

IN THE HIGH COURT OF BOMBAY AT GOA**TAX APPEAL NO.9 OF 2008**

Vassantram Mehta & Co.(P) Ltd.,
Suvarn Bandekar Bldg.,
VascoDa Gama, Goa.

.... Appellant

V/s.

Joint Commissioner of Income-Tax,
Margao Range, Margao, Goa.

.... Respondent

Mr. Mihir Naniwadekar with Ms. Vinita Palyekar, Advocates for the
Appellant.

Ms. Asha Desai, Advocate for the Respondent.

**Coram:- F. M. REIS &
M. S. SANKLECHA, JJ.**

Date:- 17th APRIL, 2015

JUDGMENT : (Per M.S. SANKLECHA, J.)

In this appeal under Section 260A of the Income Tax Act (the Act) the challenge is to the order dated 8/08/2007 passed by the Income Tax Appellate Tribunal (Tribunal) in respect of Assessment year (AY) 2001-02.

2. This appeal was admitted on 10/03/2008 on the following substantial questions of law :

(A) Whether on the facts and in the circumstances of the case, the appellate Tribunal is right in disallowing the claim of interest payment because

of the interest-free advances made to sister concern, solely impelled by commercial expediency and used by the payee company for its business only, on the ground that the advances were excessive considering the requirements of assessee's trade with that concern ?

(B) Whether on the facts and in the circumstances of the case, the appellate Tribunal is right in confirming the order of the Commissioner (Appeals) disallowing the actual loss incurred due to fluctuation in currency rates in respect of advance received from a foreign buyer and demurrage payable to a foreign buyer ?

Facts:-

3. For the assessment year 2001-02 the appellant-Assessee filed its return of income declaring a total income of Rs.28.61 lakhs. In its return of income the appellant had :

(a) claimed an expenditure on account of interest aggregating to Rs.27.03 lakhs being the interest paid on pre shipment packing credit facility obtained by it. The Assessing Officer disallowed the entire expenditure on account of interest of 27.03 lakhs. This on the ground that the appellant had immediately on receipt of pre shipment packing credit funds had diverted (part of the amount) an amount of Rs. 9.36 crores as advances to its sister concern one M/s. Bandekar Brothers Private Limited (BBPL) from whom it purchased iron ore of Rs. 6.02 crores

during the Assessment Year. Thus the Assessing Officer reached a conclusion that the interest was being paid in respect of credit facilities obtained not for the appellant's own business; and

(b) claimed an amount of Rs.12.85 lakhs as loss on foreign exchange fluctuation. The appellant had received advances for supply from foreign parties for supply of iron ore. The variation/fluctuation in the exchange rate led to a revenue loss/profit. Therefore, at the end of the accounting period i.e 31st March, 2001 being the previous year relevant to subject assessment year the appellant had debited an amount of Rs.12.84 lakhs to its profit and loss account. The Assessing Officer on actual verification found that the loss on account of foreign exchange rate fluctuation was only Rs.3.59 lakhs and not Rs.12.85 lakhs. Consequently, the excess foreign exchange loss claimed of Rs.9.26 lakhs was disallowed by the Assessing Officer.

As a result of the above, the Assessing Officer by an order dated 26/03/2004 passed under Section 143(3) of the Act the enhanced the appellant's income from Rs.28.61 lakhs to 35.87 lakhs after adjusting an enhanced deduction on account of 80HHC of the Act.

4. Being aggrieved by the order dated 26.3.2004 of the Assessing Officer, the appellant preferred an appeal to the Commissioner of Income of Income Tax (Appeals) [CIT(A)]. By an order dated 26/12/2005, the CIT(A) concluded as under:

(a) On principle upheld the disallowance of interest on pre shipment packing credit in respect of funds diverted to its sister concern M/s. BBPL. This by following the decision of the Punjab and Haryana High Court in *S.A. Builders Ltd. V/s. CIT* reported in **(2004) 269 ITR 535** and a decision of this Court in *Phaltan Sugar Works Ltd. V/s. CIT* reported in **(1994) 208 ITR 989** wherein it was held that interest on borrowed capital which is being advanced to a sister concern/subsidiary as not a permissible expenditure. However the disallowance was restricted to Rs.17.21 lakhs being the interest payable by the appellant in respect of advances made by it to BBPL (diverted funds) out of the packing credit facility obtained by it.

(b) Not only upheld the amount of Rs.9,26,842/- disallowed by the Assessing Officer on account of fluctuation in rate of foreign exchange but further on principle also disallowed the amount of Rs.3.59 lakhs which was allowed by the Assessing Officer. This on the ground that no amount on account of

foreign exchange fluctuation can be debited to the profit and loss account to arrive at the appellant's net profit for the financial year ending 31st March, 2001. It held that the amounts which have been received by the appellant are only in nature of advances and the loss on account of exchange fluctuation could be only allowed as and when the goods are supplied against the advances received and not on a notional basis. Therefore, deleting an amount of Rs.3.59 lakhs allowed by the Assessing Officer. Consequently, the entire amount debited as loss on foreign exchange fluctuation by the appellant to its profit and loss account was disallowed.

5. Being aggrieved, the appellant filed an appeal to the Tribunal. By the impugned order, the Tribunal upheld the order dated 26.12.2005 of the CIT(A) in its entirety as under:-

- (a) on account of interest paid on pre shipment packing credit to the extent the funds were diverted by the appellant to its sister concern BBPL; and
- (b) disallowance of the entire loss claimed on foreign exchange fluctuation while making of its account as on 31/03/2001 i.e. previous year ending relevant

to Assessment Year 2001-02.

6. Being aggrieved by the impugned order dated 8.8.2007 of the Tribunal, this appeal has been filed by the appellant - assessee on the above substantial questions of law.

7. Re: Question (A):

(i) It is the appellant's case that it had funds of its own available for the purposes of making advances to its sister concern M/s. BBPL. This is an admitted position as recorded in the order of the Assessing Officer. Notwithstanding the above, the presumption in the impugned order is that funds advanced to M/s BBPL were out of borrowed funds is contrary to the decision of this Court in ***CIT Vs. Reliance Utilities & Power Ltd reported in 2009(313) ITR 340.*** Further it is contended that the advances were given to M/s BBPL for the purposes of the appellant's business so as to ensure an uninterrupted supply of iron ore from BBPL. This advance to BBPL according to the appellant was given on account of business expediency for ensuring supply of iron ore and therefore it is submitted that the issue stands concluded by the decision of the Apex Court in ***S. A. Builders Vs. CIT*** reported in ***2888 ITR 1***, which

had in fact not only reversed the decision of Punjab and Haryana High Court relied upon by the CIT (Appeals) but also observed that the decision of this Court in *Phaltan Sugar Works Ltd.*(supra) is not correct. Therefore, it is submitted by Mr. Mihir Naniwadekar, the learned Counsel for the appellant that question (A) be answered in favour of the appellant. As against the above, it is contended by Ms. Dessai, the learned Counsel on behalf of the Revenue, that no interference is warranted to the impugned order. This is particularly so as there are concurrent finding of fact in favour of the Revenue.

(ii) We proceed on the basis of the admitted position (Assessment Order dated 26.3.2004) that the appellant had enough funds of its own to make advances to M/s BBPL. However, all the authorities under the Act have come to the finding of fact that the appellant had advanced money to M/s BBPL out of the interest bearing borrowed funds. Thus no occasion to apply any presumption to the present facts can arise and therefore, the decision of this Court in *Reliance Utilities & Power Ltd.*(supra) proceeding on the basis that when both interest free funds and interest bearing funds are available then the presumption would be that investments etc are made would be out of interest free funds can have no application in the face of finding of fact in this case. Thus no interference with the

impugned order on application of incorrect presumption, is called for.

(iii) However, the Apex Court in *S. A. Builders Ltd*(supra) has held that even where the funds are advanced out of interest bearing funds to its sister concern, yet the deduction of interest paid on account of the borrowed funds cannot be disallowed as an expenditure if the amounts have been given to a sister concern on account of commercial expediency. This is for the reason that it would then be satisfying the test of utilising the funds for the “purposes of its business”. The Court observed that it is not for Revenue to put itself into the arm-chair of the businessmen to decide the manner in which the business is to be run. Nevertheless, the Apex Court also observes that each case would be decided on its own facts, depending upon how the funds lent to the sister concern have been utilised satisfying the test of purpose of assessee's business. The Apex Court in *S.A. Builders Ltd*.(supra) has observed as under:

“We wish to make it clear that it is not our opinion that in every case interest on borrowed loan has to be allowed if the assessee advances it to a sister concern. It all depends on the facts and circumstances of the respective case. For instance, if the Directors of the sister concern utilize the amount advanced to it by the assessee for their personal benefit, obviously it cannot be said that such money was advanced as a measure of commercial expediency. However, money can be said to be advanced to a sister concern for

commercial expediency in many other circumstances (which need not be enumerated here).”

We find that the impugned order has not carried out the aforesaid exercise. Neither the Revenue led any evidence to show how the borrowed funds were utilized by BBPL or the appellant given an opportunity to establish the need of the funds by BBPL for the benefit of appellant-Assesses. In the above view, we set aside the order of the Tribunal disallowing payment of interest to the extent of Rs.17.27 lakhs and restore the issue to the Tribunal for fresh consideration. It is made clear that the Tribunal would also consider the decision of the Apex Court in *S.A. Builders Ltd.* (supra) to decide its applicability to the present facts after letting the parties before it an opportunity to produce evidence in support of their respective cases.

8. Re: Question (B):

It is agreed position between the parties that claiming of revenue loss on account of foreign exchange rate fluctuation, is an allowable expenditure on the date of making its balance sheet. This revenue loss is not to be postponed to a future date when the transaction gets crystalised either by performance and/or cancellation of the contract. This is so agreed, as the issue now stands covered by

Apex Court decision in *Commissioner of Income Tax V/s. Woodward Governor India P. Ltd.* reported in *(2009) 312 ITR 254 (SC)*. Therefore, in view of the above, the impugned order dated 8.8.2007 with regard to question (B) is also set aside. However, the issue is restored to the Tribunal for deciding the quantum of loss on account of foreign exchange fluctuation which is to be allowed to the appellant-Assesse under Section 37 of the Act on the facts of this case.

9. For the aforesaid reasons, the appeal is partly allowed. The impugned order passed by the Tribunal is quashed and set aside. The appeal is restored to the file of the Tribunal for fresh disposal in accordance with law.

M. S. SANKLECHA, J.
NH/-

F. M. REIS, J.