* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA No. 1337/2010, 1339/2010 & 1340/2010**

Date of Order : 3rd January, 2011

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**COMMISIONER OF INCOME TAX**
**DELHI-I, NEW DELHI** ...APPELLANT

*Through*: Ms. Prem Lata Bansal, Advocate.

*Versus*

**BHARTI TELEVENTURE LTD.**
**QUTAB AMBIENCE, H-5/12,**
**MEHRAULI ROAD, NEW DELHI** ...RESPONDENT

*Through*: Mr. Kaanan Kapur, Advocate.

**CORAM:**
**HON'BLE MR. JUSTICE A.K.SIKRI**
**HON'BLE MR. JUSTICE M.L.MEHTA**

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

Yes

**M. L. MEHTA, J. (Oral)**

1. These three appeals have been preferred by the revenue under Section 260A of the Income Tax Act (hereinafter referred to as Act) against a common order dated 24th July, 2009 passed by learned Income Tax Appellate Tribunal (ITAT in short). Since the parties are common, the questions of law are common and the appeals have been preferred

against the common order of the ITAT, we propose to dispose of these three appeals by this common order.

2. ITA 1340/2010 relates to Assessment Year 2001-02, ITA 1337/2010 to Assessment Year 2003-04 and ITA 1339/2010 to Assessment Year 2004-05. In all these cases common questions of law are whether the Assessing Officer was right in disallowing the interest claimed by the assessee on borrowed funds giving interest-free advances to its subsidiaries and whether the expenditure incurred by the assessee by way of interest was for business purposes so as to allow deductions under Section 36(1)(iii) of the Act. Since the basis of the orders of the AO as passed in ITA 1337/10 and ITA 1339/10 was the same as order of the AO passed in ITA 1340/2010, we may briefly refer to the facts of the case of this appeal which pertained to AY 2001-02.

3. AO assessed income at Rs.29,85,70,311/- as against returned income of Rs.73,47,390/- for the AY 2001-02. The assessee company had claimed deduction of Rs.28,98,86,967/- being interest paid on the borrowings. The AO while noticing that the assessee had made interest free advances to its subsidiary companies out of funds borrowed on interest, disallowed deduction of

Rs.28,98,86,967/-. In the appeal the CIT(A) after going through the entire record allowed the deductions of the aforesaid amount of payment of interest on borrowings. Relevant part of the order of CIT(A) is reproduced as under :

> " The facts of the case clearly indicate that the disallowance has been made without establishing on record, any nexus between borrowed funds and specific advances to subsidiaries. It is further seen that the appellant company has maintained bank account with mixed common fund in which all deposits and withdrawals have been made. The Ld. AR pointed out that at all points of time the appellant company had adequate non-interest bearing funds by way of Share Capital and Reserves. The learned AO has not tax pointed out any specific instance in respect of any direct nexus between the borrowed fund and said advances made to subsidiaries out of this borrowed fund. The AO has made additions on general observations without going into depth of the matter and without pointing out any specific instance where an interest bearing borrowing has been advanced to the subsidiaries or establishing that the borrowings made by the appellant were not for business purposes. The appellant has explained the Sources of the advances and investments made to subsidiaries which could not be linked to the borrowed funds. In the result the disallowance cannot be sustained as prima facie the advances were made out of appellant's own capital and also because the Ld. AO has not brought any material on record to show that any amount of borrowed fund was advanced to the subsidiaries and that there is a direct nexus. The AO has also not established that the borrowings of the appellant company were not for the business purposes. The argument of the appellant that advances to wholly owned subsidiaries are even otherwise for business considerations only has considerable force."

4. The revenue preferred appeal against the order of the CIT(A). It may be noted that in ITA 1337/2010 pertaining to the AY 2003-04 also, the CIT(A) relied upon the order as passed by the CIT(A) for the AY 2001-02. CIT(A) noted that since the facts of the case as well as the law remaining the same, and also since the advances made to subsidiaries were part of opening balance brought forward from earlier year and that during the year under consideration (AY 2003-04), the appellant's additional borrowed funds were only used for purchasing the vehicles, following the order of AY 2001-02 the disallowances made by the AO during the year under consideration is also deleted. Similarly, the CIT(A) for the AY 2004-05 also relied upon the order as made for the AY 2001-02 and stated that since the facts of this case for the AY 2004-05 as well as the law remaining the same, as also since the advances made to subsidiaries were part of opening balance brought forward from the earlier year, the disallowance made by the AO for the AY 2004-05 is also deleted.

5. The revenue preferred appeals against the orders of the CIT(A) in all the three cases before !TAT. The contention of the revenue before the ITAT and also before us were that it

was not the assessee's business to invest the shares of the subsidiary companies; that while the assessee had borrowed money and had paid interest thereon, the amount borrowed had been diverted interest-free to the subsidiary companies which no prudent businessman would do so; that the assessee company wrongly debited to its profit and loss account, the amount of interest towards acquisition of capital asset and that the expenditure incurred was not for the business purposes of the assessee.

6. Learned ITAT after perusing the material on record and hearing arrived at the following :

> " The expenditure to the tune of Rs.28.99 crores was disallowed as having funds borrowed and interest expenditure not for the assessee's business purposes. The amounts were made out of mixed funds. At page 41 of the assessee's paper book is the balance sheet of the assessee. During the year, all borrowals have been shown as repaid. In 'S.A. Builders' (supra), the Hon'ble Supreme Court has held, inter alia, that in order to decide whether interest on funds borrowed by the assessee to give an interest free loan to a sister/subsidiary concern should be allowed as a deduction, it has to be enquired as to whether the loan was given by the assessee as a matter of commercial expediency; that the expression "commercial expediency" is one of wide import and includes such expenditure as a prudent business-man incurs for the purpose of business; that the expenditure may not have been incurred under any legal obligation, yet it is allowable as a business expenditure, if it was incurred on grounds of commercial expediency. In the present case, the AO as observed by the learned CIT(A), did not bring any

material on record to show that any amount of borrowed fund was advanced to the subsidiaries and that there was a direct nexus. The advances made by the assessee company to its wholly owned subsidiary concerns were for business considerations only. Further, at the relevant time, the assessee company had adequate non-interest bearing funds by way of share capital and reserves. The advances were made out of the assessee's own funds."

7. Making same submissions before us as made before the ITAT, learned counsel for the revenue relied upon the judgment in **'Indian Metals & Ferro Alloys Ltd. Vs. Commissioner of Income Tax', (1992) 193 ITR 0344** and also submitted that where the assessee sought to deduct certain items from business profits, the onus of proving the same fell on him. She submitted that Section 36(1)(iii) relates to the amount of interest paid on capital borrowed for the purpose of business, profession or vocation and not for advancing interest-free amounts from the borrowed funds to its subsidiaries. Since admittedly, the interest-free advances had been given by the assessee to its subsidiaries, it was upon the assessee to show that the amounts so advanced were from its own funds.

8. On the other hand, the learned counsel for the assessee relied upon the judgment of Division Bench of the Hon'ble Supreme Court reported as **"S.A. Builders Ltd. Vs.**

**Commissioner of Income Tax (Appeals)" (2007) 288 ITR 0001** and submitted that advances were made by the assessee to its subsidiaries only for business considerations and that in any case, assessee had sufficient non-interest bearing funds at the time of making advances to its subsidiaries. He submitted that the investment in subsidiaries should not be viewed in line with other interest free advances and that the same should be treated for the purpose of business for the reason that profit of subsidiary eventually forms part of the holding company. He further submitted that since all the funds were deposited in common account of the assessee company and there being sufficient interest-free funds available, there was no nexus between the advances given to the subsidiaries and borrowals.

9. In the case of ***CIT v. United Breweries*** (1973) ITR 17, a plea was also raised stating that subsidiary company was a part and parcel of the parent company and, therefore, the principals of agency applied and interest as claimed was entitled to deduction under Section 36(1)(iii). It was held that if the parent company exercised functional control over the subsidiary then the existence of such subsidiary

company as a separate legal entity did not prevent the business of the subsidiary being treated as that of the parent company.

10. In the case of S.A. Builders (supra) the Hon'ble Supreme Court was seized of the similar matter. In that case, it was held as under:

> " The question involved in this case is only about the allowability of the interest on borrowed funds and hence we are dealing only with that question. In our opinion, the approach of the High Court as well as the authorities below on the aforesaid question was not correct. In this connection we may refer to Section 36(1)(iii) of the Income Tax Act, 1961 (hereinafter referred to as the 'Act') which states that "the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession" has to be allowed as a deduction in computing the income tax under Section 28 of the Act. In Madhav Prasad Jantia vs. CIT [1979] 118 ITR 200 (SC); AIR 1979 SC 1291, this Court held that the expression "for the purpose of business" occurring under the provision is wider in scope than the expression "for the purpose of earning income, profits or gains", and this has been the consistent view of this Court. In our opinion, the High Court in the impugned judgment, as well as the Tribunal and the Income Tax authorities have approached the matter from an erroneous angle. In the present case, the assessee borrowed the fund from the bank and lent some of it to its sister concern (a subsidiary) as interest free loan. The test, in our opinion, in such a case is really whether this was done as a measure of commercial expediency. In our opinion, the decisions relating to Section 37 of the Act will also be applicable to Section 36(1)(iii) because in Section 37 also the expression used is "for the purpose of business". It has been consistently held in the decisions relating to Section 37 that the expression

"for the purpose of business" includes expenditure voluntarily incurred for commercial expediency, and it is immaterial if a third party also benefits thereby.

Thus in Atherton vs. British Insulated & Helsby Cables Ltd (1925)10 TC 155, it was held by the House of Lords that in order to claim a deduction, it is enough to show that the money is expended, not of necessity and with a view to direct and immediate benefit, but voluntarily and on grounds of commercial expediency and in order to indirectly to facilitate the carrying on the business. The above test in Atherton's case (supra) has been approved by this Court in several decisions e.g. Eastern Investments Ltd. vs. CIT (1951) 20 ITR 1, CIT vs. Chandulal Keshavlal & Co. (1960) 38 ITR 601 etc.

In our opinion, the High Court as well as the Tribunal and other Income Tax authorities should have approached the question of allowability of interest on the borrowed funds from the above angle. In other words, the High Court and other authorities should have enquired as to whether the interest free loan was given to the sister company (which is a subsidiary of the assessee) as a measure of commercial expediency, and if it was, it should have been allowed.

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

No doubt, as held in Madhav Prasad Jantia vs. CIT (supra), if the borrowed amount was donated for some sentimental or personal reasons and not on the ground of commercial expediency, the interest thereon could not have been allowed under Section 36(1)(iii) of the Act. In Madhav Prasad's case (supra), the borrowed amount was donated to a college with a view to commemorate the memory of the assessee's deceased husband after whom the college

was to be named. It was held by this Court that the interest on the borrowed fund in such a case could not be allowed, as it could not be said that it was for commercial expediency. Thus, the ratio of Madhav Prasad Jantia's case (supra) is that the borrowed fund advanced to a third party should be for commercial expediency if it is sought to be allowed under Section 36(1)(iii) of the Act."

11. The Hon'ble Supreme Court further held that though, the borrowed amount was not utilized by the assessee in its own business and had been advanced as an interest free loan to the sister concern, but that is not relevant. What is relevant is whether the assessee advanced such amount to its sister concern as a measure of commercial expediency? The law laid down by the Bombay High Court in ***Phaltan Sugar Works Ltd. v. CIT*** (1995) 215 ITR 582 was over-ruled whereas that of Delhi High Court in ***CIT v. Dalmia Cement (B.) Ltd.*** (2002) 254 ITR 377 was approved. It was further held that it all depends on the facts and circumstance of the case as to whether the directors of the sister concern utilized the amount advanced to it by the assessee for their personal benefit, which obviously could not be said to be an advance as a measure of commercial expediency.

12. In the instant case, from the order of the CIT(A) and that of ITAT, as reproduced above, in paragraphs 3 and 6, we note that the assessee was maintaining a bank account with mixed common funds in which all deposits and withdrawals were made. There was no specific instance noted by the Assessing Officer in respect of any direct nexus between the borrowed fund and the said advances made to the subsidiaries. The Assessing Officer had made general observations without going into the depth of the matter and without pointing out any specific instance where an interest bearing borrowing was advanced to the subsidiaries or establishing that the borrowings made by the appellant were not for business purposes. Both the appellate authorities below were of the view that the assessee had explained the sources of the advances and investments made to the subsidiaries, which could not be linked to the borrowed funds and that the advances were made out of the assessee's own capital. At the relevant time the assessee was found to be having an adequate non-interest bearing fund by way of Share Capital and Reserves. Even otherwise, the advances were found to be made to the subsidiaries for business considerations which is nothing

but the commercial expediency of assessee. That being the factual position reflected from the record of the assessee, the onus that laid on it stood discharged.

13. We are in entire agreement with the findings recorded by the CIT(A) as also by ITAT in all the three cases and do not find any ground to interfere with those findings.

14. Consequently, all the appeals deserves to the dismissed and are hereby dismissed with no orders as to costs.

**M.L.MEHTA**
**(JUDGE)**

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

**JANUARY 3, 2011**
Vld/AK