(2009) 10 KL CK 0022

In the High Court Of Kerala

Case No : Income Tax Appeal No''s. 1474, 1479 and 1554 of 2009

Commissioner of Income Tax APPELLANT

Vs

Mangalam Publications India (P.) Ltd. RESPONDENT

Date of Decision : 16-10-2009

Acts Referred:
Income Tax Act, 1961 — Section 36(1)

Citation : (2010) 190 TAXMAN 38

Hon'ble Judges : V.K. Mohanan, J;C.N. Ramachandran Nair, J

Bench : Division Bench

Advocate : P.K.R. Menon and Jose Joseph, for the Appellant; P. Balakrishnan, for the Respondent

Judgement

C.N. Ramachandran Nair, J.—The question raised in the connected appeals filed by the Revenue is whether the Tribunal was justified in allowing deduction of interest paid on borrowed funds which were diverted by the assessee to sister concerns as interest-free loans. We have heard Senior Standing Counsel Sri P.K.R. Menon appearing for the appellant and Sri P. Balakrishnan, counsel appearing for the respondent.

2. Even though the Tribunal has followed the decision of the Supreme Court in S.A. Builders Ltd. Vs. Commissioner of Income Tax (Appeals), Chandigarh and Another, , we notice that the Tribunal has just accepted arguments without referring to the facts. In the first place, the assumption of the Tribunal is that the advances were made out of own funds because assessee had a huge profit. However, we notice that the interest-free advances made every year is Rs. 2 crores when the assessee had substantial borrowings. The argument of the assessee is logically unacceptable because if assessee had huge profits and own funds, we do not know why the assessee should depend on borrowed funds. In any case if at a given point of time assessee has own funds and they have advanced it as interest-free loans to sister concerns for meeting their business needs in which assessee also has an interest, then such advances should not

lead to disallowance of interest paid on subsequent borrowings. In other words, unless the assessee establishes with cash flow statements about availability of its own funds at the time of making the interest-free advances, the finding of the Tribunal cannot stand. Besides this, going by the decision of the Supreme Court, unless the assessee establishes the benefit it derives from each sister concern to which loans were advanced and the financial plight of such business concerns deserving interest-free advances, we do not know how the test of business expediency is satisfied. The Tribunal has just accepted the argument ofthe assessee that the sister concerns were in financial difficulties and the cheques issued by them could be honoured only with the interest-free advances made by the assessee. We have to necessarily accept the argument of the Standing Counsel that the Tribunal has decided the case without verifying facts available on record and by assuming arguments as true facts. The settled law is that interest on borrowed funds can be allowed u/s 36(1)(iii) of the Income Tax Act only if it is for business purposes. Admittedly the funds borrowed were not used directly for the business of the assessee and the only question is whether interest-free advances made to sister concerns is also a business purpose. The Supreme Court has held that if loan is justified by applying the principle of commercial expediency, then claim can be allowed. We are of the view that it is for the assessee to establish the interest it has in the sister concern, the business carried on by it, the financial position of the sister concern and the interest derived by the assessee to prove commercial expediency for justifying interest-free advances made from out of borrowed funds. We notice that the decision of the Supreme Court relied on by the Tribunal also was not available when the assessment was made. We, therefore, allow the appeals vacating the orders of the Tribunal and by remanding the cases to the Assessing Officer for the assessee to produce cash flow statements showing availability of own funds for advances made to sister concerns, constitution, assessee''s interest, etc., in the sister concerns and the documents showing nature of assessee''s business interest and financial position of such business concerns at the time of making the advances for the officer to consider eligibility for deduction of interest on borrowed capital. In order to avoid further contest, we direct the Assessing Officer to examine the details furnished by the assessee, issue a written pre assessment notice containing proposals for disallowance of interest, if any, and the reasons thereof so that the assessee gets an opportunity to file written objection and that the assessment should be completed after giving sufficient opportunity to the assessee.