**IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH**

**ITA No.892 of 2008 (O&M)**
**Date of decision: 17.9.2015**

**Commissioner of Income Tax, Faridabad**

**……Appellant**

**M/s Nuchem Limited**

**…..Respondent**

**CORAM: HON'BLE MR. JUSTICE AJAY KUMAR MITTAL**
**HON'BLE MR. JUSTICE RAMENDRA JAIN**

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: Mr. Tajender K.Joshi, Advocate for the appellant.

Mr. P. C.Goyal, Advocate for the assessee.

**Ajay Kumar Mittal, J.**

**1.** This order shall dispose of ITA Nos.892 of 2008 and 130 of 2009 as according to the learned counsel for the parties, the issues involved in both the appeals are identical. However, the facts are being extracted from ITA No.892 of 2008.

2. ITA No.892 of 2008 has been preferred by the revenue under Section 260A of the Income Tax Act, 1961 (in short, "the Act") against the order dated 22.2.2008, Annexure A.III passed by the Income Tax Appellate Tribunal, Delhi Bench 'B' New Delhi (in short, "the Tribunal) in ITA No.857/DEL/2000 for the assessment year 1993-94, claiming following substantial questions of law:-

"1. Whether on the facts and in the circumstances of the case, the Hon'ble ITAT is right in law in confirming the order of learned CIT(A) deleting the trading addition of ₹ 74,96,376/- made by the Assessing Officer after rejecting the account books by invoking the provisions of Section 145(2) when there were sound reasons for the said rejection?

2. Whether on the facts and in the circumstances of the case, the Hon'ble ITAT is right in law in holding that the revenue had not filed appeal before the Hon'ble ITAT on the same point in the assessment year 1988-89 and therefore accepting the findings of the learned CIT(A) for the said year, disregarding the settled law that each assessment year is a separate year?

3. Whether on the facts and in the circumstances of the case, the Hon'ble ITAT is right in law in upholding the order of the learned CIT(A) deleting the addition made by the Assessing Officer on account of interest on interest free loans amounting to ₹ 4,43,730/- given to sister concern or persons covered under section 40A(2) of the Income Tax Act in contradiction with the judgment of jurisdictional High Court in CIT, Ludhiana vs. Abhishek Industries Limited, 298 ITR 1 (P&H)?

4. Whether on the facts and in the circumstances of the case, the Hon'ble ITAT is right in law in confirming the order of learned CIT(A) deleting the addition on account of "Inauguration Expenses" by keeping silent on merits of the present case in respect of disallowance of ₹ 4,78,845/- made by the Assessing Officer, when the expenses were not properly explained and duly vouched?"

In ITA No.130 of 2009, the following question of law has been claimed:-

"Whether on the facts and in the circumstances of the case, the Hon'ble ITAT is right in law in reversing the order of the learned CIT(A) sustaining the addition made by the Assessing Officer on account of interest on interest free loans given to sister concern or persons covered under section 40A(2) of the

Income Tax Act in contradiction with the judgment of jurisdictional High Court in ***CIT, Ludhiana vs. Abhishek Industries Limited,*** 286 ITR 1 (P&H)?

3. A few facts relevant for the decision of the controversy involved as narrated in ITA No.892 of 2008 may be noticed. The assessee company filed its return on 31.12.1993 declaring loss of ₹ 18,29,95,260/- which was revised to ₹ 18,45,95,550/- vide revised return filed on 2.5.1994. Again the return was revised to ₹ 18,23,70,250/- vide revised return filed on 12.12.1994. Assessment under section 143(3) of the Act was completed on 27.3.1996, Annexure A.I at total loss of ₹ 15,98,87,690/-. The Commissioner of Income Tax (Appeals) [CIT(A)] vide order dated 20.10.1999, Annexure AII accepted the assessee's appeal in part. Both the assessee and the department filed cross appeals before the Tribunal. The Tribunal vide combined order dated 22.2.2008, Annexure A.III allowed both the appeals in part. The issues on which the Tribunal dismissed the department's appeal are as under:-

i) The Assessing Officer made addition of ₹ 74,96,376/- on account of trading addition by applying GP rate of 48.88% instead of 46.88% shown by the assessee after rejecting book results declared in MDF Division. On appeal, the CIT(A) deleted the addition. The Tribunal confirmed the decision of CIT(A) and dismissed the revenue's appeal on this ground.

ii) The Assessing Officer made disallowance of ₹ 9,41,077/- on account of interest on interest free loans given inter alia to M/s Southern Synthetics Limited which was worked out at ₹ 4,43,730/-. On appeal, the CIT(A) allowed relief in respect of loan given to M/s Southern Synthetics Limited which worked out at ₹ 4,43,730/-. The department filed further appeal before the Tribunal which was dismissed.

iii)The Assessing Officer disallowed ₹ 4,78,845/- in connection with inauguration of MDF plant of Tohana. Although the assessee had separately debited expenses on account of travelling by business associates to attend the inaugural function of the assessee company at Tohana, yet another amount of ₹ 1,34,063/- was claimed on account of travel by others. The bills regarding this expenditure were furnished on the last date of hearing and no vouchers were produced. Further the bills pertained to expenses incurred after 12.4.1992 i.e. the date of inauguration. The CIT(A) deleted the addition of ₹ 4,78,845/- by relying upon judgments of Bombay High Court in ***CIT vs. Nirlon Synthetics Fibres Chemicals Limited,*** (1982) 137 ITR 1 and Calcutta High Court in ***CIT vs. Hindustan Aluminum corporation Limited***, (1989) 176 ITR 206. The Tribunal upheld the view taken by the CIT(A).

The appeal filed by the assessee before the Tribunal was partly allowed whereby out of disallowance of ₹ 4,97,347/- sustained by CIT(A) on account of interest given as interest free loan to sister concerns, the further relief of ₹ 80,000/- was given to the assessee by holding that the interest of ₹ 80,000/- on interest free loan to M/s Novika Investments was for business expediency. ITA No.130 of 2009 challenges such relief accorded to the assessee. Hence the instant appeals by the revenue.

4. We have heard learned counsel for the parties.

5. We proceed to discuss the relevant findings of the authorities below on the issues involved.

**<u>i) Trading addition of ₹ 74,96,376/-</u>**

6. The assessee declared gross profit of ₹10,65,51,163/- on the total sales which came to 27.43% as against 25.03% and 24.38% in the assessment years 1992-93 and 1991-92 respectively. The assessee's MDF Division at Tohana declared gross profit of 46.88%. The Assessing Officer found that there was discrepancy in the value of stock of eucalyptus wood and the stock of cotton stalk. The value of the stock as per the books was less than the value of the stock shown to the bank. The Assessing Officer did not accept the explanation of the assessee that the difference was due to theoretical calculation. The Assessing Officer invoked the provisions of Section 145(2) of the Act and estimated the gross profit at 48.88% in the MDF Division which resulted in the addition of ₹ 74,96,376/-. The CIT(A) deleted the addition. The Tribunal affirmed the view taken by the CIT(A). The relevant findings recorded by the Tribunal read thus:

> "80. On a careful consideration of the rival submissions and the material on record, we are satisfied that the CIT(Appeals) did not act unreasonably in deleting the addition. Firstly, when the overall gross profit rate has shown a consistent or even a better trend for the year in appeal – it is better by more than 2% compared to the earlier two years, there was no justification for tampering with the same by enhancing the gross profit rate of the MDF Division by 2%. The Assessing Officer seems to have overlooked that this is the first year of the Tohana Division and in the very first year, an impressive rate of gross profit has been shown by the assessee. We

are doubtful about the correctness of the action of the Assessing Officer in tampering with the gross profit rate of a particular division of the assessee's business in order to make a trading addition. Be that as it may, even otherwise there was no justification for the addition. The records maintained by the assessee were accepted by the excise and sales tax authorities. The assessee did maintain a stock register in respect of the MDF Division which was also produced for the Assessing Officer's verification but his objection was that a stock register showing consumption of raw material was not produced. The total consumption of the raw material has been given in the financial statements which are audited and these figures have not been questioned at all. As regards the objection that higher figures of stock were given to the Bank,it is seen that the figures of cotton stalks given to the bank were actually less than the figure shown in the books. In respect of the other stock, the assessee's submission before the Assessing Officer that the figures given to the bank were based on theoretical assumptions and they were substituted by actual figures available to the assessee later has not been doubted and there is no evidence to show that the assessee did not make such corrections. Even before us, such a stand was not taken. As regards the objection of the Assessing Officer that the moisture content shown by the assessee in the logs of eucalyptus tree was not correct and that the assessee ought to have put in place a system by which the moisture content can be measured not only when the logs arrive in stock but also when they are fed into the plant for being sown, we can only say that the manner in which the manufacturing activity should be carried out must be left to the assessee who is the best judge in such matters; in fact the assessee pointed out that how impractical it would be to stop the production process merely to verify the moisture content of the logs at the point of time when they are fed into the plant to satisfy the curiosity of the Assessing Officer or to comply with his unreasonable direction. It seems to us that the assessee has a valid point here. As regards the use of cotton stalks, the assessee had a technical problem when they got entangled in the machinery and for a temporary period, the assessee switched over to the use of eucalyptus wood but it could not be continued for long because it is costlier than the cotton stalks. Had the assessee continued to use eucalyptus wood in the place of cotton stalks, perhaps the gross profit rate would have been lower. It is also true that the Assessing Officer had not pointed out any suppression of sales or inflation of expenses. For these reasons, we are of the view that the Assessing Officer was not justified in not accepting the results of the MDF Division. We confirm the decision of the CIT (Appeals) and dismiss the ground."

Learned counsel for the revenue has not been able to point out any error in the concurrent findings recorded by the CIT(A) and the Tribunal which are based on appreciation of material on record. Thus, no ground for interference by this Court is called for in the said findings.

7. With regard to question No.2, learned counsel for the parties are agreed that the same is general in nature and does not arise.

8. Adverting to Question No.3 in ITA No.892 of 2008 and the solitary question in ITA No.130 of 2009, the addition was on account of interest on interest free loans.

9 . **Addition on account of interest on interest free loans**

The assessee had given interest free advances to sister concerns out of interest bearing borrowings. The Assessing officer disallowed ₹ 9,41,077/- which consisted of ₹ 4,43,730/- relating to interest free advances made to Southern Synthetics Limited and ₹ 4,97,347/- relating to the sister concerns. The CIT(A) restricted the disallowance to ₹ 4,97,367/- on interest free advance other than made to Southern Synthetic Limited and the amount of disallownace in respect of Southern Synthetic Limited amounting to ₹ 4,43,730/ was deleted. The Tribunal following its decision in the earlier years further deleted the disallowance of the interest referable to the advance made to Novika Investment amounting to ₹ 80,000/- while disallowance of interest referable to the advances made to other four sister concerns was sustained. The relevant findings recorded by the CIT(A) read thus:-

> "Ground No.4 is with regard to an addition of ₹ 9,41,077/- made by the Assessing Officer on the reason that the assessee had made interest on borrowed funds. It is stated by the appellant that the advances have been made by the company out of own funds from share capital, reserves and surplus and not out of borrowed funds. It is further stated that nowhere department has co-related that the borrowed funds are used for the purpose of advancing the amount to these parties. The appellant has relied upon the case of CIT vs. Indian Explosive Limited, (1991) 192 ITR 144. The disallowance of interest on the advanced amount to Southern Synthetic Limited was dealt with by my predecessor in assessment year 1991-92 and assessment year 1992-93 in appeal No.185/94-95 dated 23.8.95 and 98/95-96 dated 31.3.1996 respectively, wherein the disallownace of interest has been deleted on the ground that the financial conditions of the said company deteriorated and recovery of principal amount of debts had become improbable and doubtful. The southern synthetic Limited subsidiary company which alter on became BIFR case, has merged with M/s Kothari Plantations Industries Limited (KPIL) w.e.f 31.3.1993 and stood dissolved without winding up on and from 23.4.1994. Since there was no change of recovering principal amount,hence the charge of interest is unreaslistic and hypothetical. The appellant has relied upon the case of CIT vs. Motor Credit & Co. (Pvt) Limited, (19881) 127 ITR 572 (Mad.) and CIT vs. Birla Gwalior (P) Limited, (1973) 89 ITR 266 (SC). Therefore, the disallowance in respect of interest on advance to Southern synthetics Limited is deleted following the order of my

predecessor in assessment year 1991-92 and Assessment year 1992-93.

As regards the amount of disallowance on advance to the balance five concerns, it is stated by appellant that the Assessing Officer has also not shown any nexus between the borrowed funds and the amounts advanced interest free. The claim of the appellant is that they had share capital reserves and surplus. Since, my predecessor has confirmed that disallownace on interest free loans to these five parties assigning the reason that the share capital reserve and surplus has been invested in the fixed assets and the appellant's share capital reserves and surplus are not available of advancing to these parties, therefore, the disallownace from this will be restricted to ₹ 4,97,367/- on interest free advance other than made to southern Synthetic Limited and the amount of disallownace in respect of SSL amounting to ₹ 4,43,730/- is deleted."

10. The Tribunal while giving partial relief to the assessee recorded as under:-

"69. The second ground relates to the disallowance of interest of ₹ 4,97,347/- made on the footing that the assessee has given interest free advances to sister concerns out of interest bearing borrowings. This issue has been dealt with by the CIT(Appeals) in paragraph 6 of his order. The amount disallowed by the Assessing Officer was ₹ 9,41,077/-. This consisted of ₹ 4,43,730/- relating to interest free advances made to Southern synthetics Limited and ₹ 4,97,347/- relating to the sister concerns. From page 18 of the assessment order, it is seen that the amount of ₹ 4,97,347/- consists of the following:-

| **Interest free advances to** | **Interest** |
|---|---|
| i) Nuchem Industries | ₹ 2000/- |
| ii) Ratan Chand Harjas Rai | ₹ 64,000/- |
| iii) Novika Investment | ₹ 80,000/- |
| iv) Nuchem Investment | ₹ 3,35,062/- |

v) Nuchem engineering ₹ 16,085/-

The case of the sister concerns has already been considered by us in the appeals for the assessment years 1991-92 and 1992-93. We have also considered the case of interest referable to the advances made to Southern synthetics Limited in those years. As in earlier years, the department has also come in appeal for this year vide ground No.(iv) in its appeal challenging the decision of the CIT(Appeals) to delete the interest of ₹ 4,43,730/-. This has also been considered by us in the appeals filed by the department in the earlier two years. In the earlier year's appeals, we have deleted the interest referable to advances made to Novika Investment following the order of the Tribunal for an earlier year. However, the interest referable to other four sister concerns was confirmed by us. In the appeals of the department, we had confirmed the decision of the CIT(Appeals) deleting the disallowance of interest referable to the advances made to Southern Synthetics Limited. It is common ground that the facts and circumstances relating to the disallownace of the interest of the year under appeal are identical with the earlier years. Therefore, in line with our decision for those years, the disallowance of the interest referable to the advance made to Novika Investment is deleted, while the disallowance of the interest referable to the advances made to other four sister concerns is sustained. The deletion of the disallownace of the interest referable to the advances made to Southern Synthetics Limited is sustained as in the earlier years. The result will be that the assessee's ground is partly allowed, whereas the ground of the department, which is dealt with here itself, is dismissed."

The findings of fact recorded by CIT(A) and the Tribunal are based on appreciation of material and evidence on record in which no error could be pointed out by the learned counsel for the revenue so as to hold the same to be perverse. The issue is thus adjudicated against the revenue.

11. The last disallowance raised for consideration in the appeal

relates to inauguration expenses.

12. **Disallowance of inauguration expenses**

The assessee claimed ₹ 8,33,593/- as inauguration expenses. The Assessing Officer disallowed ₹ 1,90,729/- on account of payment to hotel as entertainment expenses,₹ 1,34,063/- being travelling expenses in connection with the inauguration function of MDF Division at Tohana and ₹ 1,54,051/- being expenses incurred without vouchers in connection with the inauguration. The total amount came to ₹ 4,78,845/-. The CIT(A) deleted the disallowance of the inauguration expenses of ₹ 4,78,845/-. The Tribunal concurred with the findings recorded by the CIT(A) and held that the expenditure had been incurred wholly and exclusively for the purpose of the business of the assessee. The findings recorded by the CIT(A) read thus:-

> "11.Ground No.9 is with regard to disallowance of inauguration expenses amounting to ₹ 4,78,845/-. It is stated by the appellant that the inauguration expanses bills of Hotel Surya Sofital, New Delhi. The company's branch officials, dealers, distributors, stockists, agents of company have visited MDF Nuwud plant at Tohana, who have stayed in New Delhi at Hotel Surya Sofital. Similarly an amount of ₹ 1,34,063/- have been incurred on account of travel and other expenses of the dealers, stockists, distributors, Company's officials and agents, who have come from all over the country to participate in the inauguration function. Another item of disallowance ₹ 1,54,051/65 pertaining to the inauguration expenses of Pune office. It is stated by the appellant that the conference was organized at Bombay and Pune where dealers, distributors, architects, designers and builders have participated in the conference and inauguration of Pune branch. The expenditure includes travellign expenses, expenses incurred on hoardings, wall painting etc. It is further stated that the expenditure had been incurred wholly and exclusively for the purpose of business. The appellant has relied

upon the case of Nirlon Synthetics Fibers Chemicals Limited, (1982) 137 ITR 1 (Bom.) and CIT vs. Hindustan Aluminium Corp. Limited, (1989) 176 ITR 206 (Cal.) in which the inauguration expenses are held allowable. In view of the decision of various High Courts, the inauguration expanses of ₹ 4,78,845/- are allowed and the disallowance in this respect is deleted."

13. The Tribunal while concurring with the findings recorded by the CIT(A) recorded as under:-

"92. Ground No.9 is that the CIT(Appeals) erred in deleting the disallowance of the inauguration expenses of ₹ 4,78,845/-. The total amount claimed by the assessee as deduction under this head was ₹ 8,33,593/-. The Assessing Officer disallowed ₹ 1,90,729/- representing payment to hotel as entertainment expenses, ₹ 1,34,063/- being travelling expenses incurred in connection with the inauguration function of the MDF Division at Tohana and ₹ 1,54,051/- being expenses incurred without vouchers in connection with the inauguration. The total came to ₹ 4,78,845/-. On appeal, the assessee represented that the entire expenditure was incurred in connection with the conference of the stockists, dealers, distributors, architects, designers and builders in Bombay and Pune as well as in connection with the inauguration of the MDF plant in Tohana and that such expenditure is routine business expenditure. The CIT(Appeals) accepted the assessee's submission relying on the judgment of the Bombay High Court in CIT vs. Nirlon Synthetics Fibres Chemicals Limited, (1982) 137 ITR 1 and that of the Calcutta High Court in CIT vs. Hindustan Aluminum Corporation Limited, (1989) 176 ITR 206. On a careful consideration of the matter, we are of the view that the decision of the CIT(Appeals) is correct. The expenditure in our opinion too has been incurred wholly and exclusively for the purpose of the assessee's business. Relying on the judgments cited above, we affirm the decision of the CIT (Appeals) and dismiss the ground."

14. The findings recorded by the CIT(A) as well as the Tribunal are pure findings of fact where they have recorded that the said expenditure was incurred exclusively for the purpose of assessee's business. The said findings have not been shown to be illegal or perverse in any manner by the learned counsel for the appellant, warranting interference by this Court. The substantial questions of law as claimed by the revenue are answered accordingly. The appeals stand dismissed.

**(Ajay Kumar Mittal)**
**Judge**

**September 17, 2015** **(Ramendra Jain)**
**'gs'** **Judge**