IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

Date of Decision: 30.01.2015

I.T.A.No.119 of 2004

Commissioner of Income Tax (Central), Ludhiana ...Appellant

Versus

M/s Hero Cycles Ltd., Ludhiana ...Respondent

CORAM: HON'BLE MR. JUSTICE HEMANT GUPTA
HON'BLE MR. JUSTICE HARI PAL VERMA

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

Present : Ms. Savita Saxena, Advocate, for the appellant.

Mr. Aalok Mittal, Advocate, for the respondent.

HEMANT GUPTA, J. (ORAL)

The Revenue is in appeal under Section 260 A of the Income Tax Act, 1961 (for short 'the Act') aggrieved against the order passed by the Income Tax Appellate Tribunal, Chandigarh Bench, Chandigarh (for short 'the Tribunal') on 02.12.2003 relating to the assessment year 1994-95. The Revenue - appellant has raised the following substantial questions of law:

(i) Whether on the facts and in the circumstances of the case, the Tribunal was right in law in deleting the addition of Rs.10,02,350/- on account of closing stock of stores, spares, tools etc.?

(ii) Whether on the facts and in the circumstances of the case, the Tribunal was right in law in deleting the addition of Rs.1,13,35,469/- made on account of advances of interest free loans to the associated concerns whereas the assessee company was paying huge interest on the borrowed?

The first substantial question of law has been answered in favour of the Revenue and against the assessee vide separate order of today rendered in I.T.A.No.68 of 2001 titled '<u>Commissioner of Income Tax (Central), Ludhiana Vs. M/s Highway Cycle Industries Ltd.</u>' The said question is, thus, answered in favour of the revenue for the same reasons as are recorded therein.

Now coming to the second substantial question of law, the Tribunal disallowed the interest amounting to Rs.1,13,35,469/- on the amount of interest free loan advanced to M/s Gujarat Cycles Ltd. and M/s Majestic Auto Ltd. Such deduction was set aside by the Commissioner of Income Tax (Appeals) vide order dated 29.12.1997 remitting the matter back to the Assessing Officer and to make any disallowance if there is nexus between the borrowed funds and the diversion thereof in the form of interest free loans. The relevant finding recorded by the Commissioner of Income Tax (Appeals) reads as under:

> "Reverting to the issue, I hold that a re-consideration by the A.O. is required. As mentioned above, a disallowance under Section 36(1)(iii) could be made only if there is a nexus between the interest bearing loans and the diversion thereof for non-business purposes. Unless a nexus is proved, no disallowance would be called for. To re-examine the case from this angle, the issue is restored to the file of the A.O. The A.O. is directed to have a look into the case again and make any disallowance if there is nexus between the borrowed funds and the diversion thereof in the form of interest free loans. Unless any nexus is proved, no disallowance would be called for."

The Revenue went in further appeal before the Tribunal. The Tribunal followed the earlier decision and set aside the disallowance made by the Assessing Officer. It may be noticed that the assessee was not in appeal against the order remitting the matter to the Assessing Officer, but still the Tribunal has set aside the disallowance altogether.

We find that the issue to find out the nexus between the borrowed funds and the diversion thereof in the form of interest free loans requires to be examined in the light of the judgment of the Hon'ble Supreme Court in S.A.Builders Ltd. Vs. Commissioner of Income Tax (Appeals) (2007) 288 ITR 1 followed by this Court in ITA No.225 of 2004 titled 'Commissioner of Income Tax Vs. M/s Southern Bottlers Pvt. Ltd.' decided on 07.05.2013.

Thus, the order of the Tribunal setting aside the disallowance is set aside and that of the Commissioner of Income Tax (Appeals) is restored. The Assessing Officer is directed to consider the disallowance in terms of the order of the CIT (Appeals), after examining the nexus between the borrowed funds and the diversion thereof in the form of interest free loans.

Consequently, while answering both the substantial questions of law in favour of the appellant – Revenue, the present appeal is allowed.

(HEMANT GUPTA)
JUDGE

30.01.2015 (HARI PAL VERMA)
Vimal JUDGE