(2009) 01 BOM CK 0023

In the Bombay High Court

Case No : IT Appeal No. 71 of 2006

Commissioner of Income Tax APPELLANT

Vs

Srishti Securities (P.) Ltd. RESPONDENT

Date of Decision : 22-01-2009

Acts Referred:
Income Tax Act, 1922 — Section 10(2)(3)
Income Tax Act, 1961 — Section 36, 36(1), 36(1)(3), 37, 37(1)

Citation : (2009) 226 CTR 551 : (2010) 321 ITR 498 : (2009) 183 TAXMAN 159

Hon'ble Judges : R.S. Mohite, J;F.I. Rebello, J

Bench : Division Bench

Advocate : Suresh Kumar and P.S. Sahadevan, for the Appellant; K.B. Bhujle and B.V. Bhujle, for the Respondent

Final Decision : Dismissed

Judgement

F.I. Rebello, J.—The assessee acquired shares in the financial year 1993-94. They were shown as investment in the balance sheet as on 31-3-1994. In the subsequent balance sheets as on 31-3-1995 and 31-3-1996 they were shown as stock-in-trade.

2. The object Clause of the Memorandum and Articles of Association of the assessee show their main object as under:

To purchase, acquire, hold, sell, invest, dispose and otherwise deal in shares, stocks, debentures, stock, Government securities, bonds, units of any company or other authority supreme municipality or local.

The assessee held the funds which were utilized for acquiring shares by way of investment as well as by way of stock-in-trade. The value of the shares held as investment as on 31-3-1997 was Rs. 2,59,22,692 and the cost of shares held as stock-in-trade on the same day amounted to Rs. 18,56,250. The assessee had borrowed funds on which the assessee paid total interest of Rs. 14,37,255 for which deduction was claimed u/s 57(iii) of the Income Tax Act. During the course of assessment proceedings, the assessee claimed deduction u/s 36(1)(3) of the Act. The Assessing Officer disallowed the entire interest on the ground that primary object of acquiring shares was not to earn dividends but to acquire controlling interest in the company. As such Assessing Officer disallowed the claim u/s 36(1)(c) of the Income Tax Act.

3. In an appeal preferred before the CIT (Appeals), the learned CIT(A) bifurcated the interest on pro rata basis between investment and stock-in-trade. It held that to the extent the borrowed funds were used for acquiring shares by way of stock-in-trade, the assessee was entitled to deduction of interest and on that basis allowed interest at the rate of Rs. 96,040. The balance interest was considered as neither allowable u/s 57(3) or u/s 37(1)(z) of the Act.

4. This order was in appeal before the ITAT. The learned Tribunal addressed itself to the question, as to whether the assessee is entitled to deduction in respect of interest liability either u/s 36(1)(3) or u/s 57(3) of the Income Tax Act. Reliance was placed on the judgment of this Court in the case of Commissioner of Income Tax Vs. Lokhandwala Construction Inds. Ltd., for the proposition that when the assessee claims deduction of interest paid on capital borrowed, all that the assessee has to show is that the capital which was borrowed was used for the business purpose in the relevant year of account and it does not matter whether the capital was borrowed or not to acquire revenue asset or capital asset. The learned Tribunal also relied on the judgment of the Calcutta High Court in the case of Commissioner of Income Tax Vs. Rajeeva Lochan Kanoria, where the Calcutta High Court took a view that under the provisions of Section 36(1)(3) of the Income Tax Act, the only enquiry to be made is whether the payment of interest was in respect of capital borrowed for the purpose of assessee''s business or profession. Such amount borrowed, if for the purpose of business of profession may be utilised for the purpose of acquisition of stock-in-trade or for the purpose of acquisition of capital asset. The learned court took a view that u/s 36(1)(3) there is no bar for allowance of interest paid in respect of capital borrowed which has been utilized for the purpose of acquisition of capital assets. Considering this the learned ITAT held that if the funds are borrowed by an investment company for making investment in shares which may be held as investment or as stock-in-trade or for the purpose of controlling interest in other companies, interest paid on such borrowed funds will be deductible u/s 36(1)(m) of the Income Tax Act. After recording this finding, it held that the interest expenditure is allowable u/s 36(1)(3) and therefore, disallowance to the extent sustained by the CIT(A) was directed to be deleted.

5. The Tribunal also considered two other grounds namely denying to the appellant claim of loss under the head "Business" on the ground that the shares of M/s. L.K. Pandey Shares and Securities were held as investment and not stock-in-trade. Similarly another ground raised and considered was whether the CIT(A) erred in not accepting the appellants claim of loss on account of valuation of the stock of shares of M/s. Pandey Shares and Securities. Dealing with these grounds

the Tribunal noted that the shares in 1993-94 were acquired and shown as investment in the balance sheet as on 31-3-1994. However, in the subsequent balance sheet on 31-3-1995 and 31-3-1996 the shares were shown as stock-in-trade. It was also contended that the shares had been sold during the subsequent assessment years. The Tribunal was of the opinion that the Revenue Authority has not properly examined the issues and accordingly restored the same to the Assessing Officer with a direction that the assessee''s claim that the investment was converted into stock-in-trade with reference to the entries made in the books of account of the relevant year in which the alleged conversion took place should be verified. Directions were also issued that the claim can be considered with reference to the provisions of Section 45(2) of the Income Tax Act.

6. Revenue is in appeal on the following questions:

(a) Whether in view of facts and circumstances of the case the Hon''ble ITAT is justified in allowing the interest on the borrowed fund u/s 36(1)(iii) of the Income Tax Act, 1961, when the share of the group company which was acquired was not shown as stock-in-trade but as investment?

(b) Whether in view of facts and circumstances of the case the Hon''ble ITAT is justified in allowing the interest on the borrowed fund u/s 36(1)(m) of the Income Tax Act, 1961, when the money is not used for business purpose as held by the Assessing Officer and confirmed by the CIT said finding of fact was not justified by the ITAT.

(c) Whether in view of facts and circumstances of the case the Hon''ble ITAT is justified in allowing the interest on the borrowed fund u/s 36(1)(m) of the Income Tax Act, 1961, on the basis of the judgment of Calcutta High Court in case of Rajeeva Lochan Kanoria, without appreciating the factual position in the said case and the present case, the assessee business in case of Rajeeva Lochan Kanoria was in the business of acquiring share for managing, controlling and rehabilitating different company whereas in the present case it was not the business of the assessee as held by the authority below?

(d) Whether in the facts and circumstances of the case and in law, the Tribunal is right in restoring the issue of valuation of closing stock of the shares held by the respondent in LKP Merchant Financing Ltd. when the said shares were held as an investment and not as stock-in-trade?

7. We may firstly consider the first three questions as to whether the interest of borrowed capital which was utilised in the business of purchase of shares both by way of investment and stock-in-trade is allowable deduction.

Insofar as first three questions are concerned, in our opinion a Co-ordinate Bench of this Court in Lokhandwala Construction Inds. Ltd.''s case (supra) had addressed itself to this issue. Reliance was placed on India Cements Ltd. Vs. Commissioner of Income Tax, Madras, which was u/s 10(2)(3) of the Income Tax

Act, 1922 which corresponds to Section 36(1)(3) of the present Act. This Court answered the issue in the following manner:

...That, while adjudicating the claim for deduction u/s 36(1)(iii) of the Act, the nature of the expense - whether the expense was on capita) account or revenue account was irrelevant as the section itself says that interest paid by the assessee on the capital borrowed by the assessee was an item of deduction. That, the utilization of the capital was irrelevant for the purpose of adjudicating the claim for deduction u/s 36(1)(iii) of the Act. (see the judgment of the Bombay High Court in the case of Calico Dyeing and Printing Works Vs. Commissioner of Income Tax, Bombay City-II,). In that judgment, it has been laid down that where an assessee claims deduction of interest paid on capital borrowed, all that the assessee had to show was that the capital which was borrowed was used for business purpose in the relevant year of account and it did not matter whether the capital was borrowed in order to acquire a revenue asset or a capital asset?.

It may be noted that in India Cements Ltd.''s case (supra) the Apex Court was specifically pleased to observe that the object of the loan is an irrelevant consideration. In the State of Madras Vs. G.J. Coelho, the Supreme Court was dealing with the deduction claimed u/s 5(e) of the Madras Plantations Agricultural Income Tax Act, 1955. While considering the issue the court was pleased to observe that in principle there is no distinction between interest paid on capital borrowed for the acquisition of a plantation and interest paid on capital borrowed for the purpose of an existing plantation. Both are for the purpose of the plantation. The court further observed that the payment of interest on the amount borrowed for the purpose of the plantations when the whole transaction of purchase and the working of the plantations was viewed as an integrated whole was so closely related to the plantations that the expenditure could be said to be laid out or expended wholly and exclusively for the purpose of the plantations.

8. We may also gainfully refer to the judgment of the Calcutta High Court in Rajeeva Lochan Kanoria''s case (supra). The learned Court was considering Section 36(1)(m) and was pleased to observe as under:

The only enquiry that is to be made is whether the payment of interest was in respect of capital borrowed for the purpose of the assessee''s business or profession. There is no dispute that the capital was borrowed in the instant case and interest was paid on the borrowed capital. It is to be established that the amount was borrowed for the purpose of business or profession. The amount borrowed may be utilized for the purpose of acquisition of stock-in-trade or for the purpose of acquisition of capital assets. But so long as the money is utilised for business purposes the interest will have to be allowed as deduction. It is well-settled that business expenditure is not confined to expenses incurred on revenue account. Capital expenditure may not be allowed as a deduction u/s 37 because the section specifically bars any deduction of expenditure of capital nature. But Section 36 is differently worded. There is no bar in Section 36(1)(iii) to allowance of interest paid in respect of capital borrowed which has been utilised for purchase of a capital asset. The position of law in this regard was explained by the Supreme Court in the cases of India Cements Ltd. Vs. Commissioner of Income Tax, Madras, and State of Madras Vs. G.J. Coelho, .

9. Considering these judgments and the test that the object of the loan is irrelevant, the interest which was disallowed to the extent of investment will have to be allowed as held by the Tribunal.

10. Insofar as question (d) is concerned, as noted the Assessing Officer and CIT(A) proceeded on a wrong assumption of facts, namely that the amounts continued to be shown as investment, without considering that in the subsequent balance sheets, the shares were shown as in stock-in-trade. Considering the above, in our opinion, it is not required to interfere with the view taken by the learned Tribunal.

11. For the aforesaid reasons there is no merit in this appeal which is accordingly dismissed.

