



\* **IN THE HIGH COURT OF DELHI AT New Delhi**

+ **ITA No.938/2009**

% Decision Delivered On: 15.12.2010

**COMMISSIONER OF INCOME TAX** . . . Appellant

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel.

VERSUS

**MANOR HOTELS PVT. LTD** . . . Respondent

Through: Ms. Shashi M. Kapila, Advocate

**CORRAM:**

**HON'BLE MR. JUSTICE A.K. SIKRI**  
**HON'BLE MR. JUSTICE SURESH KAIT**

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

**A.K. SIKRI, J. (ORAL)**

1. In this present appeal under Section 260 (A) of the Income Tax Act, 1961 (hereinafter called as Act), against the order of the ITAT dated 11/04/08;

following questions of law are being proposed:-

- a) Whether the provisions of section 40A (2) (b) of the Income Tax Act, 1961 are not applicable to the facts of the present case?
  - b) If the answer to above question of law is affirmative, then whether interest paid @ 26% compounded quarterly on amounts borrowed from persons having substantial interest in the company is excessive/or reasonable?
2. To recite the genesis of the instant appeal, facts are concisely produced herein under:



The respondent/assessee is a Pvt. Ltd Company running a hotel in the name of **M/S MANOR HOTELS PVT. LTD.** In this appeal we are concerned with the A.Y. 2002-2003 where the assessee had shown an unsecured loan of ₹ 7, 67, 61,615/- from M/S Merlin Resources as on 31/03/2002. AO noticed that original amount of loan was ₹4 crores were taken on 01/06/09 @ 26% per annum at compounded rate of interest. Moreover, AO had noticed that principal and the interest had been shown as unsecured loan liability without any payment been made to the Merlin Resources from 01/06/99 to 31/03/02. Furthermore, AO believed that assessee had no reasons as to why unjustifiably high rate interest of 26% p.a. should be allowed to Merlin Resources and restricted the same to 13% compound interest. In this behalf, the AO examined the interest paid by Merlin Resources Pvt. Ltd. in respect of the borrowed amount by it i.e. 9.43% for the year ending ended 31/3/2001 and 9.63% for the year ending 31/3/2002 and comparing these rates of interest with 26%, he found it very high, hence an addition was made of ₹ 84, 08, 944 to the income of the assessee on account of interest claimed in excess.

3. Thereafter, assessee being distressed with the order of AO had preferred an appeal before the CIT (A), who had confirmed the order of the Assessing Officer, after considering the reluctance on part of the assessee to disclose the details. The CIT (A) in order dated 31/01/06 held the view that the



shareholders of Merlin Resources Pvt. Ltd. were having substantial holding/interest in the Assessee Company through network of various companies, which were traced upto the Mauritius (TCG Development India Pvt. Ltd) and held that the payment of interest to Merlin Resources was sheltered by section 40A (2) (b) of the Act and confirmed the disallowances made by Assessing Officer on account of such gratuitous interest.

4. The Assessee, yet again being disgruntled by the order of CIT (A) filed an appeal before ITAT, who has decided the issue relating to the rate of interest by observing suitably that there was a need for such huge amount for the newly incorporated company to carry on its business which could only have been obtained from a private party i.e. Merlin Resources Pvt. Ltd., who had fixed their rate of interest @ 26%. Holding this view, the ITAT has set aside the order of CIT (A) by holding that the provisions of section 40A (2) (b) were not applicable to the given transaction and the CIT (A) although had invoked section 40A (2) (b) did not examine the question whether the payment of interest was excessive or unreasonable, having regard to the parameters of section 40A (2) (b). Additionally, the ITAT accepted the plea of the assessee that for such a huge amount of ₹4 crores the Assessee was not able to offer any security, and for that reason the rate of interest was fixed at 26%, and held that the rate of interest was not excessive or unreasonable having regard to the legitimate needs of the



business of assessee, therefore, the rate of interest fixed at 26% p.a.

justified.

5. At this instant, it is clearly depicted from the findings of the ITAT's order, that the even after the assessee had stated the feasible reasons for such a high rate of interest, the Assessing Officer did not invoke section 40A (2) (b) but merely proceeded to disallow a part of the interest on the ground that it was unduly high. Moreover, there was no finding of the Assessing Officer with regard to the payment/expenditure being excessive or unreasonable, having regard to the fair market value of the goods or services or the legitimate needs of the assessee's new business.

After considering all the facts & circumstances of the case, we are therefore of the opinion that the original amount of loan of ₹4 crores taken at 26% p.a. at compound rate of interest was justified. It is pertinent to mention here that the assessee is a newly incorporated company, which undeniably wants to enlarge its hotel which it had taken on lease, and could not acquire credit from the banks and other financial institutions due to the present market scenario. Conversely, the ITAT had precisely appreciated the fact that since the amount of loan of Rs. 4 crores was high for a novice company and the assessee was not able to offer any security to the borrower, it was justified in paying such a high rate of interest.

6. In view of the aforementioned discussion, we are inclined to accept the approach taken by the ITAT with regard to the interest of ₹84,08,944, paid by the assessee on the loan taken from Merlin Resources Private Limited by



holding section 40 A (2) (b) to be not applicable. Although, there might be some linkage between the two companies and a circuitous shareholding pattern, the senior DR was not able to point out how the provisions of section 40A (2) (b) were attracted. The rate of interest was not at all excessive or unreasonable having regard to the legitimate needs of the Assessee, and thereby CIT (A) was not justified in sustaining the disallowances.

7. No question of law arises and this appeal is accordingly dismissed.

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**(A.K. SIKRI)**  
**JUDGE**

*(Handwritten signature)*  
**(SURESH KAIT)**  
**JUDGE**

December 15, 2010.

AV/lr.