

Gurbax Singh
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**IN THE HIGH COURT OF PUNJAB AND HARYANA
CHANDIGARH**

**ITA No. 219 of 2013
Date of decision: 08.3.2017**

Commissioner of Income Tax, Jalandhar 1, Jalandhar

.....Appellant

Vs.

**M/s Max India Limited, Bhai Mohan Singh Nagar, Rail Majra, District
Nawanshahar.**

.....Respondent

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

Present: Mr.Vivek Sethi, Advocate for the appellant.

Mr. Ajay Vohra, Sr. Advocate with
Mr. Gaurav Jain, Advocate for the respondent.

Ajay Kumar Mittal,J.

1. This order shall dispose of ITA No. 219 of 2013 and 91 of 2017 as according to the learned counsel for the parties, the issue involved in both the appeals is identical. However, the facts are being extracted from ITA No.219 of 2013.

2. ITA No.219 of 2013 has been preferred by the appellant-revenue under section 260A of the Income Tax Act, 1961 (in short, “the Act”) against the order dated 19.3.2013, Annexure A.3 passed by the Income Tax Appellate Tribunal, Amritsar Bench, Amritsar (in short, “the Tribunal”) in ITA No.274/(Asr)/2012, for the assessment year 2008-09, claiming following substantial questions of law:-

“i) Whether on the facts of the case, the ITAT has erred in holding that no interest payment is disallowable under section 36(1)(iii) on interest free loan given to sister concern ignoring the facts that the assessee has a mixed fund wherein both its

internal generation and borrowed funds contribute and that the interest paid on working capital loan is directly proportional to the funds withdrawn out of it?

ii) Whether on the facts of the case, the ITAT has erred in holding that interest cannot be attributed under section 14A in case of positive cash flow, ignoring the explicit provisions of Rule 8D(2)(ii), the sole objective of which is to determine the quantum of interest payment indirectly attributable to investments giving rise to tax free income?”

3. A few facts relevant for the decision of the controversy involved as narrated ITA No.219 of 2013 may be noticed. The assessee-company is deriving its income from manufacturing and marketing of biaxially oriented polypropylenes (BOPP) films, a flexible packaging material. Assessment was completed under section 143(3) of the Act at an assessed loss of ₹ 1,11,95,249/- on 29.12.2010 against the returned income as declared loss of ₹6,30,65,443/- e-filed on 28.9.2008. Additions/disallowances were made on account of interest under section 36(1)(iii) of the Act on interest free advances to subsidiaries amounting to ₹ 1,45,91,805/- and expenditure related to exempt income amounting to ₹ 3,65,28,393/- under section 14A of the Act. The Assessing Officer noticed that while the assessee company was paying interest on its loan taken, it had advanced interest free loans to its sister concerns/subsidiaries aggregating ₹ 297.83 lacs including advance of ₹ 704.51 lacs during the previous year upto the end of the relevant year. These advances remained outstanding in the name of the subsidiaries throughout the year and there was no business transaction of any nature with the subsidiaries involved against the advance given to these concerns. The assessee submitted that the loans were extended out of surplus and interest free funds. The Assessing officer not satisfied

with the reply held that there was no commercial expediency in advancing interest free loan to the sister concerns. Thus, the Assessing officer by applying the rate of 7.5% for making disallowances under section 36(1)(iii) of the Act on the same rate at which the assessee had charged interest from its sister concerns and hence disallowed ₹ 1,45,91,805/-. With regard to the expenditure related to exempt income, the Assessing officer found that the assessee received dividend income which was claimed as exempt under section 10(34) of the Act. The assessee pleaded that no expenses were incurred in respect of earning of exempt income whereas perusal of profit and loss account of the assessee company showed that expenditure pertaining to treasury department at ₹ 20.80 lacs had been incurred under the head 'personal and administrative expenses' related to number of services like advising on funding by way of debt and equity etc. Thus, the Assessing officer disallowed ₹ 3,65,28,393/- under section 14A of the Act read with Rule 8D of the Income Tax Rules, 1962 (in short, "the Rules") vide order dated 29.12.2010, Annexure A.1. Aggrieved by the order, the assessee filed an appeal before the Commissioner of Income Tax (Appeals) [CIT(A)]. Vide order dated 30.3.2012, Annexure A.2, the CIT(A) dismissed the appeal filed by the assessee and even enhanced the disallowances made by the Assessing Officer under Section 14A of the Act. Not satisfied with the order, the assessee filed appeal before the Tribunal. Vide order dated 19.3.2013, Annexure A.3, the Tribunal allowed the appeal of the assessee and deleted the additions/disallowances. Hence the instant appeals by the revenue.

4. We have heard learned counsel for the parties.

5. With regard to the first issue qua disallowance of interest expenditure under section 36(1)(iii) of the Act, admittedly, the assessee company had given interest free loans and advances amounting to

₹ 2297.83 lacs upto the end of the relevant year including ₹ 704 lacs during the relevant year to its three subsidiary companies. The Assessing officer did not make any disallowance in respect of expenditure incurred on borrowed funds under section 36(1)(iii) of the Act in relation to interest free loans and advances given to the said three subsidiary companies in the earlier years. After perusing the cash flow statement of the assessee company for the assessment year in question, the Tribunal observed that the assessee company had received substantial proceeds from preferential issue of shares capital amounting to ₹ 99999.98 lacs. It had also received dividend income of ₹ 166.13 crores from various investments. After giving interest free loans of ₹ 7.04 crores to its subsidiary companies, the assessee was left with surplus interest free funds of ₹ 53.86 crores which were utilized for giving interest free advances. Thus, there was no nexus of interest expenditure incurred during the year with the aforesaid loans/advances given to the subsidiary companies, warranting disallowance under section 36(1)(iii) of the Act. After considering the relevant provisions and the case law on the point, the Tribunal deleted the disallowance of interest expenditure made under section 36(1)(iii) of the Act. The relevant findings recorded by the Tribunal read thus:-

“25. We have perused the cash flow statement of the assessee company for the assessment year under consideration and it is observed that during the relevant year, the assessee company had received substantial proceeds from preferential issue of shares capital aggregating to ₹ 99999.98 lacs and it also received dividend income of ₹ 166.13 crores from various investments. The assessee company also provided a summary of cash flow statement for the impugned year wherein after considering the interest free funds and application thereof towards various investments made in subsidiary companies, in

mutual funds and aforesaid interest free loans of ₹ 7.04 crores given to subsidiary companies, the assessee is left with surplus interest free funds of ₹ 53.86 crores. The aforesaid establishes that interest free funds available with the assessee were sufficient for the aforesaid investments and interest free advances which has not been disputed by the AO or the learned CIT(A). We have already held that the assessee company for the assessment years 2001-02 to 2006-07 in our order dated 8.3.2013 that in case of mixed pool funds, presumption should be drawn in favour of the assessee regarding utilization of interest free funds or borrowed funds in a manner which is most favourable to the assessee company. In view of the same, it is to be presumed that interest free funds available with the assessee company during the impugned year were utilized for giving interest free advances of ₹ 7.04 crores given to the subsidiary companies and therefore, there is no nexus of interest expenditure incurred during the year with the aforesaid loans/advances given to the subsidiary companies, warranting disallowance under section 36(1)(iii) of the Act.

26. As regards interest free advances given by the assessee company to the subsidiary companies in earlier years, it was submitted with reference to overall fund flow position that the aforesaid loans and advances were given out of surplus interest free funds available with the assessee company in those years and consequently no part of the interest expenditure warrants disallowance under section 36(1)(iii) of the Act. Although, we have decided in the appeals of the assessee company for the assessment years 2001-02 to 2006-07 (*supra*) in the context of disallowance of interest expenditure under section 14A of the Act and observed that the assessee company had sufficient surplus interest free funds to make investments, however, without going into the issue whether such funds were sufficient to cover up interest free advances in those years, which *prima facie* appears to be available, we are of the view that since no disallowance of interest expenditure attributable to the interest

free loans/advances given to the subsidiary companies was made under section 36(1)(iii) of the Act, in those years, it was not open to the Assessing Officer to make such disallowance in the succeeding assessment year. We draw support for the aforesaid decision from the judgments of the Hon'ble Karnataka High Court in the case of *CIT vs. Sridev Enterprises* reported in 192 ITR 165 and the decision of the Hon'ble Delhi High Court in the case of *CIT vs. Givo Limited* in ITA No.941/2010. In that view of the matter, having held that the borrowed funds had no nexus with interest free advances given to the subsidiary companies in earlier years (on account of no disallowance having been made in the assessment of earlier years) and during the relevant assessment year (on account of positive overall cash flow statement of the relevant year), it is not necessary to go into the issue whether interest free advances given by the assessee company to the subsidiary companies was on account of commercial expediency or not. We are not in agreement with the observations of the learned CIT(A) that in all cases, it is required to be seen whether loan was given for the business purposes or not and not the source from which the loans is given. We are of the view that only if on facts, it is clear that loans/advances have been made out of interest bearing borrowed funds that the alternative plea for contesting disallowance under section 36(1)(iii) that loan was given on account of commercial expediency will have relevance. In view of the aforesaid discussions, the disallowance of interest expenditure made under section 36(1)(iii) of the Act is directed to be deleted and this ground of the assessee is allowed.”

Learned counsel for the appellant has not been able to show that the findings recorded by the Tribunal are illegal or perverse warranting interference by this Court.

6. With regard to the second issue regarding expenditure related to exempt income, the same is covered by the decision of this Court in the case of the assessee in *Commissioner of Income Tax, Jalandhar I, Jalandhar*

vs. M/s Max India Limited, ITA No.186 of 2013, decided on 6.9.2016, wherein after considering the relevant case law on the point, the issue was decided in favour of the assessee and it was recorded thus:-

“9. This presumption is unfounded. Merely because the interest free funds with the assessee have decreased during any period, it does not follow that the funds borrowed on interest were utilized for the purpose of investing in assets yielding exempt income. If even after the decrease the assessee has interest free funds sufficient to make the investment in assets yielding the exempt income, the presumption that it was such funds that were utilized for the said investment remains. There is no reason for it not to. The basis of the presumption as we will elaborate later is that an assessee would invest its funds to its advantage. It gains nothing by investing interest free funds towards other assets merely on account of the interest free funds having decreased. In that event so long as even after the decrease thereof there are sufficient interest free funds the presumption that they would be first used to invest in assets yielding exempt income applies with equal force.”

Learned counsel for the appellant-revenue has not been able to distinguish the aforesaid decision taken by this Court.

7. In view of the above, no substantial question of law arises. Consequently, both the appeals stand dismissed.

(Ajay Kumar Mittal)
Judge

March 08, 2017
'gs'

(Ramendra Jain)
Judge

Whether reasoned/speaking order
Whether reportable

Yes/No
Yes