



THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment Reserved on: 04.05.2010
Judgment Delivered on: 14.05.2010

+ **ITA 47/2008**

M/S PUNJAB STAINLESS STEEL INDS. ... Appellant

- versus -

COMMISSIONER OF INCOME TAX-VII & ANR. Respondents

Advocates who appeared in this case:

For the Appellant : Mr Satyen Sethi, Mr Johnson Bara & Mr A T Panda
For the Respondent : Ms Prem Lata Bansal

CORAM:-

HON'BLE MR JUSTICE BADAR DURREZ AHMED
HON'BLE MR JUSTICE V.K. JAIN

1. Whether Reporters of local papers may be allowed to see the judgment? Yes
2. To be referred to the Reporter or not? Yes
3. Whether the judgment should be reported in Digest? Yes

V.K. JAIN, J.

1. This is an appeal against the order of the Income Tax Appellate Tribunal dated 3.8.2007, whereby it dismissed the appeal, being ITA No.5533/Del/2004, filed by the appellant/assessee against the order passed by the



Commissioner of Income Tax(Appeals) dated 28.9.2004, whereby he dismissed the appeal filed by the assessee in respect of the Assessment Year 2001-2002.

2. During the year in question, the appellant/assessee paid an amount of Rs.80,93,749/-towards net interest, which included Rs.84,30,252/- paid to the banks on credit facilities and foreign bills etc. and Rs.1,34,334/- paid to the partners of the assessee firm. On going through the account of the assessee in respect of M/s.Kesho Ram Industries, it transpired that there was an opening debit balance of Rs.1,80,64,962/- in that account, on 1st April, 2000. The debit balance in that account, at the end of the financial year, stood at Rs.1,75,49,633/-. It was noted by the Assessing Officer that M/s.Kesho Ram Industries was a sister concern of the assessee, in which two partners of the assessee firm, namely, Shri Paramjit Singh and Shri Harvinder Singh, were also partners, holding 50% shares in the profits of that firm. The Assessing Officer held that there was a clear cut diversion of the funds borrowed by the assessee, since the funds were advanced to M/s.Kesho Ram Industries out of CC 40 account of the assessee with Punjab & Sind Bank, in which the secured loan stood at Rs.1.33 crores. He was of the view that interest



bearing funds had, thus, been diverted to the associate concern. He rejected the contention that since the firm had interest free funds in the current account of the partners aggregating Rs.22.7 crores, besides Rs.4.60 crores in the account of the father of a late partner Shri Trilochan Singh, the interest free advance to M/s.Kesho Ram Industries were made by the firm out of those interest free funds of Rs.27.32 crores. He, accordingly, disallowed the interest paid by the assessee firm to the extent of Rs.30,92,266/-, taking the rate of interest at 14.45% per annum, which was the rate at which interest was being paid by the assessee firm to the bank in CC 40 account.

3. In the appeal filed by the assessee, the CIT(A) held that interest free advances were given out of the cash from account with the bank, which had debit balance, on which the assessee firm was required to pay interest and, therefore, there was a direct nexus between the interest bearing funds borrowed by the assessee and interest free advances given by it to its sister concern. He rejected the explanation that interest free advances were made out of interest free funds available with the assessee firm, as he found that the advances were made out of the overdraft bank account maintained with



Punjab & Sind Bank. He, accordingly, upheld the disallowance made by the Assessing Officer.

4. In the appeal before the Income Tax Appellate Tribunal, it was submitted by the assessee that the debit balance in the name of the sister concern was much smaller compared to the interest free funds available with the assessee and no disallowance of interest had been made in the earlier year, in respect of debit balance in the account of M/s.Keshoo Ram Industries.

5. In para 2.3.4 of its judgment, the Tribunal noted that there was no dispute that interest free advance of Rs.1.75 crores had been given to the sister concern and that the assessee had borrowings on which substantial interest had been paid. The Tribunal was of the view that what is required to be seen is whether there was any commercial expediency in making the interest free advances. The Tribunal did not find any commercial expediency in making interest free advances to the sister concern. It was noted by the ITAT that no material had been brought to its notice to show that the interest free advances had been given for the purpose of business or that by giving interest free advance, the business of the assessee would be served better. The Tribunal rejected the argument of the



assessee that there was business connection because part of the advances were on account of sale of import licences and found that the assessee, instead of getting the money back on account of sale of licences, had allowed the same to remain with the sister concern to be used interest free and, therefore, the nature of the amount was the same as interest free advance. It was also found by the Tribunal that there was direct nexus between interest bearing loans and the interest free advances, since the advances had been made from the cash credit account and this position had not been disputed before it. The Tribunal was of the view that no case for commercial expediency in making the interest free advances was made out by the assessee.

6. In **S.A.Builders Ltd. v. Commissioner of Income-Tax(Appeals) & Another**: (2007) 288 ITR 1 (SC), it was found by the Assessing Officer that the assessee had transferred a sum of Rs.82 lakhs to its subsidiary company and there was a huge debit balance in the account of the subsidiary company. He, therefore, held that since the assessee had diverted the borrowed funds to its sister concern without charging any interest, proportionate interest relating to the said amount deserved to be disallowed. In the appeal filed by the assessee,



Commissioner of Income Tax(Appeals) was of the view that only a sum of Rs.18 lakhs advanced to the subsidiary company had a clear nexus with the borrowed funds, since the borrowed amount had been paid out of receipts from other parties, to whom no interest had been paid. The Tribunal, however, held that the entire amount of Rs.82 lakhs had been advanced by the assessee realizing overdraft account and, therefore, upheld the disallowance made by the Assessing Officer. The appeal filed by the assessee having been dismissed by the High Court, he approached the Supreme Court, obtaining Special Leave. The Supreme Court was of the view that the approach of the High Court, the Tribunal as well as the Income Tax Authorities was erroneous, since the test in such a case was whether the advances were made as a measure of commercial expediency. The Supreme Court was of the view that the High Court as well as the other authorities should have enquired as to whether the interest free loan to the sister company was given as a measure of commercial expediency. It was observed by the Supreme Court that the expression 'commercial expediency' includes such expenditure as a prudent businessman incurs for the purpose of business, though it may not have been incurred under any legal obligation. Interpreting its earlier



decision in the case of **Madhav Prasad Jatia v. CIT** : (1979) 118 ITR 200 (SC), the Court was of the view that the ratio of its decision in that case was that the borrowed funds, advanced to a third party, should be for commercial expediency if it is sought to be allowed under Section 36(1)(iii) of the Income Tax Act. The Court agreed with the view taken by this Court in **CIT v. Dalmia Cement (B.) Limited** : (2002) 254 ITR 377, holding that once it is established that there was nexus between the expenditure and the purpose of business, the Revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of a Board of Directors and assume the role to decide how much is reasonable expenditure, having regard to the circumstances of the case. It was observed that the income tax authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. The matter was to be seen from the point of view of commercial expediency and not from the point of view whether the amount was advanced for earning profit.

7. A perusal of the assessment order would show that the assessee did not claim before him, that the advances to M/s.Kesho Ram Industries were actuated by way of commercial expediency. The contention before the Assessing



Officer was that the interest free advances to M/s.Kesho Ram Industries were made out of interest free funds available with the assessee firm. No case of commercial expediency was set up before him. From a perusal of the order passed by the CIT(A), we find that the plea of commercial expediency was not set up before him as well. The assessee firm did not claim before him that the advances to M/s.Kesho Ram Industries were in the business interest of the assessee firm and were a measure of commercial expediency. The plea of commercial expediency in advancing the loan was set up for the first time before the Income Tax Appellate Tribunal. The assessee, however, failed to make out a case of commercial expediency before the Tribunal. During the course of arguments before us the assessee did not try to make out a case of commercial expediency in extending interest free advances to M/s.Kesho Ram Industries. The assessee did not tell the Tribunal as to what business interest of the assessee firm was sought to be achieved by making interest free advances to M/s.Kesho Ram Industries and in what manner that interest was served. The assessee was required not only to claim commercial expediency but also to establish it from the material available to the Assessing Officer. It has not even made such an attempt.



8. In **Elmer Havell Electrics & Others v. Commissioner of Income Tax & Another** : (2005) 277 ITR 549, the assessee had borrowed funds while giving interest free loan to its sister concern. The Tribunal held that there was no commercial expediency in extending the interest free loan to the sister concern. It was held by this Court that whether there existed any commercial expediency for the assessee to transfer amount in question to one of its sister concerns and whether the funds were advanced from self-generated funds of the assessee and there was a need for that purpose, were questions of fact and the Tribunal was the final fact finding authority in this regard.

9. Thus, the question whether the advances to M/s.Kesho Ram Industries were extended for commercial expediency or not was a question of fact and the Tribunal, which is the final fact finding authority, has returned a finding against the assessee in this regard. The finding recorded by the Tribunal has not been shown to be perverse and, therefore, cannot be interfered with in exercise of jurisdiction under Section 260A of Income Tax Act.

10. During the course of arguments before us, referring to the ledger account of M/s.Kesho Ram Industries, it was



submitted by the learned counsel for the appellant/assessee that an amount of Rs.1,35,90,103/- out of the opening debit balance of Rs.1,80,64,962.35 in the account represented the amount payable by M/s.Kesho Ram Industries to the assessee firm towards premium on transfer of DEPB licences and during the course of the relevant year M/s.Kesho Ram Industries made a payment of Rs.6,05,930/- towards part repayment of that amount. We find from a perusal of this account that during this year five payments – two of Rs.10 lakhs each, one of Rs.20 lakhs, one of Rs.16 lakhs and one of Rs.5.5 lakhs – were made by the assessee to M/s.Kesho Ram Industries directly from CC 40 account which, admittedly, was the interest bearing account in which interest was paid by the assessee firm to Punjab & Sind Bank. We also find that two payments of Rs.10 lakhs each were made by M/s.Kesho Ram Industries to the assessee firm in CC 40 account. Therefore, it cannot be said that no advances to M/s.Kesho Ram Industries were extended by the assessee firm from CC 40 account, during the year in question. It appears that there was a purchase of sheets amounting to Rs.40,50,900/- from M/s.Kesho Ram Industries on 7th February, 2001. It was contended by the learned counsel for the appellant/assessee



that this payment should be adjusted against the advances made from CC 40 account during this year. We are unable to accept the contention. There was already a debit balance of Rs.1,80,64,962.35 in the account as on 1st April, 2000. Therefore, this amount payable by the assessee to M/s.Kesho Ram Industries has to be adjusted against debit balance payable by M/s.Kesho Ram Industries prior to the advances extended during this year and not against the cash advances extended during the course of the year. Moreover, there is no finding recorded by the Assessing Officer, CIT(A) or by the ITAT that the opening balance of Rs.1,80,64,962.35 on 1st April, 2000 represented the premium payable by M/s.Kesho Ram Industries to the assessee firm, on transfer of DEPB licences. In fact, a perusal of the assessment order would show that the assessee itself submitted before him that interest free advances to M/s.Kesho Ram Industries amounted to Rs.1.81 crores at the beginning of the year and Rs.1.75 crores at the closing of the year. The plea taken by the assessee firm before the Assessing Officer was that these advances were made from the interest free funds available with the firm. It was also submitted before CIT(A) that the debit balance in the account of M/s.Kesho Ram Industries was not only on account of



advances made to them but also included debits on account of sale of DEPB licences aggregating to Rs.1.36 crores. A perusal of the order of CIT(A) would show that the case set up by the assessee before him was that it had interest free deposit amounting to Rs.27.47 crores in the account of partners and ex partners, interest free advances to the sister concern of the appellant amounted only to Rs.1.75 crores and the advances were made to the sister concern out of the mixed funds which comprised appellant's own funds, retained profits and other interest free funds available with it. It, thus, appears to us that the appellant did not dispute, before CIT(A) that the amount which it did not realize from M/s.Kesho Ram Industries, to which DEPB licences were transferred by it, were allowed to be retained as advances to M/s.Kesho Ram Industries from the assessee firm. As noted earlier, even before the ITAT, the assessee did not dispute that it had given interest free advances of Rs.1.75 crores to its sister concern. The Tribunal was of the view that since the assessee, instead of getting money back on account of sale of licences, allowed the same to remain with the sister concern, to be used as interest free, the nature of amount was of interest free advances. We see no reason to take a contrary view.



11. In view of the provisions contained in Section 36(1)(iii) of Income Tax Act, the interest paid by the assessee in respect of capital borrowed for the purpose of business or profession is to be allowed as a deduction. Hence, the question to be considered in a case such as the one before us is as to whether the interest free advance was made by the assessee for commercial expediency or not. If the advances were not made by the assessee for a business purpose of the assessee firm, interest paid by the assessee on that part of the borrowed capital which is commensurate with the amount of the interest free advances extended by it cannot be said to have been paid for the purpose of its business.

12. The commercial expediency, in our view, would include such purpose as is expected by the assessee to advance its business interest and may include measures taken for preservation, protection or advancement of its business interests. The business interest of the assessee has to be distinguished from the personal interest of its directors or partners, as the case may be. In other words, there has to be a nexus between the advancing of funds and business interest of the assessee firm. The appropriate test in such a case would be as to whether a reasonable person stepping into the shoes



of the directors/partners of the assessee firm and working solely in the interest of the assessee firm/company, would have extended such interest free advances. Some business objective should be sought to have been achieved by extending such interest free advance when the assessee firm/company itself is borrowing funds for running its business. It may not be relevant as to whether the advances have been extended out of the borrowed funds or out of mixed funds which included borrowed funds. The test to be applied in such cases is not the source of the funds but the purpose for which the advances were extended.

13. The learned counsel for the appellant has referred to the decision of the Supreme Court in **Munjal Sales Corporation v. Commissioner of Income Tax & Another** : (2008) 298 ITR 298 (SC). In that case it was held by the Tribunal that the assessee had given interest free loan in the assessment year 1992-93, out of its own funds and not from interest bearing loan taken by the firm from the third party and, consequently, the assessee was entitled to claim deduction under Section 36(i)(iii) of the Act. It was observed by the Supreme Court that the Tribunal had held that the loans were given for business purposes. It was further



observed that similarly for the assessment year 1993-94, the Tribunal had taken the view that the loans given to the sister concern of the assessee were for business purposes. The loans given by the assessee in August/September, 1991 to its sister concern were wiped out in the assessment year 1997-98. The Court was of the view that once the Tribunal had found that the loans were advanced for business purposes and the interest paid by the assessee did not exceed 18% per annum, the assessee was entitled to deduction under Section 36(1)(iii) read with Section 40(b)(iv) of the Act. As regards a small interest free loan of Rs.5 lakhs extended by the assessee during the assessment year 1995-96, the Court was of the view that since the opening balance as on 1st April, 1994 was Rs.1.91 crores whereas loan given to the sister concern was a small amount of Rs.5 lakhs, profits earned by the assessee during the relevant year were sufficient to cover the loan of Rs.5 lakhs. The assessee before the Supreme Court succeeded on the peculiar facts of the case before the Court. However, in the present case, there is absolutely no finding recorded by the Tribunal that the interest free advances were made by the assessee to M/s.Kesho Ram Industries for its business purposes. There is no such finding by the Tribunal even with



respect to the advances extended in the previous years. It is not the case of the appellant before us that it had so much surplus cash available with it at the time of extending these advances that the same could have been extended by it out of those surplus funds available to it. In fact, the payments made to M/s.Kesho Ram Industries from CC 40 account indicate to the contrary and show that advances made during the financial year relevant to the assessment year 2001-02, were extended out of borrowed funds and not out of any credit balance available with the assessee firm at that time. Therefore, this judgment is of no help to the appellant.

14. The learned counsel for the appellant has also referred to **Commissioner of Income Tax & Another v. Tin Box Co** : (2003) 260 ITR 637 (Del). We find that in the case of Tin Box Company(supra) the capital of the firm and interest free unsecured loans available with the appellant far exceeded the amount advanced to the sister concern in all the years under appeal. The question as to whether the loans to the sister concern were extended for commercial expediency or not was neither raised nor examined in that case. Considering the decision of Supreme Court in S.A.Builders(Supra), what is relevant in such a case is as to whether the loan was extended



for any commercial expediency or not and, therefore, it would be immaterial whether the assessee firm had interest free funds available to it or not.

15. The learned counsel for the appellant has also lastly referred to **Commissioner of Income Tax v. Sridev Enterprises** : (1991) 192 ITR 165 (Kar). In the case before the Karnataka High Court, it was found that in past years the assessee's claims for deduction were allowed in respect of the sums advanced during those years and a departure from that finding in respect of the amount advanced during the previous year would result in a contradictory finding and it would not be equitable to permit the Revenue to take a different stand in respect of the amounts which were subject matter of the previous year. We find that no such argument was advanced by the appellant before the Income Tax Appellate Tribunal. We, therefore, do not deem it appropriate to allow the argument to be raised in an appeal under Section 260A of Income Tax Act, particularly when the advances made by the assessee firm do not stand the test of commercial expediency laid down by the Supreme Court in the case of S.A. Builders(supra).

16. For the reasons given in the preceding paragraphs,



no substantial question of law arises for our consideration.

The appeal is accordingly dismissed.

(V.K. JAIN)
JUDGE

(BADAR DURREZ AHMED)
JUDGE

MAY 14, 2010
RS/