
(2016) 08 AHC CK 0125
In the Allahabad High Court
Case No : Income Tax Reference No. 2 of 2010

M/s Hindalco Industries Co. APPELLANT
Vs
CIT RESPONDENT

Date of Decision : 09-08-2016

Acts Referred:

Income Tax Act, 1961 — Section 36(1)(iii)

Citation : (2016) 389 ITR 430 : (2017) 95 UPTC 94

Hon'ble Judges : Sudhir Agarwal and Kaushal Jayendra Thaker, JJ.

Bench : Division Bench

Advocate : Shubham Agarwal, Advocate and CSC, for the Commissioner; Vinod Upadhaya assisted by R.S. Agrawal, Advocates, for the Assessee

Final Decision : Disposed Off

Judgement

1. Heard Sri Vinod Upadhaya, Advocate, assisted by Sri R.S. Agarwal, Advocate, for the Assessee and Sri Shubham Agarwal for Revenue.

2. This is a reference under Section 256 (2) of Income Tax Act, 1961 (hereinafter referred to as "Act 1961"). The dispute relates to Assessment Year 1989-90. Following question has been referred to be answered by this Court by Income Tax Appellate Tribunal (hereinafter referred to as "Tribunal").

"Whether on the facts and in the circumstances of the case disallowance of the interest paid by the assessee on its borrowed funds in excess of 12% was justified under section 36(1) of the Income Tax Act, 1961, only because the assessee company had utilised its own funds to advance loans at a lower rate of interest to sister concern."

3. Assessee borrowed and taken loan to the tune of Rs. 2,31,22,000/-. It paid interest to Bank and others to the tune of Rs. 68,07,000/-. The rate of interest paid to Bank was 16 percent whereas rate of interest to other deposits ranges between 11 percent to 16 percent.

4. Assessing Officer came to the conclusion that market rate of interest was 16 percent yet Assessee advanced loan to Sister Subsidiary Company at a lesser rate of 6 percent or 12 percent. The difference between interest i.e. market rate and the rate at which loan advanced to Sister Company, was disallowed. It has been affirmed by Commissioner Income Tax (Appeal) [hereinafter referred to as "CIT(A)"] on the ground that Assessee was not a financing company, had it not advanced loan, money could have been available to Assessee for its own business purpose and to that extent it may not have borrowed from Banks. It disallowed difference of interest under Section 36 (1) (iii) of Act 1961, and upheld by Tribunal also.

5. From the record, we find that it is not the case of Revenue Authorities that loan advanced to Sister Subsidiary Company was for non business purpose. Tribunal has recorded a finding concurrent with CIT(A) that no direct link could be established between borrowing and lendings and it is also not the case that loan was not advanced for commercial expediency of Sister Subsidiary Companies. But on mere fact that Assessee Company was a profit making Company, itself has paid higher rate of interest hence it was not justified to advance loan on lower rate of interest, hence difference has been disallowed under Section 36 (1) (iii) of Act 1961. The moot question is whether this approach of Revenue is justified.

6. Section 36 talks of permissible deductions. One of such deduction under Section 36 (1) (iii) reads as under:-

"the amount of 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 put to use, shall not be allowed as deduction.]"

7. It talks of interest in respect to capital borrowed for the purpose of business or profession.

8. There is nothing on record to show that loan advanced to Sister Subsidiary was not in respect of capital borrowed for the purpose of business or profession.

9. This provision came up for consideration in S.A. Builders Ltd. v. CIT (Appeals) (2007) 288 ITR 1(SC). Court held that the term "for the purpose of business" is wider in scope than the expression "for the purpose of earning profits" and relied on its earlier decisions in CIT v. Malayalam Plantations Ltd. (1964) 53 ITR 140 (SC) and CIT v. Birla Cotton Spinning & Weaving Mills Ltd. (1971) 82 ITR 166 (SC). It held that if borrowed amount is donated for sentimental or personal reasons and not on the ground of commercial expediency, interest thereon would not be allowed under Section 36(1) (iii) of Act 1961, but if it is advanced to a

third party for commercial expediency it must be allowed and for that purpose reliance was placed on *Madhav Prasad Jatia v. CIT*, 1979 (118) ITR 200 (SC). Court referred the following expression discussing scope of "commercial expediency" and said:

"the expression "commercial expediency" is an expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. Expenditure may not have been incurred under any legal obligation, but yet it has allowable as a business expenditure if it was incurred on grounds of commercial expediency."

10. In *S.A. Builders Ltd. v. CIT* (supra) Court held that true test is, whether the amount advanced to subsidiary or associated company or any other party was advanced as a measure of commercial expediency. If so, interest was deductible.

11. Recently in *Hero Cycles P. Ltd. v. Commissioner of Income Tax*, (2015) 379 ITR 347 (SC), matter has been discussed and Court agreeing with Delhi High Court judgment in *CIT v. Dalmia Cement (B) Ltd.*, (2002) 251 ITR 377 (Delhi), has observed;

"Once it is established that there was a nexus between the expenditure and the purpose of business, the Revenue cannot justifiably claim to put itself in the armchair of a businessman or in the position of the board of directors and assume the said role to decide how much is reasonable expenditure having regard to the circumstances of the case. Court also observed that no businessman can be compelled to maximise his profits and the Income Tax Authority must put themselves in the shoes of Assessee and see how a prudent businessman would act. The authorities must not look into the matter from their own point of view but that of a prudent businessman."

12. In the present case, financial condition of Sister concerned was not good and to help those, for their smooth running, loan was advanced and a lesser rate of interest was charged. Both Sister Companies are subsidiary of Assessee and there is nothing per-se averse. For the welfare and proper functioning of Sister Companies, Assessee in its wisdom, if decided to advance loan so that ultimately Sister Company may function properly, Assessee being holding Company would also be benefited. Thus, the loan advanced to Sister Companies was for commercial expediency and not for any charity, sentimental or personal reasons.

13. We therefore, answer the question in favour of Assessee and hold that Assessee was entitled for deduction of interest under Section 36(i) (III) and the view taken by Tribunal otherwise is not correct. Reference is answered accordingly and stands disposed of.