



**IN THE HIGH COURT OF KARNATAKA AT BENGALURU**

**DATED THIS THE 5<sup>TH</sup> DAY OF MARCH, 2025**

**PRESENT**

**THE HON'BLE MR JUSTICE KRISHNA S DIXIT**

**AND**

**THE HON'BLE MR JUSTICE RAMACHANDRA D. HUDDAR**

**INCOME TAX APPEAL NO. 45 OF 2019**

**BETWEEN:**

1. SHRI. V MADHUSUDHAN REDDY,  
(SINCE DEAD)  
RECORDS BROUGHT BY LRs
  - 1.(a). SMT. V. SOUMINI REDDY  
W/O. LATE SHRI V. MADHUSUDHAN REDDY,  
AGED ABOUT 64 YEARS,  
NO. 2-788, SATHYANARAYANAPURAM,  
WARD NO. 10, KONGAREDDY PALLI,  
CHITTOR - 517 001, ANDHRA PRADESH.
  - 1.(b). SHRI. V. NACHIKETH REDDY,  
S/O. LATE SHRI V. MADHUSUDHAN REDDY  
AGED ABOUT 20 YEARS,  
NO. 2-788, SATHYANARAYANAPURAM,  
WARD NO. 10, KONGAREDDY PALLI,  
CHITTOOR - 517 001, ANDHRA PRADESH.
- ...APPELLANTS
- (BY SRI. ASHOK A KULAKARNI.,ADVOCATE)

**AND:**

ASSISTANT COMMISSIONER OF INCOME TAX  
CIRCLE-7 (2), 4<sup>TH</sup> FLOOR, "C" WING,  
KENDRIYA SADAN, KORAMANGALA,  
BENGALURU-560 034.

PRESENTLY AT  
ASSISTANT COMMISSIONER OF  
INCOME TAX, CIRCLE-7 (2)

Digitally  
signed by  
CHETAN B C  
Location:  
HIGH COURT  
OF  
KARNATAKA



BMTC BUILDING, 80 FT ROAD,  
6<sup>TH</sup> BLOCK KORAMANGALA,  
BENGALURU-560 095.

...RESPONDENT

(BY SRI. Y V RAVIRAJ .,ADVOCATE FOR  
SRI. M DILIP., ADVOCATE)

THIS ITA/INCOME TAX APPEAL UNDER SEC.260-A OF INCOME TAX ACT, 1961, ARISING OUT OF ORDER DATED 14.09.2018 PASSED IN ITA NO.192/BANG/2014, FOR THE ASSESSMENT YEAR 2009-2010, PRAYING TO A) FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW AS STATED ABOVE AND B) ALLOW THE APPEAL BY SETTING ASIDE THE ORDER OF THE INCOME TAX APPELLATE TRIBUNAL IN ITA NO.192/BANG/2014 DATED 14.09.2018 (ANNEXURE-A) AND THE APPELLATE ORDER IN ITA NO.369/C-7(2)/CIT(A)III/BNG/11-12 DATED 24.10.2013 (ANNEXURE-C) AND THE ASSESSMENT ORDER IN PAN:AABHV7947N DATED 27.12.2011 (ANNEXURE-B) AND SUITABLY MODIFY IT AS SOUGHT IN THE APPEAL AND ETC.,

THIS ITA, COMING ON FOR HEARING, THIS DAY, JUDGMENT WAS DELIVERED THEREIN AS UNDER:

CORAM: HON'BLE MR JUSTICE KRISHNA S DIXIT  
AND  
HON'BLE MR JUSTICE RAMACHANDRA D. HUDDAR

### **ORAL JUDGEMENT**

(PER: HON'BLE MR JUSTICE KRISHNA S DIXIT)

Assessee is in appeal against the order of the Income Tax Appellate Tribunal. He has framed the following Substantial Questions of Law for consideration:

*"1. Whether on the facts and in the circumstances of the case the disallowance of*



*any part of the interest on Rs.7,05,98,612/- was justified in law while determining the total income of the appellant.*

*2. Without prejudice and in the alternative, if the answer to the above question is in the affirmative whether on the facts and in the circumstances of the case the restoration of the issue of disallowance of any part of the interest of Rs.55,18,394/- as an item of expenditure while determining the income of the appellant should have been without placing any limitation on the Commissioner of Income Tax (Appeals) to consider only the net interest free advances of Rs.7,05,98,612/- (Rs.12,38,45,350-5,32,46,738) as done by the Income Tax Appellate Tribunal and the entire issue of allowability of the interest of Rs.1,23,07,353/- should be allowed to be examined against the background of law and facts of the case.*

*3. Whether on the facts and in the circumstances of the case it should have been held that when out of a common pool of funds consisting of borrowings bearing interest and free of interest as well as other interest free funds of the assessee any disallowance of interest on the ground of diversion of borrowed capital would survive only when such alleged diversion exceeds the aggregate of the interest free funds available in the common pool inclusive of interest free borrowed funds and owned funds, from time to time and proportionately after making due allowance for the opening debit balances in the borrowing accounts at the commencement of the accounting year and it is for the assessing officer to specifically show on the basis of*



*evidence that the diversion comes out of interest bearing borrowed funds.”*

2. Learned counsel appearing for the Assessee in a very lucid and simple way submits that if income from interest earned on the money lent is to be taxed, as a matter of corollary, the interest paid by the Assessee on the amount borrowed by him has to be given deduction to and only thereafter net interest component can be arrived at for the purpose taxation. Learned counsel appearing for the Revenue vehemently opposes the appeal contending that the submission of Assessee essentially involves a question of fact and therefore, cannot be subject matter of adjudication at the hands of this court. He also makes submission in justification of the impugned order of the Tribunal and the reasons on which it has been constructed.

3. Having heard the learned counsel for the parties and having perused the Appeal Papers, we are of the considered opinion that when income by way of interest is taxable, it goes without saying that while arriving at that



component, the amount which the Assessee incurs by way of interest on the money borrowed by him necessarily has to be deducted. A contra legal position or Ruling is not notified to us. This view accords with the provision of section 28 of the Income Tax Act, 1961 and also the common sense.

4. The observation of the Tribunal at para 6 of its order runs counter to the above reasoning. For ease of reference, we reproduce the same though we do not agree with that:

*"6. Regarding the second claim of the assessee that the interest income earned by assessee of Rs.61.20 Lakhs received from M/s .B.V. Reddy and Sons (fin) should be reduced from interest expenditure to be considered for working out interest disallowance, in our considered opinion, on this issue, the assessee has not made out its case because we find that this is undisputed that an amount of Rs.12,38,45,350/- was given by assessee as interest free advances and this is also not being disputed that this interest free advances are financed by interest bearing loans except Rs.5,32,46,738/- which has been borrowed by assessee interest free. To the extent of interest free borrowing of Rs.5,32,46,738/-, relief has already been allowed by CIT(A). Now*



*whether this interest bearing loan advanced by assessee to M/s. B.V. Reddy and Sons (Fin), advanced to the extent of Rs.5.10 Crores is out of interest bearing borrowed funds or out of own funds available with the assessee of Rs.56.98 Crores approx. is relevant for this purpose and it has not been established by assessee by bringing direct nexus of such loan of Rs.5.10 Crores advanced by assessee to M/s. B V Reddy and Sons (Fin Division) for earning interest income with the interest bearing borrowed funds borrowed by the assessee and in the absence of such direct nexus having been brought on record by assessee, this claim of assessee cannot be accepted. Hence, we find no reason to interfere in the order of CIT(A) on this issue and only this much issue is being restored back to the file of CIT(A) for fresh decision as to whether in respect of net interest free advances of Rs.7,05,98,612/-, disallowance should be made @ 12.75% or @ 9% per annum. This issue should be decided by CIT(A) afresh after providing adequate opportunity of being heard to both sides and this issue should be decided by CIT(A) by passing a speaking and reasoned order and in this manner, ground no.2 of assessee's appeal is partly allowed for statistical purposes."*

In the above circumstances, the Substantial Questions of Law raised in the appeal are answered eventually in favour of Assessee and against the Revenue. Appeal is allowed and impugned order of the Tribunal to that extent is set at naught; it is made clear that the



Assessee is entitled to have deduction of Rs.61,20,000/-  
(Rupees Sixty One Lakh Twenty Thousand) only.

Ordered accordingly, costs having been made easy.

Sd/-  
**(KRISHNA S DIXIT)**  
**JUDGE**

Sd/-  
**(RAMACHANDRA D. HUDDAR)**  
**JUDGE**

CBC  
List No.: 1 Sl No.: 29