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IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 23.08.2021

CORAM :

THE HON'BLE MR.JUSTICE T.S.SIVAGNANAM
AND
THE HON'BLE MR.JUSTICE SATHI KUMAR SUKUMARA KURUP

T.C.A.NO.458 OF 2016

The Commissioner of Income tax,
Chennai. ... Appellant/Respondent

Vs

M/s.Diamond Engineering (Chennai) Private Ltd.,
179, Old Mahaballipuram Road,
Sholinganallur, Chennai - 600 119.
PAN: AACD3949E ... Respondent/Appellant

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, Chennai dated 11.11.2015 passed in I.T.A.No.820/Mds/2013.

Against the Order of Commissioner of Income Tax(A)-IX, Chennai, dated 28.02.2013 in ITA.No.624/2011-2012 for the Assessment Year 2009-2010, against the Assessment Order passed by the Assistant Commissioner of Income Tax, Company Circle-I (4), Chennai - 34, dated 21.12.2011 for PA/GIR.No.AACD3949E, for the Assessment Year 2009-2010.

For Appellant : Mrs.R.Hemalatha,
Senior Standing Counsel

For Respondent : Mr.A.S.Sriraman

J U D G M E N T

(Delivered by T.S.SIVAGNANAM, J.)

This Appeal filed under Section 260-A of the Income Tax Act, 1961 ('the Act' for brevity) is directed against the order dated



11.11.2015 in I.T.A.No.820/Mds/2013 passed by the Income Tax Appellate Tribunal "C" Bench, Chennai (for brevity "the Tribunal") for the Assessment Year 2009-2010.

2. The Appeal was admitted on 19.07.2016 to decide the following substantial questions of law:-

"1.Whether on the facts and circumstances of the case, the Tribunal was right in permitting the matter to AO for the limited purpose of verifying whether the amount of equity capital reserve/surplus was more than the interest free advances given to sister concern without giving scope to the department to verify the fact whether these funds were not available on the date of advancing the interest free loans?

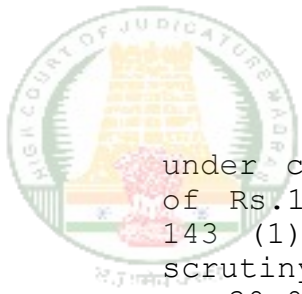
2.Is not the finding of the Tribunal bad by remitting the matter to the AO for the limited purpose especially when the Assessee had contended the advances were made towards material costs which was found to be incorrect since the cost of the entire services related concern was lower than the advances made?

3.Whether on the facts and circumstances of the case, the Tribunal was right in disallowing the additions made by the AO under Section 36 (1) (iii) of the Income Tax Act and remitting it back without appreciating the fact that there was no business expediency involved in advancing the interest free loan to sister concerns?"

3. We have elaborately heard Ms.R.Hemalatha, Learned Senior Standing Counsel appearing for the Appellant/Revenue and Mr.A.S.Sriraman, Learned Counsel appearing for the Respondent/ Assessee.

4. At the first blush, on going through the order passed by the Tribunal, we wondered as to why the Revenue is aggrieved by the impugned order, as the Tribunal has remanded the matter back to the Assessing Officer for certain verification. However, on a careful reading of the order passed by the Tribunal, we found that legal questions have been raised by way of this Tax Case Appeal by the Revenue which require consideration.

5. The Assessee is a company registered under Indian Companies Act, 1956 following Mercantile method of accounting engaged, in the business of Engineering and Fabrication. The Assessee filed its return of income for the Assessment Year



under consideration, 2009-10 on 29.09.2009 declaring an income of Rs.13,42,02,851/-. The return was processed under Section 143 (1) of the Act. Subsequently, the case was selected for scrutiny and notice under Section 143 (2) of the Act was issued on 30.08.2010, pursuant to which the Authorized Representative of the Assessee was heard in the matter and details were called for.

6. The issue before us in the instant Appeal is with regard to the allegation of diversion of funds by way of interest free loans to related concerns. The Assessing Officer after noting the facts, requested the Assessee to justify huge interest free advances to its related concerns. The reply given by the Assessee was that those units have to buy huge quantity of raw materials to execute the work in progress and therefore, these payments were made as advance to meet the material cost. Subsequently, the Assessee took another stand by way of another statement that the nature of work requires minimum land space and outsources lesser value addition works which require large land space to its associate concerns and accordingly to perform the above jobs, it has to pay huge advance to cover the cost of material and also the working capital.

7. Admittedly, there appears to be a slight discrepancy between the two replies given by the Assessee. The Assessing Officer on going through the explanation and noting the transaction pointed out that in the P & L account and the balance sheet of the two related concerns namely, Emerald Engineering Unit II and Ruby Engineering, held that almost their entire receipts are from the Assessee-Company and they do not have any secured or unsecured loans. On the other hand, apart from the revenue receipt from the Assessee Company for the services rendered, these related concerns have also received huge advances. On analysis of the advances given to the related concerns, the following findings were returned by the Assessing Officer.

"(d)An analysis of the above table shows that in the case of Emerald Engineering, the advances received during the year amounts to Rs.10.71 crores which are still outstanding as on 31-03-2009 and if we add the opening balance, the total outstanding advances as on 31-03-2009 for which the related concern has to render service in future comes to Rs.14.28 crores, whereas, the total volume of services rendered by the related concern for the whole year in the F.Y.08-09 is only Rs.9.55 crores. The entire Rs.9.55 crores should also have been paid as otherwise, the assessee company would have figured as sundry



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debtors in the related concern's books. Similarly, in the case of Ruby Engineering, the corresponding figures are: advances received during the year Rs.5.63 crores, which are still outstanding as on 31-03-2009 for which the related concern has to render service in future - Rs.7.30 crores, the total volume of services rendered by the related concern for the whole year in the F.Y.08-09- Rs.7.12 crores. In this related concern also, the assessee company is not figuring as sundry debtor meaning, the entire consideration for the services rendered during the year has already been received from the assessee. It is common knowledge that in the normal business transactions, the advances would mostly be in the range of 15% to 20% of the total volume of the work to be done or the services to be rendered, and in general, it will relate to the services likely to be rendered in the next two or three months. Also, it will always be the case that advances can never be far in excess of the services rendered and in most cases, in fact, it will be the case of full services already rendered but par of the consideration yet to be paid, where the volume of work is so huge. However, in the assessee's case, it is a stark reality that the assessee has not only made 100% payment towards the services rendered by the related concerns, but, over and above that, even exceeding the total turnover of the year, it has advanced interest free funds to the related concerns during the year."

8. The Assessee's explanation was that these advances are made towards material cost. The correctness of such explanation was examined by the Assessing Officer and deeper scrutiny into the facts was made and on perusal of the fixed assets during the year, it was observed that there are huge addition to fixed assets during the year which could only have been funded out of the advances received from the Assessee, as those concerns do not have any other loans or the capital or reserves to fund such huge capital addition. By way of illustration, the Assessing Officer pointed out that in respect of Emerald Engineering, the total of liabilities is Rs.16.52 crores out of which Rs.14.28 crores is the outstanding advance from the Assessee. Similarly, at the assets side, out of Rs.16.52 crores, Rs.16.24 crores relates to fixed assets and the addition during the year to fixed assets is Rs.10.57 crores. In the case of other related concern, viz., Ruby Engineering, the total of liabilities side is Rs.7.41 crores, advance from the Assessee



company is Rs.7.30 crores, total of fixed assets is Rs.7.22 crores and addition to fixed assets during the year is Rs.5.60 crores.

9. Further, the financial health of the Assessee company was also noted by the Assessing Officer and it was pointed out that the Assessee is having a total borrowal of Rs.65.55 crores and the total finance charges incurred comes to Rs.21,74,70,019/-. Out of the said amount, the Assessing Officer excluded the bank charges of Rs.3,88,33,959/-, the total interest paid comes to Rs.17,86,36,060/- Ultimately, the Assessing Officer came to the conclusion that proportionate disallowance has to be made and the argument that these interests were paid for loans taken for a specific purpose and they do not form part of the funds diverted to related concerns, is not tenable.

10. Aggrieved by the said order, the Assessee preferred an Appeal to the Commissioner of Income Tax (Appeals) -IX (for brevity "the CIT(A)") under Section 250(6) of the Act. By order dated 28.02.2013, the CIT(A) re-examined the factual position and confirmed the order passed by the Assessing Officer. Hence, the Assessee was on appeal before the Tribunal. The Tribunal without looking at the background position of the order, remanded the matter back, which is a qualified remand for the limited purposes of verifying the amount of equity capital and reserves/surplus disclosed in the balance sheet. Further, the Tribunal has qualified by stating that if the Assessing Officer finds that the non-interest bearing fund of the Assessee is more than the interest free advance extended to its sister concerns, then the Assessing Officer shall delete the addition made by him to the tune of Rs.3,27,78,927/- towards disallowance of proportionate interest on interest free fund diverted to its sister concerns.

11. The order passed by the Tribunal partly appears to be a remand order. However, it does not appear to be an open remand, but a qualified remand to the Assessing Officer to complete the assessment and the Assessing Officer is assigned to do only a clerical job.

12. On a reading of the order passed by the Tribunal, we find, the same is absolutely devoid of any reasons. The operative portion of the order is in Paragraph Number 5 which reads as follows:

"5.We have heard both the parties and carefully perused the materials available on record. On perusing the balance sheet submitted by the assessee it is apparent that the assessee is having reserves and surplus of Rs.11.8 crores



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approximately and Rs.20/- crore equity as on 01.04.2008. This fund of the assessee is non-interest bearing and available to the assessee for deploying in the business as it deems fit. Therefore, the non-interest bearing fund of the assessee company viz. Equity and reserves/surplus of Rs.31.8 crores (approx.) can be presumed to have been advanced as the interest free advances to the sister company of Rs.21.6 crores (approx) which is far less than the non-interest bearing fund available with the assessee company. Hence, the addition made by the Ld.Assessing Officer by disallowing the interest is not warranted. Since these facts were not examined by the Revenue, we hereby remit the matter back to the file of the Ld.Assessing Officer for the limited purposes of verifying the amount of equity capital & reserves/surplus disclosed in the balance sheet and if the Ld.A.O. Finds that the non-interest bearing fund of the assessee is more than the interest free advance extended to its sister concern then the Ld.A.O. Shall delete the addition made by him of Rs.3,27,78,927/- towards disallowance of proportionate interest on interest-free fund diverted to sister concerns. However if found otherwise he shall pass appropriate order as per law and merits."

None of the facts as noted by the Assessing Officer or by the CIT(A) with regard to the question as to how the assets were diverted to the related concerns, has not been touched upon by the Tribunal. To say the least, the order passed by the Tribunal is devoid of reasons and therefore, bereft of particulars and non-est in law.

13. Though the Tribunal states that on perusing the balance sheet submitted by the Assessee, it is seen that the Assessee is having reserves and surplus of Rs.11.8 crores approximately and Rs.20 crore equity as on 01.04.2008, the Tribunal concluded that this fund of the Assessee is a non-interest bearing fund and is available to the business as it deems fit. There is no discussion as to the finding rendered by Assessing Officer, wherein detailed examination has been done regarding the fund flow and transaction. This aspect was noted by the CIT(A) and reasons have been given by the CIT(A) holding that it is evident that the Assessee has given its funds to its sister concerns to meet their capital expenditure and not given to meet material cost as claimed by the Assessee and the CIT(A) held that the Appellant's funds are diverted to its sister concerns and by doing so, the Assessee did not get anything in return and hence,



the interest expenditure paid by the Assessee is required to be restricted proportionately which was quantified by the Assessing Officer at Rs.3,27,78,927/-.

14. The Tribunal has not rendered any finding with regard to the correctness of the above finding given by the CIT(A) which confirmed the finding rendered by the Assessing Officer. Therefore, we are of the clear view that Tribunal has erroneously passed the order, that too, without any finding regarding the findings of the Assessing Officer or the CIT(A), which was wrong on facts. Therefore, we are of the clear view that the order passed by the Tribunal calls for interference.

15. Accordingly, this Tax Case Appeal is allowed and the substantial questions of law are answered in favour of the Revenue. No costs.

Sd/-

Assistant Registrar(CS V)

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Sub Assistant Registrar

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To

1. The Commissioner of Income tax,
Chennai.
2. The Income Tax Appellate Tribunal 'C' Bench,
Chennai.
3. The Commissioner of Income Tax(A)-IX,
Chennai.
4. The Assistant Commissioner of Income Tax,
Company Circle-I(4),
Chennai - 34.

+1cc to Mr.S.Sridhar, Advocate, S.R.No.42220

+1cc to Mr.T.Ravikumar, Advocate, S.R.No.42209

T.C.A.NO.458 OF 2016

AK-II(CO)

PBS/23/09/2021