SooperKanoon - India's Premier Online Legal Search - sooperkanoon.com

Debikay Information Technology Vs. Assistant Commissioner of Income

Debikay Information Technology Vs. Assistant Commissioner of Income

SooperKanoon Citation : sooperkanoon.com/69350

Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Feb-04-1998

Judge : B Kothari, J Bengra

Appellant : Debikay Information Technology

Respondent : Assistant Commissioner of Income

Judgement :

1. These are three appeals by the assessee against the orders of the CIT(A), IV New Delhi, pertaining to asst. yrs. 1989-90 to 1991-92.

Since the issues involved in all these appeals are common and also arise out of the consolidated order, therefore, for the sake of convenience these appeals are being disposed of by a consolidated order.

2. The assessee is a public limited company engaged in the business of manufacture and sale of private automatic branch exchanges, purchase and sale of yarn, HDPE bags and sale of cement on consignment basis, mining and transportation work, etc. The assessee-company set up a manufacturing unit in the accounting year relevant to asst. yr. 1988-89 at Bhilai for manufacture of electronic private automatic branch exchange (EPABX) with the technology provided by Department of Telecommunication. The assessee obtained a term loan of Rs. 43.30 lakhs from Pradeshiya Industrial Corporation, Uttar Pradesh (for short "PICUP") and utilised the same for the purpose of acquiring plant and machinery against hypothecation of company's movable properties and against an

equitable mortgage of land at Sahibabad in U.P.3. The assessee-company made payment of interest to bank, financial institutions and parties from whom inter-corporate loans were received as per details given below :Name of the party Asst. yr. 1989-90 1989-90 1990-91Interest on term loan from PICUP 6,50,000 6,88,256On cash credit account with StateBank of Patiala 2,66,124 3,06,129On inter-corporate loans fromvarious companies 17,19,235 4,21,476 ---------- ---------- The AO was of the view that the loans taken from financial institutions, bank and other companies had been advanced to subsidiary company without charging interest and for the purpose which was not incidental to the carrying on of the assessee's legitimate business.

Therefore, in the asst. yrs. 1988-89 and 1990-91 the AO disallowed the entire interest claimed at Rs. 26,36,159 and Rs. 14,15,861 respectively. In the asst. yr. 1991-92 he observed that the facts are identical to those in the preceding assessment years and further copy of the subsidiary company's accounts reveal that till 4th September, 1990, the amount of outstanding against the sister concern was Rs. 2,86,55,000. On 4th September, 1990 itself the assessee-company further advanced a sum of Rs. 50 lakhs and it is only on 31st March, 1991, that the accounts had been finally settled. Therefore, he disallowed the entire claim of interest amounting to Rs. 4,34,028 in the asst. yr.

1991-92.

4. In order to appreciate the issue in question it would be necessary to discuss the facts underlying these transactions. It appears that the assessee-company made total investment of Rs. 2,96,55,000 in the subsidiary company, namely, Debikay Technology Ltd. (hereinafter called "DTL"). The accounts revealed that money was paid to the subsidiary company for allotment of equity shares of Rs. 10 each. The accounts further reveal that out of this sum an amount of Rs. 82.35 lakhs had already been paid to this subsidiary company by the assessee-company as on 31st March, 1988, for allotment of equity shares. The AO was of the view that the assessee-company had sunk huge amount of money in the subsidiary company without shares of the subsidiary company being allotted to the assessee-company and there was no effort or attempt on the part of the assessee-company either to

obtain the allotment of shares or get its investment back. On examination of the records of subsidiary company DTL it was found that this company was incorporated on 5th February, 1985, at the same address as the assessee-company had during the relevant previous year. From the details filed by DTL it was further found that against the authorised share capital of Rs. 50 lakhs at the time of incorporation the total shareholding was only 21 shares of Rs. 10 each out of which 20 shares were held by the assessee-company. As per the statement of DTL as on 9th February, 1992, it was found that no revenue operation had commenced by it during the period ending on 31st March, 1989, on the date of formation of the company, and further an amount of only 57,885 was shown to have been incurred as operation expenditure, by the sister concern. In the meantime the authorised share capital of M/s DTL had increased from Rs. 50 lakhs to Rs. 90 lakhs as on 31st March, 1988, and it had received funds of only Rs. 82,37,000 from the assessee-company without allotment of any share to the assessee against the same. The subsidiary company DTL further increased the authorised capital to Rs. 3 crores and had obtained advances to the tune of Rs. 2,06,71,775 from the assessee-company, without making any allotment of any share whatsoever.

On the other hand, DTL had invested an amount equal to the funds received by it from the assessee-company, namely, Allen-Bradlay Ltd. for the purchase of the shares and also had given loan of Rs. 45 lakhs to the said company during the asst. yr. 1989-90. The AO enquired about the source of investment made by the assessee and found that the assessee had taken large number of inter-corporate loans from various parties on which it had paid interest at the rate of 16.5 per cent per annum. These loans were advanced by the assessee-company to DTL without charging any interest and also without any allotment of shares. He further observed that the assessee's own balance sheet revealed that it had obtained loans of Rs. 61 lakhs from the various parties and financial institutions against hypothecation of immovable properties, stock of raw material and other assets in order to meet its own requirement. On the other hand, the assessee-company had returned losses for both the asst. yrs. 1989-90 and 1990-91 and the P&L a/c of the assessee-company for the current year had shown turnover of around Rs. 2.59 crores which is marginally higher than the amount advanced to the subsidiary

company DTL. Therefore, the AO concluded that the investment made by the assessee to DTL was not for business purposes.

Hence, the interest paid on inter-corporate loans was disallowed in entirety. He further disallowed interest paid to bank and financial institutions on the ground that had the assessee used its funds generated in the business for the purpose of its business the loans taken from the banks and other financial institutions could have been reduced and no interest liability would have arisen with regard to these loans. Therefore, he disallowed interest liability of Rs. 26,36,159 for the asst. yr. 1989-90 and Rs. 14,15,861 for the asst. yr.

1990-91 and also Rs. 4,34,028 for the asst. yr. 1991-92.

5. Aggrieved by that order, the assessee filed appeals before the CIT(A). Before the CIT(A) the assessee raised the following submissions : "2.3 It was contended by the learned counsel that there is nothing on record to show that either the term loans received from PICUP or the cash credit limit available from State Bank of Patiala were diverted/utilised in making investment in DTL. It was further contended that neither the AO has proved any nexus between the borrowings from PICUP and State Bank of Patiala and its utilisation in investment in shares of DTL nor could he prove it as there was no nexus between the two. It was stated that the loan was from PICUP was taken during the previous year 1987-88 against hypothecation of movable assets and equitable mortgage title deed of its land at Sahibabad which was fully utilised for the purchase of plant and machinery. It was further stated that the interest was charged by the State Bank of Patiala on cash credit facility given to the assessee-company, for the purpose of working capital requirement and was not utilised by way of investment in DTL. On this basis, it was contended that the interest paid to PICUP as well as the State Bank of Patiala should have been allowed by the AO as these were incurred wholly and exclusively for the purpose of its business.

2.4 Regarding investment out of inter-corporate loans received during the year and interest paid thereon, the assessee filed a statement showing the details of investment made in DTL in each of the assessment years from 1987-88 to 1989-90 along with the source of investment and copy of the relevant bank statement

and the balance sheet for the financial years 1985-86 to 1987-88 and 1988-89, which were sent to the AO for examination and report as to how much of the inter-corporate loans taken by the assessee were invested in DTL. The AO vide his report dt. 11th November, 1993, stated that during the asst. yr. 1987-88, there was no nexus between the investment in DTL and the borrowed funds by the appellant company. It was further reported that in the asst. yr. 1988-89, a total investment of Rs. 24,40,000 was made in DTL out of which Rs. 19 lakhs were invested out of the assessee's own funds and Rs. 5,40,000 were invested out of loans taken from Charaiveti Estates which were, however, paid before 31st March, 1988, by taking fixed deposit from Anirudh Minerals. It was also mentioned that the assessee paid back the amount of Rs. 5,40,000 to Anirudh Minerals also on 17th August, 1988 and 29th August, 1988. However, no interest as paid on these funds borrowed by the assessee because Anirudh Minerals withdrew fixed deposit prematured. Thus, on the basis of the above report, the AO, found that there was no investment of the borrowed funds in DTL till asst. yr. 1988-89.

2.5 Coming to the asst. yr. 1989-90, it was reported by the AO that the assessee invested Rs. 1,24,20,000 in DTL which came entirely out of inter-corporate loans and the assessee paid total interest on the borrowed funds amounting to Rs. 11,84,681.95. Thus, it was mentioned by the AO that since the nexus between the investment in DTL and the inter-corporate loans in the asst. yr. 1989-90 for the amount of Rs. 1,24,20,000 is established, the disallowance of Rs. 11,84,681.95 is clearly to be made in the asst. yr. 1989-90. On the same ground for the asst. yr. 1990-91, the disallowance of interest was claimed to be atleast on account of Rs. 3,82,840 as these were paid on inter-corporate loans. For the balance amount of interest it was contended that though there is no nexus between the investment made in DTL and the borrowings from PICUP and State Bank of Patiala, however, interest paid to them also was not to be allowed as the business deduction because had the assessee not invested their funds in DTL it could have utilised these funds for reimbursement of loans to PICUP and State Bank of Patiala and thereby could have reduced interest payment to these parties." 6. During the hearing before the CIT(A) a copy of the report of the AO was given to the assessee for its comments. The assessee's counsel pleaded that out of total interest of Rs. 17,19,235 paid by the assessee on the inter-corporate loans, no

nexus has been established to the tune of Rs. 11,84,862. It was clarified that actual payment of interest on the inter-corporate loans relevant for the asst. yr.

1989-90 for the purpose of investment in DTL was Rs. 11,68,235 only because the amount of Rs. 16,446 related to previous asst. yr. 1988-89 and should not have been taken into consideration, as it is admitted by the AO that no part of the interest on borrowed funds in asst. yr.

1988-89 related to the funds invested in DTL. In asst. yr. 1989-90 out of the inter-corporate loan of Rs. 1.24 crores the assessee paid back Rs. 92.50 lakhs out of the funds generated from its own activities leaving balance of Rs. 31.50 lakhs on 31st March, 1989. It was contended that interest paid to PICUP and State Bank of Patiala could not be disallowed because the AO himself mentioned that there was no nexus between the loans and the investment made in the DTL. It was not open to suggest to the businessman how to run his business. It was further pointed out that the memorandum of articles of the assessee-company permits the company to invest funds in the subsidiaries for the purpose of carrying on its business. As such the investment made in the subsidiary company was by all means a part of business carried on by the assessee and the funds were used wholly and exclusively for the purpose of business. Therefore, the entire interest payment whether paid to the financial institutions or State Bank of Patiala or on the inter-corporate loans for investment in DTL should be allowed as business expenditure. The CIT(A) rejected the assessee's contention for the following reasons : "2.7 I have considered the facts of the case and the arguments of the learned counsel. In my opinion, interest payment on inter-corporate loans which were invested in DTL for the alleged allotment of capital which were in turn invested by DTL in another concern cannot be allowed in view of the facts and circumstances with regard to this investment, discussed in para 2.3 above, which need not be repeated for the sake of brevity. In this regard I will reject the contention of the learned counsel that the investment made by the appellant in DTL towards allotment of its shares was in the course of its business. Therefore, in the asst. yr. 1989-90 the amount of interest of Rs. 11,68,235 and in the asst. yr. 1990-91 amount of Rs. 3,82,840 are clearly disallowable, as the nexus between the inter-corporate loans and its investment in DTL is clearly established with regard to the

funds on which this interest is payable. Coming to the disallowance of the balance amount of interest in the asst. yrs. 1989-90 and 1990-91, though there is no nexus between the loans taken from PICUP and State Bank of Patiala for investment in DTL as the same were used for the purchase of plant and machinery and for providing working capital to the business of the assessee respectively, however, an important fact cannot be denied that in the asst. yr. 1989-90 out of the amount of Rs. 1.24 crores taken by way of inter-corporate loans the assessee has paid back Rs. 92,50,000 out of the funds generated from its business. This fund, the assessee could have utilised for repayment of the loans taken from PICUP and State Bank of Patiala. Details filed by the assessee shows that the outstanding balance from PICUP and State Bank of Patiala during the three years starting from the asst. yr. 1989-90 to 1990-91 are as under :----------S. No. Particulars Bal.

Bal.

Bal.

out-standing out-standing outstandingA. Loan from Pradeshiya 43,30,000 43,30,000 39,00,000 Industrial Corp. ofB. Cash credit limit 8,25,596 18,08,243 19,74,230" from State Bank of 7. As regards 1991-92 he confirmed the disallowance of interest basically on the same reasoning except the interest paid on customers' security deposit to the extent of Rs. 40,076 as he was of the view that these deposits were given by the customers as security deposits while placing orders for supply of manufacture of goods by the assessee-company to these parties. Therefore, these deposits had no relation to the investment made in the DTL in the earlier years. Hence the disallowance was reduced by Rs. 40,076. The assessee is aggrieved.

8. At the time of hearing the assessee's counsel did not press the following grounds for asst. yr. 1990-91 : "4. Without prejudice to the above, alternatively it is contended that interest paid on borrowings even if utilised for investment in subsidiary company, should have been allowed under s. 57(iii) of the Act.

5. (a) It is contended that investment of Rs. 17,03,610 as share application money paid to Debikay System Ltd., written off in the books should have been allowed as business loss under s. 28 of the IT Act.

(b) Alternatively it is contended that loss arising due to relinquishment of investment of Rs. 17,03,610 should have been allowed as long-term capital loss under the head capital gains".

9. The learned assessee's counsel very vehemently argued that the disallowance of interest is not justified. In this connection our attention was invited to the remand report of the AO, wherein after perusal of the various bank accounts and relevant entries in the books with regard to investment made in DTL, it has observed that there was no diversion of funds from the cash credit account for making investment in DTL.

He pointed out that the investment in DTL have gone out of bank accounts maintained by the company with Bank of India, Calcutta, and Bank of India, Delhi. As such, the AO himself found that there was no direct nexus between the payment of interest to State Bank of Patiala, Hauzkhas branch, and investment in DTL could be established. Therefore, it was argued that the AO himself found that there is no nexus between the funds borrowed from PIC-UP and investment in subsidiary company.

The disallowance of interest is not legal. It is submitted that in order to claim deduction of interest on borrowed capital the assessee had to fulfil three conditions namely, (a) that money must have been borrowed by the assessee; (b) that it must have been borrowed for the purpose of business; and (c) that the assessee must have paid interest on the said amount and claimed it as a deduction. According to the learned assessee's counsel, those conditions are fulfilled. Therefore, there is no reason to disallow the interest in respect of the term loan from PICUP and on cash credit facilities with State Bank of Patiala for asst. yrs. 1989-90 and 1990-91. He repeated the same contention as put forward before the CIT(A). In order to strengthen his argument, he has relied on the following decisions : (4) CIT vs. D&H Secheron Electrodes (P) Ltd. (1983) 142 ITR 528 (MP).

10. As regards the interest liability on inter-corporate deposits is concerned, the submission of the assessee's learned counsel was that this money was borrowed from various parties and it was invested by the assessee-company for allotment of shares of subsidiary company, DTL.

The above subsidiary company could not allot shares as its business could not materialise and hence the amount invested by the assessee was refunded by the subsidiary company on 4th September, 1990. In this connection, our attention was invited to the balance sheet and P&L a/c of DTL at p. 3 and assessee's statement of interest at p. 12 of the supplementary note. The application money for allotment of shares was converted into advance to the subsidiary company. The subsidiary company invested the said amount in the shares of Allen Bradley Ltd. in the same year as a prudent businessman. Therefore, if the amount is borrowed for allotment of shares and interest liability is incurred, it is allowed as per the decision of the Hon'ble Supreme Court in the case of CIT vs. Rajendra Prasad Moody (1978) 115 ITR 519 (SC). Reliance was also placed on the decision of the Supreme Court in the case of Liquidator of Mahamudabad Properties (P) Ltd. vs. CIT (1980) 124 ITR 31 (SC). It is further submitted that the company vide its memorandum and articles of association is permitted to make investment in the equity shares of any body incorporation. The investment in the other companies is a part of business carried on by the assessee-company. Therefore, the amount was utilised for acquiring the shares in the subsidiary company is also used fully and exclusively for the purpose of business.

Mere fact that the amount had been paid as application money and the assessee-company has not been allotted any share, does not change the nature and character of the payment made when the amount remains to be invested of the assessee-company in the subsidiary company. Therefore, the interest payable on loans and deposits received to the extent the same has been utilised for investment in subsidiary company is allowable as business expenditure. As a matter of clarification it is pointed out that in the asst. yr. 1990-91 DTL has ceased to be a subsidiary company of the assessee-company and the loans were squared up. As regards the disallowance relating to 1991-92 is concerned, it is pointed out that the assessee has recovered Rs. 2,06,55,000 from its subsidiary company on

4th September, 1990. The further short-term loan for 7 months of Rs. 50,00,000 was given to the subsidiary company on 4th September, 1990, which was received back during the previous year itself. Therefore, the loan of Rs. 50 lakhs was given out of its own funds of the assessee-company and no borrowed funds were utilised for this purpose. In this way the assessee-company has no liability for payment of interest after 4th September, 1990. Therefore, there is no question of disallowance of interest in asst. yr. 1991-92. The CIT(A) fell into error on the basis of order of the AO. As regards ground Nos.

1 to 3 in 1991-92 assessment year, the submissions were the same as for earlier years.

11. As against this the learned Departmental Representative supported the action of the Revenue authorities. It is pointed out that in a going concern, it possible for a company to compartmentalise the investment when funds are mixed up. With reference to the balance sheet of the assessee-company pertaining to asst. yrs. 1989-90 and 1990-91 given at pp. 64 of and 71 of paper-book, it was pointed out that a perusal of these balance sheets would show that it is clearly impossible to segregate the funds of the company. It is further pointed out that as on 31st March, 1990, the secured loans were Rs. 59,20,044 which has gone down to Rs. 53,209 as on 31st March, 1991, and similarly the loans and advances of Rs. 2,17,00,872 has come down to Rs. 1,01,82,889. The assessee-company had received all sale proceeds and instead of paying to the business creditors squared up the inter-corporate deposits. Therefore, the assessee has adopted a colourable device so as to increase the loss and claimed the interest liability. There is no material on record to arrive at the presumption that the money came from the particular source. Therefore, all the funds of the assessee got mixed up. So the CIT(A) has rightly disallowed the interest liability not only on all term loan deposits but also on PICUP and State Bank of Patiala. The learned Departmental Representative very vehemently argued that the interest liability relating to investment in the subsidiary company cannot be allowed because no shares were ever allotted. Rather it has adopted a colourable device to divert the funds of the assessee-company to the subsidiary company who in turn purchased shares of Allen Bradley Ltd. The decision of the Hon'ble Supreme Court in the case of

Rajendra Prasad Moody (supra) is not applicable because in that case shares were allotted whereas in the present case no shares were ever allotted. It is pointed out that under the Company law the shares money has to be kept separately in the bank account but there is no material on record to show that the money was kept in the bank account.

It is a case of diversion of funds for non-business purposes. It is pointed out that the investment in share money went on increasing and so the authorised capital of the subsidiary company. Money was consistently diverted by the assessee to the subsidiary company in the name of allotment of shares. Therefore, it is a perfect planning of the assessee-company to reduce the tax liability. Reliance was placed on the following decisions : (1) Highways Construction Co. (P) Ltd. vs. CIT (1993) 199 ITR 702 (Gau);Bhagwan Dass Jain vs. Union of India & Ors. (1981) 128 ITR 315 (SC) (7) Indian Metals & Ferro Alloys Ltd. vs. CIT (1992) 193 ITR 344 (Ori); (10) Karnataka Forest Plantations Ltd. vs. CIT & Anr. (1985) 156 ITR 275 (Kar); (11) Tuticorin Alkali Chemicals & Fertilisers Ltd. vs. CIT (1997) 227 ITR 172 (SC); (13) Imperial Chemical Industries Ltd. vs. ITO (1978) 111 ITR 614 (Cal); (14) Patiala Biscuit Manufacturers (P) Ltd. vs. CIT (1967) 66 ITR 33 (P&H), and In reply, with reference to p. 13 of the paper book, it was submitted that from the complete segregation of funds, it is clear from this statement, therefore, there is no substance in the argument of the learned Departmental Representative.

12. We have considered the rival submissions and have gone through the material available on record. The Revenue authorities disallowed the interest in asst. yrs. 1989-90 and 1990-91 in respect of loan taken from PICUP and State Bank of Patiala on the ground that there is no nexus between the loans taken from PICUP and State Bank of Patiala.

However, the important fact cannot be denied that in asst. yr. 1989-90 out of the amount of Rs. 1.24 crores taken by way of inter-corporate loan the assessee had paid back Rs. 92,50,000 out of the funds generated from its business. According to the Revenue authorities, this fund could have been utilised for repayment of loan taken from PICUP and State Bank of Patiala. If the assessee had used its business funds for repaying the loans, which were outstanding to the extent of

more than Rs. 60 lakhs instead of repaying the inter-corporate loans which was invested in DTL, the assessee could have saved substantial amount of interest paid. So far as this huge amount of interest is concerned, we find that the legal position as laid down by the Hon'ble Supreme Court and various High Courts does not warrant disallowance on this ground. Before we discuss the legal position, it would be pertinent to mention here that the AO submitted his remand report to the CIT(A) on 11th November, 1993, in which he has clearly mentioned that there was no investment of borrowed funds in DTL till asst. yr. 1988-89 and he further observed as under : "A perusal of the various bank accounts and relevant entries in the books with regard to the investment made in DTL did show that there are no diversion of fund from the cash credit account for making investment in DTL. The investment in DTL have gone out of bank accounts maintained by the company with Bank of India Calcutta and Bank of India, Delhi. As such no direct nexus between the payment of interest to State Bank of Patiala Hauzkhas branch and investment in DTL could be established." 13. Therefore, from the perusal of the bank account and relevant entries in the books with regard to investment it is clear that there was no direct nexus between payment of interest to State Bank of Patiala, Hauzkhas and PICUP.14. The legal position as propounded by the Hon'ble Supreme Court in the case of CIT vs. Madhav Prasad Jatia (supra) is that in order to claim deduction under s. (10(2)(iii) or 10(2)(xv), which is in pari materia with s. 36(1)(iii) three conditions are required to be satisfied to enable the assessee to claim deduction in respect of interest on borrowed capital, namely, that the money must have been borrowed by the assessee; (b) that it must have been borrowed for the purpose of business and that; (c) the assessee must have paid the interest on the said amount claimed as a deduction. It was further observed that it is not the requirement of s. 10(2)(iii) that the assessee must further show that the borrowing of the capital was necessary for the business so that if at the time of the borrowing the assessee has sufficient amount of its own the deduction could not be allowed and the High Court further took the view that in deciding whether a claim of interest on borrowing can be allowed the fact that the assessee had ample resources at its disposal and need not have borrowed, was not a relevant matter for consideration. This view was taken by the Hon'ble Bombay High Court in the case of CIT, vs. Bombay Samachar Ltd. (supra), where

the Hon'ble High Court has observed as under : "The only conditions required to be satisfied in order to enable the assessee to claim a deduction in respect of interest on borrowed capital under s. 10(2)(iii) are first, that money must have been borrowed by the assessee, secondly, it must have been borrowed for the purpose of business and thirdly the assessee must have paid interest on the said amount and claimed it as a deduction. It is not the requirement of the provision that the assessee must further show that the borrowing of the capital was necessary for the business so that if at the time of borrowing the assessee had sufficient amount of its own, the deduction could not be allowed.

The fact that the assessee had ample resources at its disposal and need not have borrowed, is not a relevant matter for consideration.

The view that if the assessee had collected the outstandings which were due to it from others, it would have been able to reduce its indebtedness and thus save a part of the interest which it had to pay on its own borrowings, that the assessee would not be justified in allowing its outstandings to remain without charging any interest thereon while it was paying interest on the amounts borrowed by it, and that to the extent to which it would have been in a position to collect interest on the outstandings due to it from others, it could not be permitted to claim as an allowance interest paid by it is not correct." Therefore, as per the legal principle laid down by the Hon'ble Supreme Court and the Bombay High Court, it is clear that the consideration which weighed with the CIT(A) for disallowing the interest in respect of PICUP and State Bank of Patiala, was not a valid consideration in the eye of law. So far as the decision of the Hon'ble Allahabad High Court in the case of H.R. Sugar Factory (P) Ltd. (supra) relied on by the CIT(A) is concerned, the facts of that case are distinguishable. In that case the assessee borrowed money from bank but advanced loan to its director on concessional rate lower than what it was paying to the bank. In that circumstance, the Hon'ble Allahabad High Court took the view that the assessee was not a financial company. Rather it was engaged in the manufacture of sugar and no business purpose was served by advancing the loan on concessional rate to its director. In those circumstances the amount of interest was disallowed. However, the facts of that case is not applicable to this case. So the decision of the Hon'ble Allahabad High Court is not

squarely applicable to the facts of the present case. It is an admitted position that the assessee-company had taken loan from PICUP and State Bank of Patiala for purchase of plant and machinery and for providing working capital to the business of the assessee. Therefore, the loan taken by the assessee-company was for the business purpose. It has to pay the interest on such borrowing, which was also for business purpose. Merely because the inter-corporate loans were received by the assessee-company and paid back will not be a valid consideration for disallowance of interest in respect of PICUP and the cash credit of State Bank of Patiala. The learned Departmental Representative mainly relied that the funds were got mixed up and it is not possible to segregate the same. However, we do find that no such finding has been given by the Revenue authorities. Further a perusal of the details of investment given at pp. 12 and 15, of the paper-book, clearly shows that these funds were not got mixed up with other funds of the assessee. Therefore there is no substance in the argument of the learned Departmental Representative. So far as the decision relied upon by the learned Departmental Representative, in connection with loans of PICUP and State Bank of Patiala is concerned, we are of the view that the facts of the case of CIT vs. M. S. Venkateswaran (supra) and in the case of Highways Construction Co. (P) Ltd. vs. CIT (supra) as also in the case of P. RM. S. Ramanathan Chettiar vs. CIT (supra) are distinguishable on facts themselves. In earlier two decisions the borrowed capital was utilised for non-business purposes and in the decision of P. RM. S. Ramanathan Chettiar (supra) the factual finding was that there was a common fund part of which came from borrowing and part of which constituted capital of business. In that circumstance it was held that the money is invested out of common fund and in some other regions. The interest cannot be allowed unless it can be bifurcated. The matter was remanded to the Tribunal for determining fresh source of money invested. In view of our discussion we are of the opinion that the disallowance of interest on loans from PICUP and State Bank of Patiala for asst. yrs. 1989-90 and 1990-91 is unjustified. We, therefore, direct the AO to allow the same accordingly.

15. As regards the disallowance of interest relating to inter-corporate loans invested in DTL, we find that the AO has reported that the assessee invested Rs. 1,24,20,000 in DTL which came out of inter-corporate loans. The assessee-

company invested the same for the purchase of shares of DTL which was never allotted to the assessee-company. Rather DTL invested the money in another concern for purchase of shares of Allen-Bradley Ltd. Therefore, it is clear that the money was borrowed for non-business purposes. The shares were never allotted to the assessee-company. So we agree with the view taken by the CIT(A) on this issue entirely.

16. The case of the assessee is that whereas the assessee-company borrowed money for the purpose of making investment in purchase of shares and paid interest thereon, it is allowable as per the decision of the Hon'ble Supreme Court in the case of Rajendra Prasad Moody (supra). So far as this contention of the learned assessee's counsel is concerned, the case of the assessee-company is distinguishable from the case of Rajendra Prasad Moody. In that case the assessee-company borrowed money for the purpose of investment in shares which was in fact allotted to that company. In that circumstance the Hon'ble Supreme Court has laid down that interest payment for making investment in purchase of shares is allowable. However, in the present case we find that the assessee-company was never allotted any share or shares.

Rather a perusal of the investment made year after year would go to show that investment in DTL got increasing rather the authorised capital of that company also increased which is a fact not denied by the assessee-company. It is also found that the assessee-company did not keep the amount separately in a bank, rather the DTL used the amount for investment in purchase of shares of another company.

Therefore, it is clear that the assessee-company was never allotted any shares. The amount invested by the assessee-company in DTL was converted as advances in the subsequent year. The amount was never kept separately as a share money in any bank as per the requirement of Company law. Therefore, it is clear that it was a colourable device of the assessee-company to utilise the money for non-business purpose. In view of the circumstances mentioned by the CIT(A) on this point, and what is stated above, we are of the opinion that interest payment in respect of inter-corporate loans invested in DTL cannot be allowed as a

business deduction. We, therefore, agree with the view taken by the CIT(A) on this issue.

17. We would like to mention here that several case law have been relied upon by the parties, which are distinguishable on facts.

Therefore, it is not necessary to deal with the ratio of the decision laid down in those cases.

18. In view of our discussion, we are of the opinion, that the amount of interest pertaining to inter-corporate loans invested in DTL for asst. yr. 1989-90 Rs. 11,68,235 and in the asst. yr. 1990-91 amounting to Rs. 8,22,840 are clearly disallowable as the nexus between inter-corporate loans and investment is not established in regard to the funds on which this interest is payable. Therefore, it was rightly disallowed by the CIT(A).

19. As regards the disallowance of interest for the asst. yr. 1991-92 is concerned, we find that the AO disallowed the claim observing as under : "Facts of this year are identical to those of the preceding assessment year. A perusal of the copy of the account of subsidiary company reveals that till 3rd September, 1990, the amount outstanding against the sister concern was Rs. 2,06,55,000 on 4th September, 1990 itself. The assessee further advanced a sum of Rs. 50 lakhs. And it is only on 31st March, 1991, that the account has been finally settled. Therefore, in view of the assessment framed for the asst. yr. 1990-91 which has been substantially upheld by the CIT(A) and the facts being identical to last year, the assessee's entire interest claimed at Rs. 4,34,028 is disallowed." So far as it pertains to interest payment to State financial institutions, the State Bank of Patiala and PICUP is concerned, our finding given on this issue in the preceding paragraph is applicable in this year also. It will be pertinent to mention here that the AO fell into error when he mentioned that the facts of this year are identical to the facts of the earlier assessment year. In this year the assessee has recovered the amount of Rs. 2,06,85,000 due from DTL on 4th September, 1990, and thereafter the company gave short-term loan of Rs. 50,00,000 (Rs. 50 lakhs) for seven months from September to 31st March, 1991 which is clear from the details given at p. 6 of the Statement of the case. This loan was given out of the funds

received back by the assessee-company and no borrowed funds were utilised for this business purpose. The assessee-company has not incurred any liability after 4th September, 1990, i.e., when the short-term loan was given to the subsidiary company, except the interest paid to Madhu Industries on security deposit. Therefore, it would be clear that the amount of Rs. 50,00,000 was given out of the funds of the company and not out of the borrowed funds of the company. Therefore, interest relating to this cannot be disallowed. The CIT(A) fell into error while disallowing the claim of interest in respect of this amount, i.e., Rs. 3,90,951, as there was no nexus between such borrowings and investment made in subsidiary company's DTL in this assessment year. Therefore, this is allowable as a business expenditure.

20. In view of our above discussion, the assessee's appeal is partly allowed.

SooperKanoon - India's Premier Online Legal Search - sooperkanoon.com