the assessee**, allowing deduction under Section 36(1)(iii). Hence, the AO's reliance is misplaced as it strengthens, rather than weakens, the appellant's position.
4. The AO in the assessment order had relied upon the case CIT v. Bombay Samachar Ltd. (Bombay HC) in which the assessee shared expenses with sister concerns, resulting in debit balances. The AO disallowed part of interest, alleging diversion. The Court held that debit balances were mere adjustments, not loans, and since borrowings were used in business, full interest deduction was allowable. The fact of the present case is different. This case also supports the assessee's position. The AO has wrongly relied on it, as the Court upheld full deduction under Section 36(1)(iii) in favor of the assessee.
5. The AO in the assessment order had relied upon the case K. Somasundaram & Bros. v. CIT (Madras HC) in which the Court held that where borrowed funds are diverted for non-business purposes, interest thereon cannot be allowed as deduction. The fact of the present case is different. In the appellant's case, advances were made from **own interest-free funds**, not borrowed funds.

Therefore, there is no diversion of borrowed funds and the ratio of this case does not apply. Thus, this case laws relied by the AO is not applicable.

6. The AO in the assessment order had relied upon the case Elmer Havells Electrics v. CIT (Delhi HC) in which The assessee borrowed funds and simultaneously advanced large interest-free loans to sister concerns. The Tribunal found a direct nexus between borrowings and such advances, and the High Court upheld the disallowance, holding that commercial expediency was not established. The appellant's case is different because (i) there is a clear availability of **ample interest-free funds** exceeding the amount advanced, and (ii) advances to subsidiaries were commercially expedient as they are in the same line of business. Hence, unlike the cited case, no nexus between borrowed funds and advances exists. Thus, this case laws relied by the AO is not applicable.

1. In the case of *S.A. Builders Ltd. v. CIT* (288 ITR 1), the Hon'ble Supreme Court dealt with the disallowance of interest under Section 36(1)(iii), where borrowed funds were advanced as interest-free loans to a sister concern. The Assessing Officer had disallowed proportionate interest, holding that funds were diverted without any business benefit. This was upheld by the Tribunal and the High Court. The Supreme Court, however, held that the correct test is whether such advances were made on grounds of **commercial expediency**, and not merely for earning profits. It clarified that "for the purpose of business" is a much wider expression than "for earning income" and includes expenditure voluntarily incurred to facilitate business indirectly. Advances to group companies can therefore qualify as being for the purpose of business, provided they serve business interests and are not driven by personal or non-business considerations. In the present case, the Ld. AO has similarly questioned the commercial expediency of interest expenditure claimed by the appellant and disallowed the same on

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the ground that funds were advanced to sister concerns without charging interest. However, the AO has ignored the fact that the appellant's sister concerns are engaged in the same line of real estate development business and the advances facilitated their acquisition of land/projects from which the appellant has derived and expects to derive substantial construction contracts. Thus, the ratio laid down by the Hon'ble Supreme Court directly supports the appellant's case.

1. In the case of CIT v. Dalmia Cement (Bharat) Ltd. (Delhi High Court, 254 ITR 377), the Delhi High Court held that under Section 37(1), the Revenue's role is limited to verifying whether expenditure is real and wholly for business, and it cannot question the reasonableness of such expenditure. Once a nexus with business is established, the Revenue cannot substitute its judgment for that of the businessman. On interest disallowance under Section 36(1)(iii), the Court held that deduction cannot be denied merely because the assessee also had alternative non-interest bearing funds available. So long as borrowings were for business purposes and interest was paid, the deduction must be allowed. The Court clarified that "for the purpose of business" is wider than "for earning income" and includes commercial expediency. In the instant case, Section 36(1)(iii) has been invoked by the AO to disallow interest. The appellant has duly satisfied the conditions of allowability — borrowings are for business, interest is actually paid, and advances are commercially expedient. The AO's approach of questioning the reasonableness or necessity of advancing funds to group concerns is contrary to the principle laid down in *Dalmia Cement*. This case reinforces that once the nexus with business is demonstrated; the AO cannot step into the shoes of the businessman. Hence, the judgment is squarely applicable in favor of the appellant.

1. In the case of Hero Cycles (P) Ltd. v. CIT (379 ITR 347, SC), the

Supreme Court dealt with disallowance of interest under Section 36(1)(iii) where advances were made to group concerns. The AO had disallowed interest alleging lack of commercial expediency. The Apex Court held that once it is established that there was a nexus between advancing of funds and business purpose, the disallowance cannot be sustained. The Court observed that commercial expediency is a matter to be judged from the point of view of the businessman and not of the Revenue authorities. In the appellant's case too, the advances to subsidiaries and associates were made to strengthen long-term business interest, as these entities are in real estate development and have awarded construction contracts to the appellant in the past and are expected to continue doing so in future. Following the ratio in *Hero Cycles*, such advances are clearly guided by commercial expediency and are wholly for the purpose of business. Hence, the judgment is squarely applicable in favor of the appellant.

1. In the case of CIT v. Reliance Utilities and Power Ltd. (313 ITR 340, Bom HC), the Bombay High Court held that if both interest-free funds and borrowed funds are available, and the investment/advance is less than the interest-free funds available, a presumption arises that the investment was made from interest-free funds. In such circumstances, no disallowance of interest is warranted. In the appellant's case, as on 31.03.2021 interest-free funds available were Rs. 3,24,420 lakhs, whereas advances to group companies stood at only Rs. 2,57,218 lakhs. Similarly, as on 31.03.2020, interest-free funds were Rs. 4,09,791 lakhs as against advances of Rs. 2,98,581 lakhs. In both years, interest-free funds were comfortably higher. Applying the presumption laid down in *Reliance Utilities*, it must be held that advances were out of interest-free funds, and therefore, the judgment is squarely applicable in favor of the appellant.
2. Further recently the Hon'ble Supreme court in the case of The South Indian Bank Ltd. v. CIT (2021) case addressed whether

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interest expenses on borrowed funds should be disallowed when a company has interest-free funds and makes tax-exempt investments. The ruling established that if the taxpayer's own interest-free funds exceed the amount of their tax-exempt investments, there is a presumption that the investments were made from those own funds, thus preventing disallowance of interest expenditure. The Court held that when a company mixes interest-bearing borrowed funds with interest-free funds and makes tax-exempt investments, the presumption is that the tax-exempt investments are funded by the interest-free funds. Further, If the tax-free investments are made from these mixed funds, and the interest-free funds are sufficient to cover the investments, then proportionate interest expenditure cannot be disallowed under the relevant tax provisions. The judgment drew upon a strong line of precedents—including *Reliance Industries Ltd.*, *HDFC Bank Ltd.*, *Bombay Dyeing & Mfg. Co.*, *Suzlon*, *Microlabs*, and *Max India*—to reinforce the approach favoring assessees, holding that availability of interest-free funds justifies treating investments as coming from such funds

1. Recently the Hon'ble Supreme court in the case of *Reliance Industries Ltd.* upheld the Bombay High Court's judgment and the Tribunal's finding that the available interest-free funds were adequate to meet the investments. It therefore affirmed the presumption that investments or advances were made from interest-free funds. As a result, **no** disallowance under sections like 36(1)(iii) (interest on borrowed capital for business purposes) or 14**A** was warranted.

1. Vide reply dated 05.09.2025, the appellant had also replied that no disallowance of interest expenses has ever been made by the AO in any earlier assessment year though the assessee has incurred interest expenditure in those years.

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1. The Supreme Court in the decision of CIT (LTU) vs. Reliance Industries Limited (2019) 307 CTR 121 (SC) held that when interest free funds available with the appellant are sufficient to meet its investment, then, it can be presumed that investments are made from those funds and hence, the interest is allowable as a deduction in terms of section 36(1)(iii) of the Act
2. The Bombay High Court in CIT v. Reliance Utilities and Power Ltd. (2009) 313 ITR 340 (Bom) held that the where the Tribunal has recorded a clear finding that the appellant possessed sufficient interest-free funds of its own which were generated in the course of the relevant financial year, apart from substantial shareholders fund, the presumption stands established that the investments in sister concerns were made by the appellant out of interest-free funds and, therefore, no part of the interest on borrowings can be disallowed on the basis that the investments were made out of interest bearing funds.

1. The Gujarat High Court in CIT vs. R K Kalthia Engineering & Automobiles (P) Ltd. [33 taxmann.com 14] has held that the disallowance of interest expenditure was not permissible where the AO had disallowed interest paid on borrowed funds on the ground that assessee diverted interest bearing funds for the purpose of investment in shares and loans to sister concern when sufficient Interest free funds were available with the assessee. The relevant extract is as under:-

"6. It is a well-established proposition that when the Revenue fails to establish any nexus between the borrowed funds and the funds diverted/lent, any denial of allowances of interest under section 36[1](iii) is not permissible. In the instant case, as both the authorities have held concurrently on the basis of material available that sufficient amount of interest-free funds were available with the assessee-respondent and therefore also, there is no justification in

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interfering with the decision of both these authorities. Resultantly, the question of law proposed is answered accordingly."

1. The Mumbai Tribunal in Metro Exporters Ltd v. ITO (ITA No. 1693/ M/05) held that a presumption cannot always be made that source of investment is borrowed funds in cases where mixed (own and borrowed) funds are used. Where an assessee has sufficient interest free funds (capital and reserves), disallowance for alleged use of borrowed funds is not warranted. Relevant extract of the same is reproduced below:

   "On the basis of above discussion a proposition / Formula can be laid down that if an assessee having sufficient interest free funds, in the form of capital reserves and other funds without interest bearing from relatives and friends not related to business, to cover funds given interest free or utilized other than for business purposes, no disallowance are warranted. If the own funds are not sufficient to cover interest free advances, a proportionate disallowance is warranted. While examining interest free funds available with assessee and interest free? given a care is required to be taken that these funds were not related to business of the assessee. Capital and Reserves are certainly assessee's own interest funds. This proportion is fortified by the decision of ITAT in the case of Torrent Financers V. ACIT, 73 TTJ 624 (Ahd), judgment of Allahabad High Court in the case of CIT V. Prem Heavy Engineering Works P. Ltd., 285 ITR 554 (All.), and the judgment of Hon'ble Supreme Court in the case of Munjal Sales Corporation V. CIT, 298 ITR 298 (SC).

1. The Supreme Court in CIT v. Reliance Industries Limited (2019)410 ITR 466 held that:

   Where there is a finding of fact that interest free funds available to the assessee were sufficient to meet its investment it will be presumed that investments were made from such interest free funds and, hence, on this ground alone the deletion of *disallowance of interest claimed under section 36(1)(iii) was upheld. In the case of South Indian Bank Ltd. (2021) 438 ITR 1 (SC) had to consider the issue as where interest free own funds available with the assessee exceeded the investments in tax free securities, could the investments be presumed to be made out of assessee's own funds and, hence, a proportionate disallowance is not warranted under section 14A of the Act. Thus applying the ratio of both the judgments, we direct that no disallowance of interest be made in respect of amount invested in subsidiaries either under section 36(1)(iii) or section 14A. The ground of the revenue is dismissed and the ground of the assessee is allowed.*

1. In this regard, at very outset, section 36(1) (iii) of the Act is reproduced as under:

"36. Other deductions.-(1) 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 out to use, shall not be allowed as deduction." (emphasis supplied)

On perusal of the above, it may be noted that interest expenditure incurred by any taxpayer is allowable as business expenditure under section 36(1)(iii) of the Act, subject to fulfillment of tite following conditions:

1. moneys should be borrowed by the appellant

2. the same must be borrowed for the purpose of the siness; and e

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borrowed amount.

3. the appellant must have paid interest on the borrowed amount.

Satisfaction of condition (1) and (3) above is not in dispute. As regards to the satisfaction of condition (2) above it is respectfully submitted that the investments made by the appellant in its subsidiaries and joint venture was entirely for the purpose of business as explained above.

Reliance is placed, in this regard, on the following decisions, wherein it has been held that interest paid on capital borrowed is allowed under section 36(1)(iii) of the Act if same has been incurred for the purpose of business or profession.

1. The Hon'ble Supreme Court in the case of CIT vs. Malayalam Plantations Limited: 53 ITR 140 at page 150 of the judgment explained the expression "for the purpose of the business" in the following terms:

"The aforesaid discussion leads to the following result: The expression" for the purpose of the business" is wider in scope than the expression "for the purpose of earning profits". Its range is wide it may take in not only the day to day running of a business but also the rationalization of its administration and modernization of its machinery; it may include measures for the preservation of the business and for the protection of its assets and property from expropriation, coercive process or assertion of hostile title; it may also comprehend payment of statutory dues and taxes imposed as a pre-condition to commence or for carrying on of a business; it may comprehend many other acts incidental to the carrying on of a business. However wide the meaning of the expression may be, its limits are implicit in it. The purpose shall be for the purpose of the business, that is to say, the expenditure incurred shall be for the carrying on of the business and the assessee shall incur it in his capacity as a person carrying on the business. It cannot include sums spent by the assessee as agent of a third party, whether the

origin of the agency is voluntary or statutory; in that event, he pays the amount on behalt of another and for a purpose unconnected with the business." (Emphasis supplied)

1. The aforesaid view has been reiterated in the following cases:

   CIT v. Birla Cotton Spg. And Wwg. Mills Ltd.: 82 1TR 166 (SC)

   Madhav Prasad Jatia v. CIT U.P. 118-ITR 200 (SC)

1. In other words, as per section 36(1)(iii), the amount of interest paid in respect of capital borrowed ford for the purpose(s) of the business is allowed business deduction in computing the Income of the assessee under the head "profits and gains of business or profession in terms of section 28 of the Act.
2. It is a settled principle of law that where interest free loans are advanced by a company to another company or investments for holding controlling interest in a company is made pursuant to commercial expediency, then interest on funds borrowed by the borrowing company is admissible as business deduction, irrespective of the fact that no interest is charged/ actually received on such loan or no income is earned/accrued on the investments.
3. Further, it is submitted that there is no bar under the Act to have transactions with group companies and the appellant is free to conduct business in the manner most suitable to it and the commercial or business expediency of incurring any expenditure is to be seen from the assessee's point of view. It is also a settled law that it is the prerogative of the businessman to organize its affairs in a manner best suited to it and the revenue authority cannot step into the shoes of the businessman.
4. The Hon'ble Supreme Court in the case of SA Builders v. CIT (Appeals): 288 ITR 1 considered a case where the assessee had made interest free advances to its sister concern out of the funds borrowed for business purposes on which interest was payable. The Court held that the real test to determine whether the interest is allowable or not is to judge whether this was done as a measure of

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commercial expediency or not. The Court, while affirming the decision of Delhi High Court in the case of CIT vs. Dalmia Cement: 254 ITR 377 held that once nexus has been established between the interest paid and the purpose of the business, the Revenue cannot sit in judgment over the reasonableness of the expenditure and the interest paid by the assessee on the borrowed funds advanced to sister concerns is allowable deduction.

1. The Hon'ble Supreme Court in the case of Hero Cycle Ltd. v. CIT: 379 ITR 347 held that once it is established that there is nexus between the expenditure and the purpose of business (which need not necessarily be the business of the assessee itself), the revenue cannot justifiably put itself in the arm-chair of the businessman and decide how much expenditure is reasonable, having regard to the circumstances of the case.
2. It is of utmost important to note that the Hon'ble Supreme Court, in the above case, specifically considered similar argument, as taken by the AO that interest on loans taken from banks for business purposes is not allowable since the assessee had advanced interest free funds to another company and/or to director of the company. On that ground, the High Court affirmed the disallowance made by the assessing officer. Repelling the said contention of the AO, as affirmed by the High Court, their Lordships of the Supreme Court held that such an approach is clearly faulty in law and cannot be countenanced. The pertinent observations of the Court are reproduced hereunder:

9. A perusal of the order passed by the High Court would reveal that the High Court has not at all discussed the aforesaid facts which were established on record pertaining to the interest free advance given to M/s. Hero Fibres Limited as well as loans given to its own Directors at interest at the rate of 10 per cent.

10. On the other hand, the High Court has simply quoted from its own judgment in the case of CIT v. Abhishek Industries [2006] 286

ITR 1/156 Taxman 257 (Punj. & Har.). On that basis, it has held that when loans were taken from the banks at which interest was paid for the purposes of business, the interest thereon could not be claimed as business expenditure.

11. We are of the opinion that such an approach is clearly faulty in law and cannot be countenanced.

12. Insofar as loans to the sister concern/subsidiary company are concerned, law in this behalf is recapitulated by this Court in the case of S.A. Builders Ltd. v. CIT (Appeals) (2007 (288) ITR 1/158 Taxman 74].

After taking note of and discussing on the scope of commercial expediency, the Court summed up the legal position in the following manner-

26. 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.

27. No doubt, as held in Madhav Prasad Jatia v. CIT [1979 (118) ITR 200 (SC)], 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 [1979 (118) ITR 200 (SC)], 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.

28. Thus, the ratio of Madhav Prasad Jatia's case [1979 (118) ITR

200 (SC)] 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.

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

30. 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 v. Malayalam Plantations Ltd. (1964 53 ITR 140 (SC), CIT v. Birla Cotton Spinning and Weaving Mills Ltd. (1971 82 ITR 166 (SC)], etc.'

13. In the process, the Court also agreed that the view taken by the Delhi High Court in CIT v. Dalmia Cement (P.) Ltd. [2002] 254 ITR 377/121 Taxman 706 wherein the High Court had held that once it is established that there is nexus between the expenditure and the purpose of 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. It further held that no businessman can be compelled to maximize his profit and that 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 ...."(emphasis supplied) businessman.

1. The Hon'ble Delhi High Court in the case of CIT vs. Bharti Televentures Ltd: 331 ITR 502 held that interest on borrowed funds utilized for giving interest free loan to the subsidiary was an allowable deduction, inter-alia, on the ground that the advance made to the subsidiaries were demonstrated on facts, to be out of business exigencies.

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1. The Hon'ble Delhi High Court in the case of CIT vs. Bharti Televentures Ltd: 331 ITR 502 held that interest on borrowed funds utilized for giving interest free loan to the subsidiary was an allowable deduction, inter-alia, on the ground that the advance made to the subsidiaries were demonstrated on facts, to be out of business exigencies.

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2. Specific reliance in this regard is placed on the decision of Delhi High Court in the case of CIT v. Tulip Star Hotels Ltd.: 338 ITR 482. In that case, the assessee, engaged in hotel business, borrowed certain funds which were utilized by it to subscribe to the equity capital of subsidiary company. The subsidiary used the said funds for the purpose of acquiring a hotel, in the same of line of business as that of the assessee. The assessee paid interest on the borrowed money which was claimed as deduction on the ground that it was business expenditure. The assessing officer refused to allow this expenditure. However, the CIT(A) reversed the decision of the AO. The order of CIT(A) was confirmed by the Tribunal. On further appeal by the revenue, the High Court held as under:

"2. A perusal of the orders passed by the Tribunal would reveal that it is noted by the Income-tax Appellate Tribunal that the assessee is in the business of owning, running and managing hotels. For the effective control of new hotels acquired by the assessee under its management it had invested in a wholly owned subsidiary, namely, M/s. Tulip Star Hospitality Services Ltd. On this ground, relying upon the judgment of the Supreme Court in the case of S. A. Builders Ltd. v. CIT (Appeals) [2007] 288 ITR 1 / 158 Taxman 74 the Tribunal has held that the assessee was entitled to the deduction of interest on the borrowed funds. The observations made by the Supreme Court in S. A. Builders Ltd.'s case (supra) were quoted by the Tribunal as under (page 10):

"... 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."

3. In these circumstances holding it to be expenditure incurred for business the same was allowed under section 36(1)(ii) of the Income-tax Act by the Tribunal. The Tribunal has also held that this

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expenditure would be allowed even under section 57(iii) of the Act. Though there may be some controversy as to whether the aforesaid expenditure is allowable under section 57(iii) of the Act or not, we have no doubt, in our mind, that the expenditure incurred under the aforesaid circumstances would be treated as expenditure incurred for business purposes and was thus allowable under section 36 of the Act. Mr. O. S. Bajpai, learned senior advocate appearing for the assessee, has produced a copy of the memorandum of association of the assessee which, inter alia, specifies the following objects:....

4. We are, thus, of the opinion that no question of law arises. These appeals are accordingly dismissed. "(emphasis supplied)

1. Further the expression "commercial expediency", as has been explained by Supreme Court in the case of S.A. Builders (supra), is an expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of the business, with the test of commercial prudency being examined from the point of view of the businessman. Reference in this regard is further made to the decision of the Hon'ble Delhi High Court in the case of PCIT v. Reebok India Company: 98 taxmann.com 413 wherein it was held that merely because non-interest bearing advances were given to third parties, would not justify a finding that the test of commercial expediency was not satisfied. It was further held that where interest free advance preferred to any party was connected with the business of the assessee, it could not be held that money taken on loan was diverted for non-business purpose.
2. Reference, in this regard, may further be made to the following decisions wherein it has been held that no disallowance of interest is warranted in case where interest free funds are advanced to sister concerns out of commercial expediency or where there is a business justification for the same:

- JK Woolen manufacturers v. CIT: 72 ITR 612 (SC)
- CIT vs. Rockman Cycle Industries Ltd.: 176 Taxman 21 (P&H)

- CIT vs. Dalmia Cement (P.) Ltd.: 254 ITR 377 (Del)
- Regal Theatre vs. CIT: 225 ITR 205 (Del.)
- CIT vs. Bombay Samachar Limited: 74 ITR 723(Bom)
- D & H Secheron Electrodes Pvt. Limited vs. CIT: 142 ITR 528 (MP)
- D & H Secheron Electrodes P. Ltd. vs CIT: 149 ITR 400 (MP)
- Ram Kishan Oil Mills v. CIT: 56 ITR 186 (MP)
- Amma Bai Hajee Issa v. CIT: 51 ITR 835 (Mad)
- JCIT vs. Beekay Engg. Corpn.: 325 ITR 384 (Chhattisgarh HC)
- Mid-Day Multimedia Ltd. vs. DCIT: ITA No. 2630/Mum/2010 (Mum ITAT)
- Akula and Co. vs. ITO: ITA No. 1786/Mds/2009 (ITAT Chennai)

1. In view of the aforesaid, since the investments were on account of furtherance of its business operations into different segments (commercial expediency) disallowance of interest expenditure made by the assessing officer is not correct.
2. It is thus evident from the above that the appellant had more than sufficient own funds to make investments in its related concern and the presumption drawn by the assessing officer that the amounts were advanced out of borrowed funds is factually incorrect and unsubstantiated. In the impugned assessment order, the AO, except for making an allegation, has not, on the facts of the case, established any direct nexus between the funds borrowed and advanced to subsidiary companies to invoke provisions of section 36(1)(iii) of the Act for the purpose of making disallowance of interest expense incurred during the year.
3. In the case of CIT vs. Tin Box Co: 260 ITR 637, before the Delhi High Court, the assessee, a registered firm, engaged in the business of manufacture and sale of tin containers and printers, had been advancing interest free loans to its sister concern, namely, P, since the assessment year 1984-85. At the same time it had been availing of overdraft facilities from the State Bank of India against hypothecation of stocks, etc., and was paying interest to the bank. The Assessing Officer disallowed a sum of Rs.3 lakhs out of the total interest paid by the assessee to the State Bank of India in its

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overdraft account. On appeal, the Tribunal deleted the disallowance observing as under:

"We are in agreement with the submissions made by learned counsel for the appellant because the factual position as submitted before us by learned counsel for the appellant has not been controverted by the learned Departmental Representative. The admitted facts are that the appellant firm has been enjoying overdraft facilities from the State Bank of India, Chandni Chowk Delhi, since long time past against the hypothecation of goods, etc., and pledge of land, building. plant and machinery and the interest paid on such overdraft account has been allowed by the Revenue year after year. Even in the assessment year 1982-83, no such disallowance had been made when admittedly substantial interest-free funds had been advanced to the sister concern. The appellant has not paid any interest to any other party either in the past or during the year under appeal. Further in the years under appeal, either the fresh advances to PNSMPL have been quite insignificant or there have been absolutely no fresh advances made by the appellant, rather during the assessment years 1990-91 to 1992-93 the appellant had received back from the sister concern more than Rs. 10 lakhs. The capital of the firm and interest-free unsecured loans with the appellant far exceed the amounts advanced to the sister concern in all the years under appeal a fact neither controverted nor disproved by the learned Departmental Representative also." (emphasis supplied).

Additionally, the Tribunal had also noted that the Departmental Representative could not point out any specific interest bearing borrowed funds, which had been diverted by the assessee to its sister concern.

The High Court on further appeal dismissed the appeal of the Revenue stating that there was no scope for interference on the aforesaid findings of fact recorded by the Tribunal.

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1. The Madras High Court in the case of CIT vs. Hotel Savera: 239 ITR 795 held that where the amount borrowed by a firm were mixed with its own funds and amount were lent interest free to private companies out of such funds, it could be presumed, in the absence of any nexus having been established between the borrowed funds and the funds lent to the private companies, that the advance had been made with firm's own funds, where the firm had sufficient fund to cover the advance. It was, therefore, held that the interest paid on borrowed funds by the firm was allowable in full under section 36(1)(iii) of the Act.
2. The Calcutta High Court in the case of Woolcombers of India Ltd. v. CIT: 134 ITR 219 held that where the assessee was having an overdraft account with the bank in which the profits were deposited and such profits exceeded the advance tax liability and money was withdrawn from overdraft account both for business purposes and also for payment of advance tax (held not to be business expenditure by assessing officer), it is to be presumed that advance tax was paid out of profits and not out of overdraft account. The disallowance of interest on overdraft related to payment of advance tax was held not to be justified. The aforesaid decision of the Calcutta High Court in the case of Woolcombers was discussed by the Supreme Court in the case of East India Pharmaceutical Works vs, CIT in the terms reproduced supra.
3. Specific reliance is placed on the following decisions, wherein in the context of section 36(1)(iii) of the Act, it has been held that interest expenditure incurred to acquire shares in order to have controlling interest in companies is allowable business deduction

- Addl. CIT v. Laxmi Agents Pvt. Ltd: 125 ITR 227 (Guj.)
- CIT v. Rajeeva Lochan Kanoria: 208 ITR 616 (Cal)
- CIT v. Jardine Henderson Ltd: 210 ITR 981 (Cal)
- CIT v. Amritaben R. Shah: 238 ITR 777 (Bom.)
- CIT v. Emerald Co. Ltd: 284 ITR 586 (Bom)
- CIT v. Gorawara Plastics and General Industries (P) Ltd.: 289 ITR 224 (All.)

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- CIT v. Premium Poly Sacks Pvt. Ltd: 321 ITR 450 (Mad)
- CIT v. Amola Holdings Pvt. Ltd: 328 ITR 275 (Guj)
- CIT v. Srishti Securities Pvt. Ltd: 321 ITR 498 (Bom)
- CIT v. Reliance Communications Infrastructure Ltd.: (Bom)
- CIT, Bangalore v. Anand Technology Resource Park (P.) Ltd.: 2002 Taxman 654 (Kar.).
- CIT v. Tulip Star Hotels Ltd.: [2011] 16 Taxmann.com 335 (Delhi) in IT Appeal Nos.43 of 2009 and 505 & 562 of 2010 order dated 18.8.2011: 338 ITR 482 (DELHI)
- CIT v. Phil Corporation Ltd, & Anr. 244 CTR 226 (Bom.)
- A.T.E. Enterprises Limited V. JCIT: 102 ITD 110 (Mum.)

In view of the above facts and binding judicial precedents, the disallowance of interest expenditure of Rs. 11,11,84,813/- made by the Assessing Officer under section 36(1)(iii) is unsustainable and is hereby directed to be deleted. This ground of appeal is accordingly allowed.

26. It is further observed that assessee has made advances to the sister concern in preceding assessment years and had claimed interest on borrowed funds as expenses which were never doubted in the assessment completed u/s 143(3) thus, as a principal of consistency also, under identical circumstances where assessee was having sufficient interest free funds, no disallowance could be made u/s 36(1)(iii) of the Act. We thus find no infirmity in the order of ld. CIT(A) which is hereby upheld. The Ground of appeal No.1 raised by the Revenue is dismissed.