

(2013) 05 AHC CK 0113
In the Allahabad High Court
Case No : Income Tax Appeal No. 357 of 2005

Commissioner of Income Tax

APPELLANT

Vs

Deepak Agarwal

RESPONDENT

Date of Decision : 30-05-2013

Acts Referred:

Income Tax Act, 1961 — Section 143(3), 260A, 28, 36(1)(iii), 57(iii)

Citation : (2013) 6 ADJ 573 : (2013) 357 ITR 741 : (2013) 216 TAXMAN 153

Hon'ble Judges : Prakash Krishna, J; Manoj Kumar Gupta, J

Bench : Division Bench

Advocate : R.K. Upadhyaya, A. Kumar, A.N. Mahajan, B.J. Agarwal, D. Awasthi, G. Krishna and S. Chopra, for the Appellant; S.D. Singh, for the Respondent

Judgement

Manoj Kumar Gupta, J.—The present appeal u/s 260A of the Income Tax Act has been filed against order dated 14.6.2005 passed by the Income Tax Appellate Tribunal (Bench Lucknow) in ITA No. 118/Luc/2005 for the assessment year 2001-02. The appeal was admitted on the following substantial question of law:

Whether the Income Tax Appellate Tribunal is justified in law in deleting the addition of Rs. 18,32,000/- sustained by the CIT(A) without appreciating the facts of the case?

The facts giving rise to the instant appeal are as follows:

The assessee is an Individual by status carrying on business of financing and investments. The modus operandi of the assessee's business is borrowing funds from the market and advancing it on interest to other parties. During the assessment year under consideration, the assessee has shown gross interest receipts from his business of financing to the extent of Rs. 56,49,614/- against which he had paid interest on borrowed funds amounting to Rs. 53,31,137/-. The Assessing Officer found that the assessee had invested an amount of Rs. 2,01,33,605/- in shares including an investment of Rs. 2 crores in the shares of Agmo Tex Ltd. He also noticed that the assessee has substantial interest in the

above concern and no benefit or income has been derived or accrued in respect of investment of Rs. 2 crores in the shares of Agmo Tex Ltd. The Assessing Officer after considering that the assessee had non interest bearing funds of Rs. 85.5 lakhs and that the assessee was paying the interest on the borrowed fund ranging from 12% to 21%, considered the rate of interest of 18% and disallowed the proportionate interest on the remaining amount of Rs. 1,14,50,000/- which comes to Rs. 20.61 lakhs out of the interest expenses debited by the assessee. The assessment was completed u/s 143(3) of the Income Tax Act, 1961 on 31.3.2004 on an income of Rs. 24,12,6000/-.

2. Being aggrieved, the assessee filed an appeal before CIT(A), Kanpur who vide his order dated 2.2.2005 has allowed a relief of Rs. 2,29,000/- out of total addition of Rs. 20,61,000/- in respect of interest disallowed on account of investment in shares.

3. Being aggrieved by the above order, the assessee preferred an appeal before ITAT, who vide its impugned order dated 14.6.2005 has allowed the assessee's appeal and deleted the addition of Rs. 18,32,000/-. The tribunal found that the investment of Rs. 2 crores in purchase of shares of Agmo Tex Ltd. is for business purposes and is allowable expenses u/s 36(1)(iii) of the Income Tax Act, 1961. The tribunal held that it is wholly immaterial that the assessee himself was controlling the company M/s. Agmo Tex Ltd. or that the investment in shares had not yielded any dividends. It further held that the department has not disputed the fact that the assessee has used the borrowed fund for the purpose of its business and on which interest is payable. Consequently, the tribunal allowed the appeal filed by the assessee. Aggrieved, department has come up in appeal.

4. We have heard Sri R.K. Upadhyay, advocate for the department and Sri S.D. Singh, advocate for the assessee.

5. Sri R.K. Upadhyay, counsel for the department vehemently contended that the order of Income Tax Appellate Tribunal is wholly cryptic and has been rendered in a slipshod manner. The tribunal has not taken into consideration the relevant factors and on the basis of which the Assessing Officer has recorded a finding of fact that an amount of Rs. 2 crore was diverted for purposes not connected with the business of the assessee by giving the shape and colour of investment in shares of M/s. Agmo Tex Ltd. It was not an investment made for business purposes but to save M/s. Agmo Tex Ltd. from recurring losses and also in order to increase the equity of promoters in the said company and thereby facilitate borrowing for the said company from banks etc. He further submitted that the tribunal had proceeded on wrong assumption of fact. It was very much in dispute that the assessee has used the borrowed fund for the purpose of its business. To the contrary, the tribunal has wrongly observed that there is no dispute that borrowed funds have been used for business purposes.

6. On the other hand, Sri S.D. Singh, learned counsel for the assessee-respondents tried to support the order of the Tribunal. He urged that admittedly,

the assessee is carrying on business of financing and therefore investing borrowed funds in the shares of M/s. Agmo Tex Ltd. was in due course of business dealing and that it is not essential that there should be reasonable expectancy of receiving dividends in order to get benefit of Section 36(1)(iii) of the Income Tax Act, 1961. In this regard, he placed reliance on the judgments in Committee of Management, Shri Mohan Singh Inter College Vs. State of U.P., , Commissioner of Income Tax Vs. Rajeeva Lochan Kanoria, , Sarabhai Sons (P.) Ltd. Vs. Commissioner of Income Tax, , Commissioner of Income Tax, West Bengal-III Vs. Rajendra Prasad Moody, and Commissioner of Income Tax Vs. Radico Khaitan Ltd., .

7. Section 36(1)(iii) of the Income Tax Act, 1961 is as follows:

36(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:

This Court after considering the aforesaid provision and the Apex Court's decisions in the case of Madhav Prasad Jatia Vs. Commissioner of Income Tax, U.P. Lucknow, , in its judgment in Commissioner of Income Tax Vs. Radico Khaitan Ltd., , has held as under:

From the aforementioned cases, the principle which emerges for allowing the amount of interest paid in respect of capital borrowed is that the following three conditions should be fulfilled:

(i) the capital must have been borrowed or taken for the purpose of the business or profession;

(ii) the interest should have been payable; and

(iii) if the borrowing is not for the business purpose and is for private purpose or is not connected with the business, interest paid on such borrowings cannot be allowed as a deduction u/s 36(1)(iii) of the Act.

8. The aforesaid proposition of law also emerges out from various decisions cited both on behalf of the department and the assessee.

In Commissioner of Income Tax, West Bengal-III Vs. Rajendra Prasad Moody, , the Apex Court was considering the scope of Section 57(iii) of the Income Tax Act, 1961 which uses the phrase "any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income." In that case, there was no dispute that the assessee has borrowed moneys for making investment in the shares of certain companies. The Apex Court repelled the contention of the department that since the investment in the shares had not yielded any dividend and therefore the expenditure is not allowable. This case is not of any help to the

assessee as there was no dispute therein that the borrowed funds were utilised for business purposes.

In *Sarabhai Sons (P.) Ltd. Vs. Commissioner of Income Tax*, , the assessee was a company which was deriving income from investments, profits from systronics division, and from its marketing division dealing in purchasing and selling of products of sister concerns. The assessee company was a shareholder of Swastik Oil Mills Limited (SOML). It decided to takeover SOML and for the said purpose it acquired 100% shares in SOML. A question arose whether the investment made in the shares of SOML to gain control over the said company was a allowable deduction u/s 57(iii). It was found that the shares were purchased by the assessee company with the object of getting 100% control over the company SOML and therefore, it was held that it was not an expenditure incurred for business purposes and is thus outside the purview of Section 57(iii) of the Income Tax Act, 1961.

In *Commissioner of Income Tax Vs. Rajeeva Lochan Kanoria*, , the assessee was found to be engaged in the business of rehabilitating and financing various companies. It was further found that the acquisition of shares by the assessee to gain control over such companies, were the activities relating to the business of the assessee. It was held that since the assessee was carrying on business of promoting, monitoring, financing and controlling the companies and therefore, the investment in shares was in connection with the business of the assessee and was held to be allowable expenditure u/s 36(1)(iii).

In *Committee of Management, Shri Mohan Singh Inter College Vs. State of U.P.*, , the assessee was a company. It was found that its memorandum and article of association provides for investment in shares. The assessee company had taken term loan from Hongkong and Shanghai Banking Corporation but the project could not take off during the substantial part of the previous year therefore, the assessee company as a prudent businessman invested the amount of term loan of Rs. 30,00,000/- in equity shares of M/s. Samtel India Ltd. and M/s. Teletube Electronics Ltd. The Assessing Officer disallowed the claim of interest on the ground that the amount of term loan was not utilized for the purpose for which it was sanctioned. Repelling the said contention, it was held that the investment in the shares in the circumstances aforesaid, was for business purposes and is allowable expenditure u/s 36(1)(iii).

9. On the other hand, the department, apart from placing reliance on the judgment in the case of *Commissioner of Income Tax Vs. H.R. Sugar Factory*, . In that case, *H.R. Sugar Factory Pvt. Ltd.* was the assessee company engaged in manufacture of sugar. The company had borrowed a huge amount from various banks and other financial institutions and it lend the same to its directors on a meager rate of interest of 5% p.a. Subsequently, under a compromise decree passed by the Civil Court, the amount of interest was reduced to 2.5%. The assessing officer disallowed the proportionate interest paid by the company on the borrowed sum holding that the said lending was not for the purpose of its

business. Aggrieved by the order of the assessing officer, the company preferred an appeal and remained unsuccessful and thereafter it took the matter in further appeal before the tribunal which allowed the appeal filed by the assessee. A division bench of this Court, after considering the entire facts found the order of the Tribunal to be not sustainable in law. It was held that the assessee is not a finance company and it is engaged in manufacture of sugar and no business purposes is served by lending the borrowed money to its directors/shareholders. It was further held that if the company has not advanced money to the directors, the same would have been available to it for its own business and to that extent it was not found necessary to borrow from the bank. Consequently, it was held that the interest paid to the bank on the sum borrowed by the company to its directors, is not an allowable expense u/s 36(1)(iii).

10. Payment of interest on purchase of shares with a view to retain the managing agency to the company was not found to be allowable expenditure (vide GOVAN BROTHERS Vs. COMMISSIONER OF Income Tax, U. P., .

11. Similarly, interest paid on the money borrowed to the extent such borrowings were given to the sister concern was held not allowable u/s 36(1)(iii) [vide Triveni Engineering Works Ltd. Vs. Commissioner of Income Tax, .]

12. From perusal of the aforesaid judgments, cited by both the sides, it is abundantly clear that in order to avail the allowance u/s 36(1)(iii), the borrowed sum should be spent for the business purpose and if on the other hand, it has been utilised for private purpose or for purposes not connected with the business of the assessee, then the interest paid on the said borrowing cannot be allowed u/s 36(1)(iii).

Applying the aforesaid principle to the facts of the present case, we find that the assessing officer and CIT(A) after taking into consideration various factors, have recorded a specific finding that the investment of Rs. 2 crores by the assessee in the shares of Agmo Tex Ltd. is not for business purpose but in order to extend financial support to the company Agmo Tex Ltd. While recording the said findings, the authorities have taken the following factors into consideration:

(a) The business of the appellant is of taking loans and advancing loans, in short known as financing. In the business of financing, investment in shares is not a part of the business.

(b) The company Agmo Tex Limited is a family owned company of the assessee in which he himself was the managing director at the relevant time.

(c) The company Agmo tex Limited was running in the heavy losses and was under financial difficulties. In order to avail of bank loans etc., equity part of the promoters were to be increased. This prompted the assessee to divert borrowed money into equity shares of the said company and thus enable the company to get loans and finances from banks and other institutions.

(d) The aforesaid amount of Rs. 2 crore was earlier advanced to the same

company on interest of 24%. The said amount was diverted in purchasing shares of Agmo Tex Ltd., so that the said company is saved from interest liability. It was a deliberate exercise of colouring the funds which were already available with the company into different shape viz., shares, knowing fully well that the company is running in losses and there is no likelihood of getting any dividend in near future.

(e) The assessee had borrowed the money by paying a huge amount of interest upto 21% and it was required to be consciously and prudently managed to offset atleast the interest liability. In such scenario, investment in the shares of M/s Agmo Tex Ltd. was not for purposes of the business of the assessee.

13. However, the order of the Tribunal proceeds on wrong assumption of fact viz. that there is no dispute that the investment in shares has been made by the assessee for the purpose of its business. In this regard, the tribunal has observed as under:

Thus, the amount of interest disallowed by the authorities below on account of investment in shares of A.L. is not justifiable as the Department has not disputed the fact that the assessee has used the borrowed fund for the purpose of its business and on which the interest (sic)

At another place, the Tribunal has again proceeded on the assumption that the assessee is in the business of financing and investment of borrowed amount in shares of other company when it observed as under:

We are of the considered view that if the assessee is in the business of financing and investment and uses the borrowed amount, inter alia, for investment in the shares of other companies, for business purposes, the interest payable on the borrowed amount is to be allowed as business expenditure u/s 36(1)(iii) of the Income Tax Act, 1961.

14. A perusal of the entire order of the tribunal demonstrates that it had proceeded on wrong assumption of fact that the assessee is in the business of investment in shares and there is no dispute that the purchase of shares of Rs. 2 crores of Agmo Tex Ltd. was for the purpose of its business. On the aforesaid wrong assumption of facts, the Tribunal had proceeded to place reliance on certain judgments of the Apex Court and of this Court and had thereafter jumped to the conclusion that even if the investment in shares had not yielded any income, the interest payable on the borrowed amount is to be allowed as business expenditure u/s 36(1)(iii).

15. It is clear that the entire approach of the tribunal is manifestly illegal. It had wrongly assumed that the assessee is in the business of investment in shares. It had not referred to any material in this regard. There is no finding that in the previous years, the assessee has ever made investments in shares of any company, or had earned profit or loss therefrom. It also wrongly proceeded on the premises that there is no dispute between the department and the assessee that the borrowed fund has been used for the purpose of its business. The

tribunal had totally glossed over the main controversy between the parties, namely, that investment in shares is not the business of the assessee. Business of financing is not the same as business of investing in shares and at least not in the instant case where there is no such history. The tribunal had failed to notice the reasonings and various factors taken into consideration by the assessing officer and Commissioner of Income Tax (Appeals) in holding that in the circumstances of the instant case, the investment by the assessee in the shares of M/s. Agmo Tex Ltd. is not in connection with its own business but to extend financial support to another company, namely, M/s. Agmo Tex Ltd. in which the assessee himself is the Managing Director.

16. Thus, the tribunal had completely lost sight of the main controversy i.e. whether the borrowings on which interest was paid was utilised for the purpose of the business of the assessee. It has already been noticed that the primary condition for allowing deduction of interest while computing business income is that interest was paid on capital borrowed for the purposes of business or profession. If the borrowed capital is utilised not in the business which was subject-matter of assessment but for some non-assessable income (in the instant case that of M/s. Agmo Tex Ltd.), interest paid thereon, is not allowable deduction under this provision.

17. Since the tribunal has proceeded to decide the controversy on wrong assumption of facts and has glossed over the findings recorded by the assessing officer and CIT(A) and had brushed aside the relevant factors and therefore, the order of the tribunal deleting the addition of Rs. 18,32,000/- cannot be sustained. Accordingly, the question of law is answered in favour of the revenue and against the assessee.

18. Since the tribunal is the last fact finding body and therefore it was its duty to take into consideration the entire facts and circumstances and findings recorded by the assessing officer and CIT(A) and more so when it was reversing their orders. We find that the tribunal had not at all set aside the findings recorded by the assessing officer and the CIT(A) regarding investment of shares in M/s. Agmo Tex Ltd. not being in connection with the business of the assessee. In view of the above, the matter is remitted back to the Tribunal for deciding the controversy afresh in the light of the observations made. Appeal allowed accordingly.