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

Decided On: 13.03.2015

\+ **ITA No.512/2013**

COMMISSIONER OF INCOME TAX (C) -III ..... Appellant

Through: Mr. N.P. Sahni, Sr. Standing Counsel, Advocate.

Versus

M/s DD INDUSTRIES LTD. ..... Respondent

Through: Mr. Salil Aggarwal with Mr. Ravin Pratap, Advocates.

AND

\+ **ITA No.516/2013**

COMMISSIONER OF INCOME TAX (C) -III ..... Appellant

Through: Mr. N.P. Sahni, Sr. Standing Counsel, Advocate.

Versus

M/s DD INDUSTRIES LTD. ..... Respondent

Through: Mr. Salil Aggarwal with Mr. Ravin Pratap, Advocates.

AND

\+ **ITA No.517/2013**

COMMISSIONER OF INCOME TAX (C) -III ..... Appellant

Through: Mr. N.P. Sahni, Sr. Standing Counsel, Advocate.

Versus

M/s DD INDUSTRIES LTD. ..... Respondent

Through: Mr. Salil Aggarwal with Mr. Ravin Pratap, Advocates.

AND

+ **ITA No.518/2013**

COMMISSIONER OF INCOME TAX (C) -III ..... Appellant

Through: Mr. N.P. Sahni, Sr. Standing Counsel, Advocate.

Versus

M/s DD INDUSTRIES LTD. ..... Respondent

Through: Mr. Salil Aggarwal with Mr. Ravin Pratap, Advocates.

AND

+ **ITA No.519/2013**

COMMISSIONER OF INCOME TAX (C) -III ..... Appellant

Through: Mr. N.P. Sahni, Sr. Standing Counsel, Advocate.

Versus

M/s DD INDUSTRIES LTD. ..... Respondent

Through: Mr. Salil Aggarwal with Mr. Ravin Pratap, Advocates.

AND

+ **ITA No.526/2013**

COMMISSIONER OF INCOME TAX (C) -III ..... Appellant

Through: Mr. N.P. Sahni, Sr. Standing Counsel, Advocate.

Versus

M/s DD INDUSTRIES LTD. ..... Respondent

Through: Mr. Salil Aggarwal with Mr. Ravin Pratap, Advocates.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE R.K. GAUBA

MR. JUSTICE S. RAVINDRA BHAT (OPEN COURT)
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1. The appeals are admitted. Mr. Salil Aggarwal, learned counsel for the assessee accepted notice of the appeals. With consent of counsel for the parties, the appeals were finally heard for disposal. These appeals are directed against the common order of the Income Tax Appellate Tribunal (ITAT) dated 17-05-2013, for AY 2007-08; 2008-09 and 2009-10, in cross appeals of the assessee and the revenue

(in ITA No. 63-64/Del/2013; Nos. 264-266/Del/2013 and ITA No. 635/Del/2013).

2. The revenue urges the following substantial questions of law for the decision of this Court:

(1) Did the ITAT fall into error in its interpretation of Section 36 (1) (iii) regarding advance of borrowed funds, to its sister concern?;

(2) Did the ITAT fall into error in holding that the sum of ₹25,04,385/- brought to tax by the AO on the interest free deposit of ₹ 1,75,50,000/- was not sustainable?;

(3) Is the ITAT's order- that the assessee's revised net taxable income of ₹ 4,08,24,559/- held by the CIT (A) to be unsustainable - and its acceptance of Rs. 1,63,60,896 as net taxable income (for AY 2008-09) erroneous?

3. The assessee is engaged in manufacturing and trading of auto components and dealership business of Maruti vehicles. In addition, it is also engaged in leasing business, CNG conversion of vehicles and high security license plates. The objects of the company also include dealing in real estate. During assessment for AY 2007-20008, it was noticed from the return of income that the assessee paid interest on borrowed capitals amounting to ₹7,54,44,421/-. At the same time, the assessee gave interest free advances to its associate company, M/s DD Properties (P) Ltd to the tune of ₹23,28,50,000/-. The assessee, in its return of income stated that the said advance was given to M/s DD Township Ltd, a company under same management in terms of Memorandum of Understanding against future township project. As advance has been made for the purpose other than the business, the assessee was asked to explain why the proportionate interest on this

amount be not disallowed. In reply to this, the assessee has stated that during the year under assessment working capital limit has been increased and short-term funds have been utilized for booking a show room with DD Properties. In addition, to the assessee also responded in writing, to the following effect:

> *"The advance to DD Properties (P) Ltd has been made for booking of space for an additional showroom for the expanding business of the assessee company. The allotment has not yet been made by the said company, and thus it cannot be said to have crystallized and as such the interest cannot be capitalized. The capitalization of interest will be from the date of actual allotment made by the said company up to the date of delivery of possession. Thus till the allotment is made, the interest paid is of revenue nature and as such has to be allowed as expenditure of business."*

4. The AO was of the opinion, in all these assessment years, (AY 2007-08, 2008-09, and 2009-10) that borrowed funds had been used for booking of a property which was to be used as a show room of the company in future years and it could not establish nexus between the money borrowed and sum advanced and that only borrowed funds were utilized to buy a show room i.e., an asset to be used by the company for its future business. It was consequently held that interest on the sum expended by the assessee as advance for the purchase of show room amounting to ₹23,28,50,000/- was not an admissible expenditure. Noting that interest paid on borrowed capital was ₹7,54,44,421/- which, divided by the total borrowed sum disclosed average interest rate of 14.27%, which on application of the same average rate on the fund diverted to the associate companies, worked

out to ₹3,32,27,695/-, the AO added back that sum and brought it to tax. Likewise, similar amounts were added back for other years: ₹3,21,09,750/- (for 2008-09) and ₹3,25,85,450/- (for 2009-10).

5. The assessee appealed against the additions for all the three assessment years. The Commissioner of Income Tax (Appeals) – hereafter "CIT (A)" by a common order, affirmed the finding of lack of business connection. However, he applied a different average rate of interest which resulted in limited relief to the assessee. The CIT (A) concluded that there was

> *"direct nexus between the interest bearing funds and interest free funds of Rs. 23,28,50,000 given to DD Properties (P) ltd. The Balance Sheet shows that the appellant has a working capital limit with Indian overseas Bank and it is appearing under the head 'Secured loans'. Further from the perusal of copy of account of Indian Overseas Bank from which the appellant has issued cheqeus to DD Properties (P) ltd. as interest free funds, (being alleged as advance for properties), it is seen that on all the days when the payments were made to DD Properties (P) ltd., the balance as per bank statement had always been a debit balance i.e. overdraft. Hence beyond any iota of doubt, it is evident that interest bearing funds from Indian Overseas Bank have been given to DD Properties (P) Ltd….. In such an event when there is a direct payment from the Indian Overseas Bank on which interest is being paid by the appellant, I fail to understand how the appellant claims that the payment made to DD Properties (P) ltd is from his own funds and from interest free funds, when the facts and evidences show that the appellant has paid Rs.2,94,62,056 as interest to Indian Overseas Bank on enjoying the working capital facility. Hence in view of the above, I hold that there is a direct nexus between the payments made to DD Properties (P) ltd. out of the interest,*

bearing funds taken from Indian Overseas Bank and thus the appellant is wrong in claiming that the payment to DD Properties (P) ltd. has been made from interest free funds."

6. The CIT (A) examined whether DD Properties (P) ltd. had credit worthiness and financial strength to examine its capacity and capability to carry the venture of constructing the proposed shopping complex in which the assessee had booked 40,000 sq. feet of area for its business. Despite opportunities, the assessee did not disclose evidence about the financial capacity, capability of DD Properties (P) Ltd. to carry on such a venture and relied only on the Memorandum of Understanding entered into between it and that concern, which revealed only the schedule of payments to be made by to the said DD Properties (P) Ltd. for purchase of 40,000 sq. feet area in a proposed shopping complex. Other evidence about the total cost of DD Properties project; its financial status; from where it proposed to fund the project; whether ₹13,500/ per sq. feet (which the assessee agreed to pay to its sister company i.e. DD Properties (P) Ltd.) was reasonable; status of the project on the date of entering into agreement was lacking. The CIT (A), therefore, held that there was no business nexus between the advance and the purpose sought to be achieved.

7. Both parties, i.e the revenue and the assessee were aggrieved by the CIT (A's) order. The revenue was aggrieved by the limited relief (based on the rate of interest arrived at, while calculating disallowance of interest free advance to DD Properties); the assessee was aggrieved by the disallowance itself. ITAT noted the contentions, particularly that of the assessee that the revenue did not dispute the CIT (Appeals')

findings that the claim was admissible u/s 36(1)(iii) of the Act and the reliance placed on the judgment of this Court in *Commissioner of Income Tax vs. Sahara India Corpn Ltd.* (2000) 296 ITR 285 (Delhi). Most crucially, it noted that the amount of ₹23,28,50,000/- was advanced in the F.Y, 2005-06 and F.Y. 2006-07 from out of surplus funds for purchase of show room and no borrowed funds were used for these advances and that no disallowance of interest expenditure was made during those years in orders made under Section 143(3) and no disallowance could be made in the assessment years in dispute, as facts were identical. It was also held that the disallowance under Section 36(1)(iii) cannot be extended to advances given in the AY which are opening balances during the year.

8. The ITAT recorded its conclusions as follows:

> *"14. We have heard the rival contentions. On a careful consideration of the facts and circumstances of the case, a perusal of the papers on record and the orders of the authorities below, we hold as follows.*
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> *15. The Ld.CIT(A) after considering the arguments of the assessee at para 7 states as follows:*
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> > *"From the perusal of the appellant's submissions, I am in agreement with the appellant's claim that in their case the disallowance u/s 36(1)(iü) cannot be made because no property/capital assets have been acquired by them."*
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> *16. This specific finding of the Ld.CIT(A) has not been challenged by the Revenue either in the grounds of appeal or by way of an argument during the course of appeal proceedings. When it is not in dispute that the claim of the assessee is allowable u/s 36(1)(iii), we do not find any reason to go to the*

> *general provisions of S.37(1) for the purpose of allowance or disallowance. The Jurisdictional High Court in the case of CIT vs. Sahara India Corp. Ltd. (supra) reported in 296 ITR 285 held that the Tribunal is not bound to answer a question not raised before it. Hence when the question whether the deduction is allowable or not u/s 36(1)(iii) not before us or even disputed, we need not go into this aspect.*
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> *17. Under these circumstances we have to necessarily hold that the claim of the assessee in question has to be allowed u/s 36(1)(iii) as it is a special provision, as compared with S.37(1), which is a general provision. The general provision i.e. Sec. 37(1) would come into play where the claim cannot be allowed under any of the specific provision of the Act. Sec.37 is only a residuary provision."*

The ITAT cited *Dy. CIT vs. Core Health Care Ltd.* (SC) (2008) 298 ITR 194 for the proposition that the dichotomy inherent in the use of borrowed funds, i.e borrowing itself does not create an asset, but the use of that borrowing to create an asset, which results in it. Having regard to the authorities, it was held that Section 37 could not be resorted to, because of applicability of Section 36 (1) (iii). The ITAT also held that:

> *"In fact the said were amounts were advanced during the FY 2005-06 and 2006-07. Orders were passed by the AO u/s 143(3) for both these years in which the scrutiny assessments have taken place, and no disallowance was made either u/s 36(1)(iii) or u/s 37(1). The advance to sister concerns in question in the case on hand are opening balance carried forward from the Previous Year and when so no disallowance can be made."*

9. It is argued by the revenue that ITAT has failed to appreciate that for the claim of interest, it is necessary that, firstly, the 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 borrowed capital. The expression *"for the purpose of business"* occurring in section 36(1)(iii) specifies that deduction under this section is admissible only when capital ¡s borrowed directly *"for the purpose of business"* of the assessee. It is argued that ITAT fell into error in appreciating section 36(1)(iii) even otherwise, because the proportionate amount of interest is needed to be added back, as the assessee during the course of the assessment proceedings has itself submitted that it has advanced the loans to its associate company for the purpose of acquiring a show room. This clearly meant "extension of existing business or profession". The revenue also disputes the factual findings of the ITAT regarding the actual advances having been made in previous years, pointing out that financial years 2005-06 and 2006-07 correspond to the assessment years in dispute. It is also urged that the finding regarding the acceptance- in scrutiny assessments- for previous years, having become final could not have been rendered. It is argued that the ITAT should not have followed the previous year's decisions, given that each assessment year constitutes a fresh cause, affording the revenue a new look at the materials placed before it. The assessee, on the other hand, contends that the ITAT's decision is entirely fact based, as it had the benefit of looking into the records. It is urged that in fact, for the assessment years in question, no advances were made to the assessee's sister concern. Having accepted the amounts lent during previous

years, it was not open for the revenue to now change its opinion when there was no material in that regard.

10. The record before the ITAT showed that the paid up equity of the assessee was `8,00,00,000/- for all the years, i.e., as on 31.03.2006; 31.03.2007, 31.03.2008 and 31.03.2009. The general reserves and surplus as on 31.03.2006 was `14,68,82,450; as on 31.03.2007, it was ₹16,36,68,384/-; as on 31.03.2008, it was ₹17,10,43,019/- and as on 31.03.2009 it was ₹15,28,48,354/-. Sundry debtors as on 31.03.2006 was ₹22,82,38,320/-; as on 31.03.2007 it was ₹28,58,66,349/-; as on 31.3.2008 it was ₹22,53,78,479/-; as on 31.03.2009 stood at ₹11,61,95,359/-. Thus, there is material to show that the amounts were not in fact advanced for the assessment years in question, i.e., 2007-08, 2008-09 and 2009-10. The assessee had provided further material disclosing that the loans taken were for specific purposes from different financial institutions such as purchase of cars, stocks, raw materials etc. These supported its contentions that adequate funds were available during the assessment years and that since in the past the Revenue had accepted the assessee's plea in this regard and not brought the amounts to tax under Section 36 (1) (iii), there was no question of its being brought to tax for the three assessment years in question. Applying the ratio in *CIT v. Sahara India Corporation Ltd*, (2000) 296 ITR 295 (Del), it is held that the Revenue could not have taken a different view for these three years, particularly, when advances were not made at this time without any conclusion that in fact general reserves, surpluses and other funds were not available. The Court here also notices that several decisions were relied upon by

the ITAT (*Reliance Utility and Power Ltd. v. CIT*, 313 ITR 340 (Bom.), *CIT v. Hotel Savera*, 239 ITR 795 (Mad), *CIT v. Tin Box Company*, 260 ITR 637 (Del.)) in support of the conclusion that when the assessee is possessed of mixed funds which include its own funds in sufficient quantity, a presumption that its own funds were utilized for the advances is to be drawn.

11. The next aspect is as regards the question whether the purpose for which the loan was given, i.e., to book 40,000 sq. ft. property for the assessee's use in an upcoming commercial complex was sufficient. We notice that the ITAT held against the Revenue on this aspect. The ITAT noted the terms of the Memorandum of Understanding (MOU) dated 28.05.2005 entered into with D.D. Properties where it had agreed to invest money in the project by way of advance. This document had not been rejected either by the AO or the CIT (A). The balance sheet of D.D. Properties Pvt. Ltd., a sister concern was also considered by the ITAT. This disclosed that as on 31.03.2006 it had inventories in the form of land to the extent of `32.4 crores. In these circumstances, given the nature of the MOU, the ITAT in our opinion rightly concluded that the Revenue's reasoning was unsound. The ITAT also relied upon *Sassoon J. David & Co. Pvt. Ltd. v. CIT*, 118 ITR 261 (SC). This Court had in a similar context, held in *Commissioner of Income Tax v Bharti Televenture* [2011] 331 ITR 502 (Del) that:

> *"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 overruled whereas that of the 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 Commissioner of Income-tax (Appeals) and that of the Income-tax Appellate Tribunal, 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 the 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 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 the assessee. That being the factual position reflected from the record of the assessee, the onus that laid on it stood discharged."

12. The second question was whether for AY 2007-08, the assessee was right in contending that the interest free security deposit which was enhanced from ₹25 lakhs to ₹1.75 crores in respect of premises of DD (I) Motors Pvt. Ltd and Lease could be allowed. Here, the revenue's conclusions were based on the assumption that there was no basis for increasing the security deposit, given that in an earlier part of the said year, the assessee had entered into an agreement, which itself kept the security deposit amount @ ₹25 lakhs. The assessee contended that the arrangement had been originally settled nearly a decade ago and given the increase in rental values over the years, the increase in security deposit amount was warranted and in any case, it was a commercial decision which could not have been gone into unless the AO had concrete material to contend that the transaction was a sham or illusory. Whether that amount was used for business or not ultimately depended on the assessee and not anyone else.

13. This court does not discern any *rationale* in the revenue's argument here. That the assessee needed the premises is not in dispute; equally it had a consistent and long standing arrangement with the sister concern, is undisputed. The rental arrangement was in the form of a commission payable according to the business of the owner of the premises, i.e the sister concern. It was not disputed that the security deposit had not been increased for a long time. That it was initially kept at the old level but increased during the year was a matter of fact. However, singling out that factor to hold against the assessee in the absence of any other material establishing dubiousness in the transaction, is not warranted. The court here recollects *S. A. Builders*

v. CIT (Appeals) [2007] 288 ITR 1 (SC) where the views of this Court in *Commissioner of Income Tax v. Dalmia Cement (B.) Ltd.* [2002] 254 ITR 377 that "*once it is established that there was nexus between the expenditure and the purpose of the business (which need not necessarily be the business of the assessee itself), the Revenue cannot justifiably claim to put itself in the arm-chair of the businessman*", and further that no businessman can be compelled to maximize his profit, were approved. The Supreme Court also held that:

> *"The Income-tax authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. The authorities must not look at the matter from their own view point but that of a prudent businessman. As already stated above, we have to see the transfer of the borrowed funds to a sister concern from the point of view of commercial expediency and not from the point of view whether the amount was advanced for earning profits.*
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> *26. 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…"*

The disallowance initially ordered by the AO and finally set aside by the ITAT for AY 2007-08 thus requires no interference. The impugned order does not suffer from any infirmity on this count. The views of ITAT are therefore, affirmed.

14. The third question of law arises in respect of AY 2008-09 and pertains to the finding of the ITAT that the acceptance of the second revised return, indicating revised income at ₹1.63 crores, originally accepted by the AO was in order. The Court notices that the CIT (Appeals) in this case issued notice for enhancement in the course of the assessee's appeal and rejected the AO's finding. This resulted in the first revised income being brought to tax at Rs.4.08 crores.

15. The counsel for the revenue urged that the ITAT's reasoning is not acceptable given that neither in the assessment proceedings nor before the CIT(Appeals) did the assessee specify the authorities as to the rationale for revising income downwards.

16. Counsel for the assessee on the other hand urged that the closure of the books of accounts had to be made on 30.09.2008 and consequently certain transactions were reflected in the subsequent year's accounts. It was submitted that these facts were duly demonstrated before the ITAT and not disputed by the departmental representative.

17. There is nothing in the order of the ITAT to indicate that the assessee had made the submissions that it claims to have done. It is quite possible that the material shown to this Court was in fact laid before the ITAT and considered by it. However, the impugned order does not reflect application of mind on this. It merely adverts to balance sheet and nothing else.

18. In these circumstances we are of the opinion that on this issue i.e. the acceptance of ₹1.63 crores (based on the second revised return), the ITAT must examine the matter afresh and return its findings on the basis of the materials made available to it during the course of hearing as well as the materials placed before the CIT(Appeals). The revenue's appeal succeeds to this extent.

19. Thus, questions 1 and 2 are answered in favour of the assessee and against the revenue. Question 3, arising in respect of assessment year 2008-09, is answered to the extent above in favour of the revenue.

S. RAVINDRA BHAT
(JUDGE)

R.K. GAUBA
(JUDGE)

MARCH 13, 2015