

## **Commissioner of Income Tax I, Tiruchirappalli Vs R. Mohan Prop. R.M. Traders B-4, First Cross, West Extension Thillai Nagar Tiruchirappalli**

**Court:** Madras High Court

**Date of Decision:** Sept. 26, 2011

**Acts Referred:** Income Tax Act, 1961 " Section 143(1), 147

**Hon'ble Judges:** M. Jaichandren, J; Chitra Venkataraman, J

**Bench:** Division Bench

**Advocate:** K. Subramaniam, for the Appellant; V.S. Jayakumar, for the Respondent

**Final Decision:** Allowed

### **Judgement**

Chitra Venkataraman, J.

The Revenue is on appeals as against the order of the Income Tax Appellate Tribunal. The only question raised

by the Revenue for the assessment year 1997-98 to 2000-01 is as follows;

Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in holding that interest on borrowed capital

could not be disallowed on the excess of interest bearing borrowals over and above what was required and utilised for business purposes?

2. The assessee is engaged in the business of purchase and sale of medicines on a wholesale basis. While claiming net business loss, the assessee

debited certain sum as representing interest paid. While going through the assessment proceedings for 1998-99, the Assessing Officer found that

the assessee had diverted a part of the business fund towards non business purposes. The Officer viewed that the claim for deduction on interest

on the funds so diverted in each of the above assessment years could not be granted, thus income liable to tax in respect of the above said

assessment years to that extent was treated as escaped assessment. Thus, the returns processed u/s 143(1)(a) for the assessment years 1997-98,

1999-2000, 2000-01 were revised by reopening the assessment u/s 147 of the Act. It was pointed out that one such non business investment

related to investment in shares issued by M/s. Capline Point Laboratories Limited. In considering the claim, the Officer viewed that the deduction

could not be allowed in full. Thus, after considering the various materials, the Assessing Authority restricted the claim applying the proportion which

the average diverted funds to the average interest bearing funds. Thus restricting the claim to 50%, the Assessing Officer rejected the balance. The

pattern of assessment made in respect of all the years are one and the same. Aggrieved by the same, the assessee went on appeal before the

Commissioner of Income Tax (Appeals).

3. As regards the investment of shares in M/s. Caplin Point Laboratories Limited, the assessee contended that the same was for the purpose of

securing the dealership which was borne out by the agency agreement. The assessee contended that the investment in shares and credits extended

to trade debtors were incidental to the assessee's business; the debit balance in the current account taken for the purpose of computing the

diverted funds had arisen due to business loss and hence, could not be considered as diversion of funds. In any event, the Assessing Officer should

have considered the interest - free deposits available with the assessee during the respective years were sufficient for making investments. It was

contended that as the investments were made in the year 1993-94, the same ought not to have been held against the assessee. The assessee had a

credit of Rs. 1,50,000/- in capital account apart from interest free funds to the tune of Rs. 14.16 lakhs as on 31.3.98, which clearly established

that advances were given only from out of such interest free funds.

4. As far as the investments in M/s. Capline Point Laboratories is concerned, the Commissioner of Income Tax (Appeal) pointed out that the

dealership agreement dated 17.8.93 made no mention about the impugned interest and even when the agreement was renewed on 8.12.1994, no

reference was made to the investment in shares although by that time the said investment had been already made. Thus, the Commissioner of

Income Tax (Appeals) agreed with the view of the Officer that the investment in the company had nothing to do with the assessee's business.

Thereby the Commissioner of Income Tax (Appeals) rejected the assessee's contention that underlying object of making investment was only to

promote the business of the assessee. The Commissioner of Income Tax (Appeals) agreed with the assessee that the business loss reflected in the

current account could not be treated as an advance or an investment. On the aspect of diversion of interest bearing borrowed funds for non

business purpose, the Commissioner of Income Tax (Appeals) pointed out records clearly pointed out utilisation of interest bearing borrowed

funds for non business purposes. Thus, the Commissioner of Income Tax (Appeals) rejected the appeal for the assessment years. The

Commissioner of Income Tax (Appeals) applied his decision relating to the assessment year 1998-99 on the aspect of diversion of funds to non

business purposes in respect of appeals relating to the assessment years 1997-98, 1999-00 and 2000-01 and rejected these appeals too.

5. As regards the debit balance in the current account relating to assessment year 1997-98 and 1999-00, the Commissioner of Income Tax

(Appeals) pointed out that these were on account of investments tax payment and house construction. Hence, he directed the Assessing Officer to

rework the diversion of funds for non business purposes.

6. As regards the interest bearing borrowals, not fully utilised for business purpose, the Commissioner of Income Tax (Appeals), particularly in its

order relating to assessment year 1998-99, pointed out that during the course of assessment proceedings, the Assessing Officer questioned the

assessee regarding the extent of interest-bearing borrowals used for non business purposes, to which, the assessee agreed in its letter dated

5.2.2001 that as a measure of compromise and to avoid litigation, the loss claimed by it under the head "business" to be ignored while completing

the assessment. In the circumstances, taking note of the facts on the claim on business loss and in the light of the letter thus written, the

Commissioner of Income Tax (Appeals) held that to the extent of loss claimed, the diversion of interest-bearing funds for non business purposes

had to be disallowed. Aggrieved by the same, the assessee went on appeal before the Income Tax Appellate Tribunal.

7. Before the Tribunal, the assessee filed its cash flow statement as well as summary of balance sheet for the above said years. On a perusal of the

same, the Tribunal pointed out that it was not correct to say that for all the assessment years, the assessee had applied the borrowed funds for non

business purposes. Even for assessment years 1998-99, the borrowed funds did not match the business assets to the tune of Rs. 1,70,000/- , to

which, the relatable interest came to Rs. 36,167/- . On going through the said statement, the Tribunal allowed the appeal to the extent as stated

above. Aggrieved by the same, the Revenue is on appeals.

8. As rightly pointed out by the learned Standing Counsel for the Revenue, given the fact that the assessee had not produced necessary materials to

point out to the extent of diversion for non business purpose, the grant of relief just based on cash flow statement and balance sheet per se would

not a justifiable ground to grant the relief to the assessee. The Commissioner of Income Tax (Appeals) in its order stated that the assessee did not

secure any fresh borrowals during the relevant year and almost the entire interest related to earlier loans and/ or brought forward balances.

However, this would not be a justifiable ground for allowing the assessee's claim that there was no diversion for non business purposes. The first

Appellate Authority, viz., the Commissioner of Income Tax (Appeals) pointed out in his order for the assessment year 1998-99 that as against the

total interest bearing borrowals amounting to Rs. 36 lakhs, the business assets aggregated to Rs. 27 lakhs. Thus, only a sum of Rs. 9 lakhs was

there to be taken as interest bearing borrowals diverted for non business advances. However, taking note of the fact that the assessee had claimed

business loss to the tune of Rs. 2,73,740/- and as a measure of compromise and to avoid litigation, the assessee claimed business loss be ignored

while completing the assessment, the Commissioner of Income Tax (Appeals) restricted the disallowance as relatable to non business purpose to

the extent of Rs. 2,73,740/- . As against this, the assessee went on appeal before the Tribunal.

9. As already pointed out by the Revenue, when the Assessing Officer had disallowed 50% of the interest payment as relatable to non business

purposes, which was further scaled down in considering the assessee's claim in the appeal before the Commissioner of Income Tax (Appeals), in

fairness to the claim of the parties herein, the Tribunal should have adverted to these facts before granting relief. Thus, the order passed based on

the cash flow statement and the balance sheet, cannot by any stretch of reasoning be taken as materials for proving the claim of the assessee. In the

circumstances, we do not find any ground to sustain the order of the Tribunal.

10. Since the Officer had restricted the disallowance to 50% of interest payment, considering the fact that the borrowing were old borrowings and

there were no fresh borrowals during the assessment years under consideration, we feel that instead of remitting the matter back to the Tribunal or

the officer, the proper course herein would be to adopt the reasoning given by the Commissioner of Income Tax (Appeals) in his orders.

11. As already pointed out in respect of assessment year 1998-99, based on the letter given by the assessee, the Assessing Officer ignored the

returned loss, and the Commissioner of Income Tax (Appeals) restricted the diversion of interest bearing funds for non business purposes to the

extent of Rs. 2,73,740/- .

12. As far as the orders passed for assessment year 1997-98, 1999-2000 and 2000-01 are concerned, the Commissioner of Income Tax

(Appeals) worked out the non business advances / investments at Rs. 13,56,937/- , Rs. 18,29,174/- and Rs. 18,94,723/- as relatable to

assessment years 1999-98, 1999-2000 and 2000-2001. The said amount was worked out by the Commissioner of Income Tax (Appeals) by

looking into the accounts of the assessee as well as on the investments made during this period. The Commissioner of Income Tax (Appeals)

pointed out that there were no materials to establish the nexus of the advances given by the assessee to some of the parties with that of the

assessee's business. Thus going by the extent of diversion, the Commissioner of Income Tax (Appeals) pointed out that no business man would

encumber himself with any liability other than what his business required. Thus, if borrowal had been resorted to after the diversion of funds, the

presumption would be that the borrowing was made to make good the deficit caused by the diversion. He further pointed out that trade credits and

sundry credits availed in the course of business were basically business funds meant for use in business. If that be so, trade credits could not be

seen as other than business liabilities, and not free-funds in the sense in which the assessee could use it freely. Keeping this in the background, the

Commissioner analysed the liability to find out, whether the assessee had resorted to more interest bearing borrowals other than what the business

needs warranted. Based on the analysis, the Commissioner of Income Tax (Appeals) came to the conclusion that the entire non business advances

and investments were made by using the borrowed funds. The Officer thus was directed to rework the disallowance by taking diverted funds as

given therein.

13. On going through the orders of the Tribunal, we feel that the order of the Tribunal is based purely on the summary of the statement and hence,

could not be accepted as such. In the circumstances, we set aside the order of the Tribunal. We have no hesitation in restoring the order of the

Commissioner of Income Tax (Appeals) in respect of all the years. Accordingly, the Tax Case (Appeals) are allowed. No costs.