CIT Vs English Indian Clays Ltd.

Court: High Court Of Kerala

Date of Decision: Jan. 24, 2012

Acts Referred: Income Tax Act, 1961 â€" Section 80M

Hon'ble Judges: C.N. Ramachandran Nair, J; Babu Mathew P. Joseph, J

Bench: Division Bench

Advocate: P.K.R. Menon and Jose Joseph, for the Appellant; A. Kumar, for the Respondent

Judgement

C.V. Ramachandran Nair, J.
These connected appeals, filed by the Revenue against the orders of the Tribunal, arise from the assessment

completed in respect of the respondent-assessee for the assessment years. 1997-98, 1999-2000, 2000-01 and 2001-02. We have heard

standing counsel appearing for the appellant and Shri A. Kumar, advocate, appearing for respondent-assessee.

2. Two questions raised are common for all the assessment years. So far as the issue as to whether assessee is entitled for depreciation on calciner

plant is concerned, we have decided the issue in favour of the assessee in an earlier judgment rendered in assessees own appeal, IT Appeal No.

183 of 2009. Following the said judgment, we reject the Departments appeals on this issue.

3. The next common issue raised for all the years is with regard to disallowance of interest on borrowed funds for purchase of equipments for lease

to two companies, one by name Prakash Industries Ltd., and other by name JCT Ltd. On enquiry, the AO found that these transactions are bogus

and, therefore, he made disallowances. Learned counsel for the Revenue relied on our judgment in assessees own case, reported in Commissioner

of Income Tax Vs. English Indian Clays Ltd., , for the immediate preceding year, that is for the year 1996-97 wherein we have considered the

matter in detail and held that these transactions with Prakash Industries Ltd. are bogus transactions. This judgment has become final at least as of

now and therefore the same binds the assessee and the Department. Since transactions with Prakash Industries Ltd. are found to be bogus, interest

disallowance is perfectly justified. We, therefore, allow the appeals by reversing the findings of the Tribunal as well as CIT(A) and restore the

disallowance.

4. So far as the question of disallowance of interest in respect of lease with JCT Ltd. is concerned, it is seen that there was some lease

arrangement which happened in the previous year relevant for assessment year 1994-95. The transaction was for 5 years. The AO, however,

completed assessments for the years 1994-95, 1995-96 after conducting inquiry and it was found that the lease arrangement was bogus in as

much as assessee did not acquire assets or lease out the same to JCT Ltd as claimed by them. In first appeal, assessments for 1994-95 and 1995-

96 got confirmed by orders of CIT(A). The assessee accepted the orders of CIT(A) by not filing appeal on this issue before the Tribunal. In spite

of the assessee accepting the finding of the CIT(A) that the transaction was bogus, the CIT(A) as well as the Tribunal allowed the same claim for

subsequent years by stating that the AO has not proved that any interest is debited for the loan taken for these transactions. Before us, counsel

appearing for the assessee repeated the same argument by stating that AO has not established that any interest is debited towards borrowal for the

lease transactions with JCT Ltd.

5. The standing counsel, on the other hand, contended that there is only one transaction of lease with JCT Ltd., which was found bogus for the

assessment years 1994-95, 1995-96 and the finding was confirmed in first appeal, which was accepted by the assessee. So much so, according to

him, interest debited on borrowed capital that is attributable to the transaction is to be disallowed.

6. After hearing both sides and after going through the orders, we do not think, the orders of CIT(A) as well as the Tribunal are sustainable

because there is no repeated transaction of lease with JCT Ltd. On the other hand, the transaction was only one and the same which was

apparently for a period of 5 years. When the original transaction is found to be bogus and assessee themselves accepted the said finding, there is

no scope for granting any deduction in interest on borrowed funds. While the case of the AO is that interest debited in the P&L Account is

attributable for acquisition of equipments for the said lease transaction, assessees contention is that the AO has not proved it. This is certainly a

factual issue on which neither first appellate authority nor the Tribunal verified the details. However, appellate orders cannot be sustained because

after the assessee accepted the transaction as bogus, assessee cannot claim any deduction in interest on borrowal for the transaction. Therefore, it

was the duty of first appellate authority and the Tribunal to verify whether any part of the interest debited in the P&L Account is attributable to

acquisition of asset for the lease with the JCT Ltd. and if so to make disallowance of interest attributable to the same. Even though the standing counsel submitted that the AO has clearly established and made only proportionate disallowance, we feel one more opportunity can be given to the

assessee to demonstrate that the borrowed funds on which interest is debited were not accounted as used for acquisition of asset for lease to JCT

Ltd. We therefore, remand the matter to the AO to verify this issue after giving opportunity to the assessee to furnish more details on utilisation of

borrowed funds, and make disallowance only if interest debited is attributable to the amount accounted as used for acquisition of asset for lease to

JCT Ltd.

7. If the lease transactions are over by 1998-99, then it is a matter to be verified whether loan was retained for subsequent years and in the

absence of retention of loan availed for lease, no disallowance is called for, for assessment years subsequent to 1998-99. The AO is directed to

reconsider the matter after giving opportunity to the assessee.

8. The separate additional issue, which is raised in IT Appeal No. 1339 of 2009 for the year 1997-98 is against the disallowance of interest on

borrowed funds stated to be used for investment in shares of companies against which assessee claimed reduction u/s 80M. While the claim of the

assessee is that assessee used its own surplus funds for investment in company shares, the finding of the AO is that the funds utilised were out of

borrowed funds. That too, only for investment in the shares of one company by name Bharat Starch Industries Ltd. and, so much so, he disallowed

interest of Rs. 21 lakhs out of total claim of Rs. 34,40,581. Going through orders of the first appellate authority as well as the Tribunal, we notice

that both these authorities have not considered details of accounts furnished and without verifying or satisfying about the correctness of

disallowance they have allowed the claim. Here again, what we feel is that the assessee did not have a case that deduction from dividend income

should not be from the net dividend income, that is, after deducting, expenditure to earn such income. So much so, there is no dispute on the legal

position that deduction u/s 80M should be granted not from gross dividend but from net dividend income. If any borrowed fund is used for

investment in Bharat Starch Industries Ltd. as found by the AO, then interest attributable to such loan has to be deducted and section 80M

deduction has to be allowed on the net dividend. When the assessee has a case that surplus funds were available and no borrowed funds were

used for investment in the said company, there was no difficulty for the assessee to produce the bank account about the surplus available and the

details of the amounts paid to establish that such funds were not borrowed but surplus available with them. It is seen that neither the first appellate authority nor the Tribunal has verified the facts but allowed the claim by accepting the arguments of the assessee. The first appellate authority as

well as the Tribunal accepted the assessees argument because assessee claimed that they have capital reserve available for investment in shares.

However, unless it is established that assessee has liquidity, assessee cannot contend that capital reserve justifies their claim that borrowed funds

were not used for acquisition of shares. When shares are acquired against cash payment, the assessee must have liquidity other than borrowed

funds to prove that any funds were available and utilised for acquisition of shares. Here again, we feel assessee can be given one more opportunity

before the AO to demonstrate and prove liquidity and cash arrangement other than borrowed funds for acquisition of shares of Bharat Starch

Industries Ltd. One more additional issue raised in IT Appeal No. 1339 of 2009 is whether subsidy received is capital or revenue which issue

stands decided in favour of the assessee vide judgment in IT Appeal No. 183 of 2009. Following the said judgment, we allow the appeal on this

issue by dismissing the Departmental appeal.

In the result, we allow the appeals in part by confirming the issues raised in regard to depreciation and subsidy in favour of the assessee and by

reversing the findings of the Tribunal and that of the first appellate authority on all other issues by remanding the matter for the AO to work out

disallowance on both leasing transactions and also in respect of investment in shares.