

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 12.10.2020

CORAM

THE HON'BLE DR.JUSTICE VINEET KOTHARI
AND
THE HON'BLE MR.JUSTICE M.S.RAMESH

T.C.(A) NOS.718/2017, 918 & 919 OF 2014

The Commissioner of Income Tax,
Chennai.

Appellant

Vs.

M/s.Asian Peroxides Ltd.,
69, 3rd Floor, Armenian Street,
Chennai 600 001.
PAN: AAACA6213G

Respondent

Tax Case (Appeal) No.718/2017 filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, 'C' Bench, Chennai, dated 3.4.2017 made in ITA No.2861/Mds/2016 against the order of the commissioner of Income Tax(A)-1, Chennai, in ITA No. 45/15-16/A-1,dated 20/07/2016 Under section 143(3) and 250 of the Income Tax Act 1961 against the order of the Deputy Commissioner of Income Tax Corporate Circle-1(1), Chennai, dated 12/03/2015 made in AAACA213G for the assessment year 2012-13

Tax Case (Appeals) 918 & 919 of 2014 filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, 'C' Bench, Chennai, dated 18.2.2014 made in ITA Nos.911/Mds/2013 and 1031/Mds/2013 against the order of the Commissioner of Income Tax Appeal- IX, Chennai dated 29/01/2013, made in ITA No. 43/11-12 Under section 143(3) of the Income Tax Act 1961 against the order of the Deputy Commissioner of Income Tax Company Circle 1(1), Chennai dated 24/12/2020 made in AAACA6213G(Ax2-002 for the assessment year 2008-09 .

For Appellant : Mrs.R.Hemalatha,
Senior Standing Counsel
For Respondent : Mr.R.Vijayaraghavan

COMMON JUDGMENT
(Delivered by DR.VINEET KOTHARI,J)

The Revenue has preferred these Appeals raising the

following substantial questions of law under Section 260A of the Act for the Assessment Year 2012-2013:-

"(i) Whether the disallowance of Rs.4.43 crores made under Section 36(1)(iii) is to be allowed especially when the Assessee has diverted interest bearing funds to its sister concern without charging any interest and such diversion of funds is covered by Section 36(1)(iii)?

(ii) Whether disallowance made under Section 36(1)(iii) is to be allowed especially when the Assessee has sufficient funds which could be utilized for its own business activity instead of borrowing funds outside by paying huge interest payment by reducing the tax liability and on such diversion of funds to its sister concern proportionate interest on such diversion is to be made?"

2. The relevant findings of the learned Tribunal in favour of the Assessee and by which the learned Tribunal dismissed the Appeal of the Revenue and upheld the order of the learned Commissioner of Income Tax (Appeals) dated 20th July 2016 in favour of the Assessee are quoted below for ready reference:-

"The Brief facts of the case that the assessee company is in the business of manufacture of Hydrogen Peroxide and filed its Return of Income for the assessment year 2012-13 on 30.09.2012 with total loss of Rs.8,55,03,164/- and the case was selected for scrutiny under CASS and notice U/s.143 (2) of the Act was issued. In compliance to the notice, the Ld. AR of the assessee appeared on various dates and filed the details. The Ld. AO on perusal of the financial statements found that the assessee has claimed an amount of Rs.6,08,56,000/- as interest and financial charges pertaining to the interest on term loans, working capital and other financial expenses. Whereas the assessee company having borrowed the funds and paying interest, has also provided interest free loans to its sister concerns and the Ld. AO found that amount outstanding as on 31.03.2012 is Rs.19,74,55,000/-. The Ld. AO observed that the assessee has borrowed liability as on 31.03.2012 Rs.26,42,21,000/- and paying interest and on the similar issue of disallowance of interest on borrowed funds in the assessee's own case for the assessment year 2008-09, the Revenue is agitating the case before the Hon'ble High Court of Madras, the Ld.AO on the similar lines, made proportionate disallowance of interest

payments taking into consideration the interest free advances provided to the subsidiaries/sister concerns Rs.4,43,25,189/- as this expenditure was not incurred wholly and exclusively for the purpose of business U/s.36(1)(iii) of the Act and with other additions passed order U/s.143(3) of the Act dated 12.03.2015.

4. Aggrieved by the order of the Ld. AO, the assessee has filed an appeal before the Ld. CIT(A). The Ld. AR argued the grounds and reiterated the submissions of assessment proceedings. The Ld. CIT(A) considered the findings of the AO and the submissions of assessee and the judicial decisions and relied on the assessee's own case for the assessment year 2000-09, where such similar disallowance made by the Assessing Officer and the Ld. CIT(A) has deleted the addition. On appeal by the Revenue, the Tribunal had confirmed the CIT(A) in favour of the assessee in ITA No.911/Mds/2013 dated 08.02.2014. The Ld. CIT(A) relied on the Co-ordinate bench decision and allowed the appeal observed at para 6 of the order.

"6. I have carefully perused the facts in issue, submissions made by the appellant and material on record. I find that the Hon'ble ITAT vide order dated 18.2.2014 in ITA No.911/Mds/2013 at page No.9 Para No.10 have categorically held that the AO had erred by disallowing the interest incurred by the appellant on the premise that interest bearing funds have been diverted to the sister concerns and consequently allowed the appeal in favour of the appellant. Material facts remaining similar, respectfully following the order of the Hon'ble ITAT this issue is decided in favour of the appellant. The AO directed to delete the disallowance of Rs.4,43,25,189/-. This ground of appeal is allowed."

Aggrieved by the CIT(A) order, Revenue has filed an appeal with the Tribunal.

5. Before us the Ld. DR argued that the Ld CIT(A) has erred in deleting the disallowance U/s. 36(1)(iii) of the Act without considering the fact that the assessee has provided interest free advances and the assessee could not substantiate that the own funds were utilized for the purpose of providing the interest free advances and supported the arguments with the judicial decisions. Contra,

the Ld.AR relied on the orders of the Ld. CIT(A) and supported with the Tribunal decisions.

6. We heard the rival submissions, perused the material on record and judicial decisions. The sole substantial ground of Revenue being disallowance U/s.36(1)(iii) of the Act was deleted by the Ld. CIT (A) relying on the judicial decisions. We find the similar issue in the assessee's own case for the AY 2008-09 in ITA No.911/Mds/2013 held at para 9 & 10 as under:

"9. We have heard both the parties and carefully perused the materials available on record from the orders of the Ld. Assessing Officer, it is apparent that the assessee has share capital of approximately Rs.43.30 crores and reserve and surplus of Rs.35.61 crores as on 31/03/2008 and further from the balance sheet it is apparent that the assessee has share capital of Rs.43.30 crores and Rs.37.30 crores reserves & surplus as on 31/03/2007, thus the assessee has own funds far exceeding the advance for Rs.24.36 crores made to its sister concerns. Further the claim of the assessee that it had transferred accumulate losses to the extent of Rs.14.17 to its sister concerns has not been looked into by the Ld.AO, need less to mention that in such case disallowance of interest expense on the premises that interest bearing funds have been diverted would be incorrect. However, the following decisions rendered by various higher judiciary has held that if the assessee has own funds exceeding the advances made to sister concerns, then interest expenditure cannot be disallowed on the premises that the assessee has diverted interest bearing fund to its sister concerns.

(i) CIT Vs. Reliance Utilities And Power Ltd. ([2009] 313 ITR 340 (Bom.))

Held, dismissing the appeal, that if there were funds available both interest-free and overdraft and/or loans take, then a presumption would arise that investments would be out of the interest-free funds generated or available with the company, if the interest-free funds were sufficient to

meet the investments. In this case, this presumption was established considering the funding of fact both by the Commissioner (Appeals) and the Tribunal. The interest was deductible.

(ii). CIT Vs. Bharti Televenture Ltd. ([2011] 331 ITR 502(Del))

Held, dismissing the appeal, that the order of the Commissioner (Appeals) and the Tribunal showed that the assessee was maintaining a bank account with mixed common funds in which all deposits and withdrawals were made. There was no specific instance noted by the AO of direct nexus between the borrowed funds and the advances made to the subsidiaries. The AO had made general observations without pointing out any specific instance where an interest bearing borrowing was advanced to the subsidiaries or establishing that the borrowings made by the assessee were not for business purposes. Both appellate authorities were of the view that the assessee had explained the sources of the advances and investments made to the subsidiaries, which could not be linked to the borrowed funds and that the advances were made out of the assessee's own capital. At the relevant time the assessee was found to have adequate non-interest bearing funds by way of share capital and reserves. Even otherwise, the advances were found to be made to the subsidiaries for business considerations, i.e. out of commercial expediency of the assessee. That being the factual position reflected from the record of the assessee, the onus that lay on it stood discharged. There was no ground to interfere with those findings.

10. Considering the above decisions of the Hon'ble High Court of Bombay in the case CIT Vs. Reliance Utilities And Power Ltd & the decision of Hon'ble High Court of Delhi in the case CIT Vs. Bharti Televenture Ltd., which are identical to the facts of the case before us, we are of the opinion that the Ld. Assessing Officer has erred by disallowing the interest expenditure incurred by the assessee on the premises that interest bearing funds have been

diverted to the sister concerns. Therefore, we hereby delete the addition made by the Ld. Assessing Officer, which was further confirmed by the Ld. CIT(A) on this issue. Thus, the ground No.3 raised by the assessee in its appeal is allowed in its favour and consequently the ground Nos.2.1 & 2.2 raised by the Revenue is decided against the Revenue."

7. We respectfully follow the Co-ordinate bench decision in assessee's own case and dismissed the Revenue appeal.

8. In the result, the Revenue appeal is dismissed."

3. The learned Tribunal has apparently only relied upon its previous decision for the Assessment Year 2008-2009 in ITA No.911/Mds/2013 which is the subject matter of T.C.A.No.918 of 2014 which is also being disposed of today. The other question involved in the said Assessment Year 2008-2009 with regard to carry forward unabsorbed depreciation by the Assessee is not pressed by the learned Senior Standing Counsel for the Revenue.

4. The only question, therefore, present before us is with regard to disallowance under Section 36(1)(iii) of the Act. The said provision of the Act provides for "Other Deductions" under Section 36 of the Act other than those specified from Sections 30 to 35 including their various sub-sections in Chapter II-D of the Income Tax Act. The relevant part of the said provision insofar as clause (iii) is concerned is quoted for ready reference:-

"Other deductions.

36. (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, all computing the income referred to in section 28--

(i) the amount of any premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purposes of the business or profession;

(ia) the amount of any premium paid by a federal milk co-operative society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society, being a primary society engaged in supplying milk raised by its members to such federal milk co-operative society;

(ib) the amount of any premium paid by any mode of payment other than cash by the assessee as an employer to effect or to keep in force an an insurance on the health of his employees under a scheme framed in this behalf by--

(A) the General Insurance Corporation of India formed under section 9 of the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972) and approved by the Central Government; or

(B) any other insurer and approved by the Insurance Regulatory and Development Authority established under sub-section (1) of section 3 of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999);

(ii) any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission;

(iii) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession."

5. The learned Senior Standing Counsel Mrs.R.Hemalatha appearing for the Revenue has urged that the Assessee Company while having majorly only borrowed funds from its Banks and paid interest thereon, diverted substantial part of those funds to its Subsidiary Company and did not charge any interest thereon from the Subsidiary Company, and therefore the learned Assessing Authority was justified in disallowing the proportionate part of the interest the Assessee Company paid to its Bank, under Section 36(1)(iii) of the Act to the tune of Rs.4,43,25,189/- which is computed in para 2 of the Assessment Order dated 12.3.2015 which is also quoted below for ready reference:-

"2. To keep the issue of proportionate interest disallowance alive, it is proposed to consider the assessee's action of diverting the loans and advances to the sister concern and reducing the profit with entire interest expenditure as not maintainable. This coupled with the assessee's submissions, which lack evidences, that are required to prove that the interest free loans given to sister concerns are not out of borrowed fund and also placing reliance on the case of R.Dalmia vs. CIT 133 ITR 169 (Del), where the Hon'ble High Court decided that "Wherever the interest paid concerns the

borrowed money for business as well as non business purposes, the claim may be disallowed in its entirety if no adequate material is adduced by the assessee to determine that portion of interest which pertains to business purposes", the non-claimable interest expenditure in the hands of the assessee is worked out as under:

Interest bearing secured Funds - Rs.26,42,21,000.. (A)

Average Interest free loan advanced-Rs.19,24,48,500/-.. (B)

Interest expense debited in the P&L -Rs.6,08,56,000/- .. (C)

Proportionate interest disallowance u/s.36(1)(iii) =
(B/A) x C

= (19,24,48,500/26,42,21,000) x 6,08,56,000

= Rs.4,43,25,189/-

Since the above interest amounting to Rs.4,43,25,189/- cannot be said to be an expenditure incurred wholly and exclusively for the purposes of assessee's business the said expenditure is disallowed u/s.36(1)(iii) of the Act."

6. The learned Senior Standing Counsel for the Revenue, therefore, submitted that since the Assessee Company did not have any interest-free Surplus Fund with it to advance loan to its Subsidiary Company, and therefore, diversion of such funds cannot be meant for that purpose and consequently, the disallowance under Section 36(1)(iii) of the Act out of the amount of interest paid by the Assessee Company to its Bank was justified.

7. Per contra, the learned counsel for the Assessee Mr.R.Vijayaraghavan submitted with reference to T.C.A.No.918 of 2014 that the Assessee had, in fact, transferred a Division of Unit of the Assessee Company viz., Sodium Perborate Division to its Subsidiary Company, M/s.Chemasia Industries Limited on 31.3.2002 for a sale consideration of Rs.14.17 crores against which Rs.1.97 crores of Receivable of the Subsidiary Company was transferred to the Assessee company M/s.Asian Peroxides Limited, but, the remaining sale consideration was not paid to the Assessee Company and which is said to be still outstanding. He further submitted that a loan outstanding liability of Rs.7.88 crores of the said Subsidiary Company Chemasia Industries Limited was also taken over by the Assessee and a small amount of Rs.0.18 crores was is the balance of amounts from various loans given by the Assessee Company to its Sister Concerns.

8. The learned counsel for the Assessee submitted that no

interest was charged from the Subsidiary Company on such outstanding amount of unpaid consideration for transfer of its Sodium Perborate Division. Further he submitted that the Assessee Company had a Share Capital to the extent of Rs.43,30,75,000/- and Reserve and Surplus to the extent of Rs.35,61,38,000/-, totalling to Rs.78,92,13,000/- out of which, interest-free funds was available with the Assessee Company and therefore, relying upon the decision of the Hon'ble Supreme Court in the case of Commissioner of Income Tax v. Reliance Industries Limited reported in (2019) 307 CTR (SC) 121 in which the Hon'ble Supreme Court has held that if any Assessee has got Surplus Funds exceeding the advances made to its Subsidiaries, a presumption could be made that interest bearing Funds have not been diverted to its Subsidiary Company.

9. Having heard the learned counsel for the parties, we are of the opinion that the matter is required to be remanded back to the Assessing Authority for holding enquiry into the matter as to whether the interest bearing borrowed funds were used for advancing loan to the Subsidiary Company or the Surplus Funds of the Company were so diverted. Prima facie, it appears that it was a case of unpaid sale price for transfer of of the Sodium Perborate Division made by the Assessee Company to its Subsidiary Company M/s.Chemasia Industries Limited and the outstanding loan liability to the 7.88 crores was also taken over by the Assessee Company. Therefore, even though borrowed funds might have been diverted, but the fact remains that the Assessee did not charge any interest on such unpaid price from the Subsidiary Company and even took over another loan liability of the Subsidiary Company.

10. The Assessing Authority has merely worked out the disallowance under Section 36(1)(iii) vide the afore-quoted portion from the Assessment order on the basis of Average Interest free loan and Interest bearing Secured Funds from the Assessee Company. The Assessing Authority has not gone into the aspect of the unpaid sale price by the Subsidiary Company. The said enquiry was necessary before making any disallowance under Section 36(1)(iii) the Act.

11. Therefore, in our opinion, the matter deserves to be remanded to the Assessing Authority for holding an enquiry into this aspect of the matter and then consider the question of disallowance under Section 36(1)(iii) of the Act. Accordingly, we set aside all the three orders of the three Authorities below for the Assessment Year 20012-2013 and direct the Assessing Authority to pass fresh orders in accordance with law after giving opportunity of hearing to the Assessee. In view of the considerable number of years having already passed, fresh orders may be passed within a period of one year from today.

With these directions, the Appeals are disposed of. No order as to costs.

Sd/-
Assistant Registrar(CS III)

//True Copy//

Sub Assistant Registrar

ssk.

To

1. Income Tax Appellate Tribunal,
'C' Bench, Chennai.
2. The Commissioner of Income Tax, (A)-1,
Chennai.
3. The Deputy Commissioner of Income tax,
Corporate Circle 1(1),
Chennai 600 034.
4. The Commissioner of Income Tax Appeal-IX,
Chennai

+2 cc to Mr.Subbaraya Aiyar, Advocate, S.R.No.33790&33791

+2 cc to Mr.T.Ravikumar, Advocate, S.R.34001&34002

T.C.A. Nos.718/2017,
918 & 919 of 2014

GP(CO)
NRA(11/12/2020)