IN THE HIGH COURT OF JUDICATURE AT MADRAS

RESERVED ON : 14.07.2020

PRONOUNCED ON: 30.07.2020

CORAM

THE HONOURABLE MR.JUSTICE T.S.SIVAGNANAM
AND
THE HONOURABLE MRS.JUSTICE V.BHAVANI SUBBAROYAN

T.C.A.NO.399 OF 2019

M/s.Hansa Estates P. Ltd.,
No.605-606, Anna Salai,
South Indian Film Chamber Building,
II Floor, Indian Film Chamber Building,
Chennai 600 006.
PAN AAACH 1879B .. Appellant

Versus

The Assistant Commissioner of Income Tax
Company Circle-II (2)
Chennai. .. Respondent

Prayer:-

Tax Case Appeal filed under Section 260-A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal, Madras 'C' Bench, dated 18.02.2019 made in I.T.A.No.543/Chny/2013 relating to the Asst Year 2009-2010.

against the Commissioner of Income Tax (Appeals)-III, dated 17.01.2013 and made in ITA.No.646/11-12 A-III and against the order of the Assistant Commissioner of Income Tax, Company Circle III(2), Chennai-34, dated 30.12.2011 for the Assessment Year 2009-10.

For Appellant : Mr.A.S.Sriraman
For Respondent: Mr.Karthik Ranganathan

JUDGMENT

[Judgment of the Court was made by T.S.SIVAGNANAM, J.]

This appeal by the assessee filed under Section 260A of the Income Tax Act, 1961 ('the Act' for brevity) is directed against the order dated 18.02.2019 passed by the Income Tax Appellate Tribunal, Madras 'C' Bench, for the assessment year 2009-10.

2. The appeal was admitted on 27.06.2019 on the following Substantial Questions of Law:

i. Whether the provisions of Section 36(1)(iii) of the Income Tax Act, 1961 permit the claim for deduction of interest paid for the borrowed amount used for business purpose?

ii. Whether the Appellate Tribunal was correct in ignoring the purpose and utilization of the borrowed money by recording perverse finding of fact of non existence of business purpose despite the execution of Joint Development Agreement entered into between the appellant and holding company?

iii.Whether the Appellate Tribunal is correct in holding that unregistered of the Joint Development Agreement would lead to the presumption of diversion of borrowed funds for non business purpose despite the undisputed fact of deployment of borrowed money in the joint development of housing project executed in reality and accepted by the Revenue in the subsequent assessment years in taxing the profits in the hands of the respective entities? And

iv.Whether the Appellate Tribunal is correct in ignoring the decision of the First Appellate Authority in granting the deduction of interest payment under Section 36(1)(iii) of the Act for the assessment year 2010-11, which decision was accepted by the Revenue by not filing second appeal while further establishing the conflict of decision / treatment to the interest outgo and while further negating the rule of consistency?

3. The assessee is a private limited Company incorporated under the provisions of the Companies Act, 1956. It filed its Return of Income for the assessment year 2009-10 on 30.09.2009, disclosing a total income of Rs.1,44,89,527/-. The assessment was completed under Section 143(3) of the Act on 30.12.2011 at a total income of Rs.6,94,76,277/-, after making certain disallowances. One among them was disallowance of interest claimed under Section 36(1)(iii) of the Act to the tune of Rs.2,09,24,549/-. This disallowance was made by the Assessing Officer on the ground that the assessee has given interest free advances to M/s.Tiruvengadam Investments Pvt. Ltd., which is a holding Company of the assessee. The assessee contented that the transaction is in the nature of current account and the advances were made for acquiring land on behalf of the assessee for construction of a project called 'Hansa Chitra Project'. In this

regard, the assessee had referred to a Joint Development Agreement with the holding Company and the assessee. Challenging the disallowance, the assessee preferred appeal to the Commissioner of Income Tax (Appeal)-III, Chennai, (hereinafter referred as 'the CIT(A)' for brevity), which was dismissed by an order dated 17.01.2013. The assessee preferred appeal to the Tribunal which had rejected the assessee's appeal by the impugned order. This is how, the assessee is before us by way of this Tax Case Appeal, raising the above mentioned Substantial Questions of law.

4. It is submitted by the learned counsel appearing for the appellant /assessee that the disallowance of interest paid which amount was claimed by the assessee as a deduction under Section 36(1)(iii) of the Act by presuming that it is diversion of borrowed funds for non business purposes, is an erroneous conclusion arrived at by the Tribunal. The Tribunal failed to note the factual position and did not properly appreciate the terms and conditions of the Joint Development Agreement dated 11.04.2007 between the assessee and the holding Company, where under the land acquired by the holding Company was to be developed by the assessee as a joint development project and therefore, the Tribunal committed an error in presuming that it amounted to diversion of borrowed funds for non business purposes. It is further submitted that the Assessing Officer erred in concluding that there was no commercial expediency in the contract, without appreciating the inextricable link caused by the Joint Development Agreement entered into between the assesee and the holding Company.

5. Further by referring to the conditions in the Joint Development Agreement, it is submitted that the Agreement entered for payment of Rs.11,25,00,000/- plus 50% of the gross profit earned in the project as a consideration for development of the land owned by the Company, it is submitted that the treatment of the advances paid by the assessee to its holding Company would squarely fall within the ambit of Section 36(1)(iii) of the Act and therefore, the Assessing officer committed an error in disallowing the claim for deduction. It is further submitted that the Assessing officer as well as the CIT(A) and the Tribunal failed to appreciate the basic fabric of the simple business transaction between the assessee and its holding Company and if it had been properly construed, the claim for deduction would have been allowed. Further it is submitted that the order of the CIT(A) for the assessment year 2010-11 dated 17.01.2013 was noticed by the Tribunal, wherein the disallowance of the interest paid on the presumption of diversion of borrowed funds was rejected by the CIT(A) in granting deduction of such interest payment as in accepting the business purpose of the

utilization of the borrowed funds namely deployment of borrowed funds in the joint venture projects, the sustenance of disallowance of interest paid, claimed as deduction in the computation of taxable total income on wrong presumption of facts for the immediate preceding assessment year namely 2009-10 was erroneous and not sustainable in law. On the above ground, the learned counsel for the assessee sought for setting aside the impugned order.

6. The learned senior standing counsel appearing for the Revenue sought to sustain the impugned order by contenting that the Assessing Officer, the CIT (A) as well as the Tribunal on facts held that the assessee could not substantiate their claim. The terms and conditions of the Joint Development Agreement were considered and it has been found that the assessee could not establish the business expediency in advancing money to the holding Company. Further on facts, the CIT (A) found that the assessee had failed to discharge the onus of proving that the lands were used only for business purpose and therefore, held that the decision of the Hon'ble Supreme Court of India in M/s.S.A.Builders Vs. CIT [288 ITR 01 (SC)] is not applicable to the case of the assessee.

7. Heard Mr.A.S.Sriraman, learned counsel appearing for the appellant/assessee and Mr.Karthik Ranganathan, learned Senior standing counsel appearing for the respondent Revenue.

8. We carefully considered the submissions on either side and perused the materials placed on record, more particularly, the Joint Development Agreement dated 11.04.2007. The petitioner is the Developer in the said Agreement. The Holding Company has been termed as an Investor, who had secured development rights of a project called 'Hansa Chitra' in the land situate in Zamin Pallavaram Village. The Investor/holding Company has approached the assessee/developer to develop the said property by constructing 67 flats. The assessee/ developer agreed to put up built up area of 84,860 sq.ft at its cost and expenses, according to the recital in the Agreement. This was because, the Investor/holding Company investing Rs.11,25,00,000/- and assigning the development rights to the assessee/developer and the developer agreed to pay the investor/holding Company Rs.11,25,00,000/- as also 50% of the gross profit earned in the project. Subsequently, the investor/holding Company is stated to have addressed a letter to the assessee/developer dated 03.04.2009, requesting for increase in the profit share from 50% to 75%. The assessee/developer readily agreed and Addendum to Joint Development Agreement was entered into on 11.06.2009 and the relevant clauses in the agreement were modified where under, the investor/holding Company was entitled to 75% of the gross profit.

9. When these facts and documents were placed before the Assessing Officer, wherein, the assessee claimed interest payment as a deduction, the Assessing Officer issued show cause notice dated 14.12.2011 calling upon the assessee to explain as to why the interest payment to the said advance should not be disallowed. The assessee's explanation was that the advance was given to the holding Company during the financial year 2008-09 and the advance is in the nature of current account transaction and therefore, the assessee had not provided any interest during the year. It has further stated that the said advance is paid to the holding Company for the investments made by them on behalf of the assessee for the 'Hansa Chitra Project' for acquiring land, for which, the assessee had not claimed deduction under Section 80 I B of the Act. The terms and conditions of the Joint Development Agreement was also referred to. The Assessing Officer did not accept the said contention raised by the assessee and noted that at no point of time, the holding Company which itself is a Investor had an occasion to take advance from the assessee's Company as they have borrowed loans from Banks. Further on considering the return of income and the materials placed, the Assessing Officer found that the assessee is paying Rs.42,85,869/- towards operational expenses of the holding Company and this amount is shown in the Ledger Account as the joint venture share of the holding Company and therefore, it is not necessary for the assessee to give any advance to the holding Company. Thus, the Assessing Officer concluded that the assessee had failed to establish commercial expediency.

10. Taking note of the requirement of business services, the Assessing Officer concluded that the expenditure was unwarranted, unreasonable and unnecessary for the business of the assessee as it is not laid out or expended wholly and exclusively for the purpose of business or profession of the assessee and therefore, the interest corresponding to the amount lent interest free needs to be disallowed under Section 36(1)(iii). With this finding the quantum of disallowance was recomputed. The assessee preferred appeal before the CIT (A) and reiterated the stand taken before the Assessing Officer, explained about the terms and conditions of the Agreement entered and decisions of the Tribunal.

11. The CIT (A) after considering the factual position, submissions made on behalf of the assessee before him, the findings rendered by the Assessing Officer, pointed out that the Hon'ble Supreme Court in the case of M/s.S.A.Builders Vs. CIT (cited supra) has made it clear that the allowability or otherwise of interest payment under Section 36(1)(iii) depends on the facts and circumstances of the case and the assessee on facts failed to establish any commercial expediency for

advancing interest free amount to the holding Company. Further taking note of the stand of the assessee that the advance amount has to be treated as deemed dividend in the hands of the holding Company, further strengthens the belief that the assessee is unable to establish the element of commercial expediency in the impugned transaction between itself and the holding Company.

12. Further CIT(A) found that the assessee has failed to establish that interest free advances were for the purpose of business and therefore, the decision in M/s.S.A.Builders VS. CIT does not come to the rescue of the assessee. Accordingly, the appeal was dismissed. The Tribunal independently considered the facts recorded by the Assessing Officer as well as the CIT(A) and confirmed their orders.

13. We find no perversity in the approach, observation and conclusion arrived at by the Tribunal. To our mind, the nature of transaction makes it clear that there is no element of commercial expediency. The holding Company holds 99.99% shares in the assessee. The assessee has given a loan of Rs.18,30,19,927/- to the holding Company during the financial year 2008-09 stating that the said advance is in the nature of current transaction and no interest was charged during the year. Thus, the assessee's case that this advance is paid to the holding Company for the investments made by them for securing land to be developed by the assessee. Further there is a Joint Development Agreement in which the assessee and the holding Company agreed to share profits at the rate of 50% each. Within about two months another Agreement dated 09.06.2009 is entered into by modifying certain clauses in the Joint Development Agreement, where under, the holding Company gets 75% of the Book profits. The Assessing Officer found that the holding Company had borrowed loans from Banks and there was no occasion rather need for the holding Company to take advances from the assessee for the purpose of purchase of the land. Apart from that the Assessing Officer found that the assessee was paying Rs.42,85,869/- toward operational expenses and in the Ledger Account, this was shown as Joint Venture Share of the holding Company. This fact also led the Assessing Officer to conclude that there was no necessity for the assessee Company to give any advance to the holding Company.

14. As held by the Hon'ble Supreme Court of India in M/s.S.A.Builders vs. CIT, the allowability or otherwise of interest payment under Section 36(1)(iii) depends on the facts and circumstances of the case. Currently, the Assessing Officer, the CIT (A) and the Tribunal, on facts held against the assessee.

15. We find no reason to dislodge the factual finding and there are no questions of law, much less, substantial questions of law arising for consideration in this appeal. Accordingly, the Tax Case Appeal stands dismissed. No costs.

Sd/-
Assistant Registrar(CS VII)

//True Copy//

Sub Assistant Registrar

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To

1. The Commissioner of Income Tax (Appeals)-III,
121, Mahatma Gandhi Road,
Chennai-600 034.

2. The Assistant Commissioner of Income Tax
Company Circle-II (2)
Chennai.

T.C.A.No.399 of 2019

MP(CO)
CS/10/11/2020
CS/24/11/2020