**(2002) 124 TAXMAN 707**

**Delhi High Court**

**Case No:** IT Reference No. 313 of 1988 6 August 2002

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| Commissioner of Income Tax | | APPELLANT |
| | Vs | |
| Orissa Cement Ltd. | | RESPONDENT |

**Date of Decision:** Aug. 6, 2002

**Citation:** (2002) 124 TAXMAN 707

**Hon'ble Judges:** S.B. Sinha, C.J; A.K. Sikri, J

**Bench:** Full Bench

**Advocate:** Sanjeev Khanna and Ajay Jha, for the Revenu, for the Appellant;

**Judgement**

S.B. Sinha, C.J.

At the instance of the revenue, the following questions have been referred to this court for its opinion by the Tribunal, Delhi Bench "C", in terms of

section 256(1) of the Income Tax Act, 1961 (hereinafter referred to as "the Act") :

1. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the assessed was entitled to the deletion of

addition of Rs. 3,67,619 out of its interest claim ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in allowing the deduction of Rs. 1,48,500 to the assessed in

respect of payments made to field organizers after the abolition of the sole-selling agency ?

Re. : Question No. 1 :

Facts

2.1 The assessed is a public limited company. It filed a return of its income declaring the total taxable income for the assessment year 1977-78 at

Rs. 3,53,28,960 while claiming various deductions under Chapter VI-A.

2.2 The Income Tax Officer disallowed the claim of expenditure made by the assessed on account of payment of interest on loans raised, as

according to him, the assessed had made interest-free advance to Utkal Investment Ltd. (a subsidiary of assessed-company), Lions Club,

Rajgangpur, Lanjiberna Quarry Employees Consumer Co-op. Stores Ltd. and employees of Rs. 3,35,111, Rs. 7,699, Rs. 4,839 and Rs. 20,000,

respectively.

2.3 Income Tax Officer, while taking into consideration the contentions raised by the assessed before him and various replies given by it to the

queries raised by the Income Tax Officer and relying on Commissioner of Income Tax, Mysore Vs. United Breweries, ; Milapchand R. Shah and

Others Vs. Commissioner of Income Tax, Madras, ; and Roopchand Chabildass and Sons and Others Vs. Commissioner of Income Tax,

Madras, took a view that it looked illogical that, on the one hand, the assessed should have raised heavy interest-bearing loans and, on the other,

should give interest-free loans to various societies /subsidiary companies.

2.4 Inspecting Assistant Commissioner out of a large number of disallowances proposed in the draft assessment order, deleted some

disallowances and confirmed the others.

2.5 In the aforesaid situation, the Income Tax Officer determined the total income of the assessed at Rs. 3,83,42,720 disallowing the claim of

deduction amounting to Rs. 3,67,619 as against Rs. 3,85,111 on account of payment of interest on loans raised.

2.6 Thereafter, the assessed preferred an appeal before the Commissioner (Appeals) :

Commissioner (Appeals) recording his finding as under :

Ground No. 9 (a) objects to the disallowance of Rs. 3,67,619 out of interest paid by the company, being amount equal to assumed interest on

loans advances to :

(i) Utkal Investment Ltd. (subsidiary of the appellant-company);

(ii) Lions Club, Rajgangpur;

(iii) Lanjiberna Quarry Employees Consumer Co-operative Stores Ltd; and

(iv) Employees.

2.7 Considering the Explanation given by the Income Tax Officer dated 18-1-1980, the Commissioner (Appeals) deleted the entire amount of

disputed disallowance of Rs. 3,67,619 and held :

On the basis of the aforesaid discussions, entire disputed disallowance of Rs, 3,67,619 is deleted. In this view of the matter, the contention

regarding interest calculation in respect of loan given to the subsidiary company being wrong as raised by Ground No. 9(b) requires no

consideration.

2.8 The Tribunal while upholding the findings recorded by the Commissioner (Appeals), observed:

The next ground pertains to allowance of interest paid on borrowings. The interest amount is equal to the assumed interest on loans/advances to

subsidiary of the assessed-company by name of Utkal Investment Ltd. and to Lions Club, Rajgangpur, Lanjiberna Quarry Employees Consumer

Co-operative Stores Ltd. and to its employees. This matter is also covered by the order of the Tribunal for the assessment year 1976-77, a copy

of which is on page 402 onwards of the paper book. In para 29 of this order, the disallowance of interest has been deleted on the ground that it

had not been proved that the advances were out of borrowed funds on which interest had been paid by the assessed-company. In fact, before

interest can be disallowed in the hands of the assessed, it is necessary for the revenue to establish that the interest-bearing loans raised by the

assessed were diverted for giving loans to the subsidiary company or to other concerns free of interest. In the absence of such proof, disallowance

cannot be sustained. We agree with the order of the Commissioner (Appeals) and uphold the same.

3. The short question, which arose for consideration was as to whether the following amount was to be allowed or not :

Name of Debtor Interest

disallowed

Rs.

Utkal Investment Ltd. (a 3,35,111

subsidiary of assessed-

company)

Lions Club, Rajgangpur 7,699

Lanjiberna Quarry Employees 4,839

Consumer Co-operative

Stores Ltd.

Employees 20,000

Total 3,67,619

4. We may notice that in The Commissioner of Income Tax, Delhi-II, New Delhi Vs. Motor General Finance Ltd., this Bench held :

From the conspectus of the decisions as noticed hereinbefore, there cannot be any doubt whatsoever that the nexus between the amount paid by

way of advance to a sister concern and the fund available at the relevant time in the assessed''s hands must be found out from the advances taken

by the assessed. The onus to prove that it is entitled to (deduction) in this regard was on the assessed. It was to be proved that a bona fide loan

had been granted in favor of a sister concern. It was, Therefore, its duty to place requisite materials on record.

This aspect of the matter has also been considered in Commissioner of Income Tax Vs. H.R. Sugar Factory, , wherein the Allahabad High Court

held :

... The court cannot shut its eyes to realities. What has actually happened is visible to the naked eye. The assessed, a private limited company

closely held by three family groups, is made to lend huge amounts (up to 23 lakhs of rupees as per the compromise arrived at between the

assessed and the directors/shareholders in the civil suits referred to above) at a very low rate of interest and the entire difference of interest is being

charged to the assessed. The assessed is not a finance company. It is engaged in the manufacture of sugar. No business purpose of the assessed-

company is served by such lending to its directors/shareholders. It cannot be said that it is expedient in the interest of business or is laid out for the

purpose of the business of the assessed.

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May be that the company borrows large amounts for the purpose of its business every year, but that does not explain the huge advances to the

directors/shareholders. Had this money been not advanced to the directors, it would have been available to the assessed for its business purposes

and to that extent it may not have been necessary to borrow from the banks. We are, Therefore, of the opinion that the Income Tax Officer was

right in disallowing the difference of interest u/s 36(1)(iii) of the Income Tax Act and that the Tribunal"s approach is not only superficial but too

naive.

In INDIAN METALS AND FERRO ALLOYS LTD. Vs. COMMISSIONER OF Income Tax., the Orissa High Court held :

... it may be pointed out that, in a hypothetical case, an assessed can earn profits only after the date of investment and advance. It cannot be said

that because, in the concerned assessment year, the profit was more than the investment and advance, those came only out of the profit. The actual

financial liquidity position on the relevant date has to be established by the assessed.

Yet again in Commissioner of Income Tax Vs. H.R. Sugar Factory, B.P. Jeevan Reddy, C.J. (as his Lordship then was) relying upon his earlier

decision in H.R. Sugar Factory (P) Ltd.''s case (supra), held that the assessed-company was not entitled to the allowance of interest.

In Hira Lall and Sons Vs. Commissioner of Income Tax, , a Division Bench of this court held that the question whether the loan was taken for the

purpose of business was a question of fact and that no question of law arose out of the order of the Tribunal.

5. It may be true that the question as to whether advance to the subsidiary company was given out of the sale proceeds or out of the funds from

the depositors from the banks is essentially a question of fact, but such question of fact must be determined on the basis of the materials, which

may be placed by the parties.

6. Section 106 of the Indian Evidence Act or the principles analogous thereto places the burden in respect thereof upon an assessed, as the facts

are within its special knowledge. However, a presumption may be raised in a given case as to why an assessed who for the purpose of running its

business is required to borrow money from banks and other financial institutions, would be giving loan to its subsidiary companies and that too

when it pays a heavy interest to its lenders, it would claim no or little interest from its subsidiaries.

7. We are not oblivious of the fact that while arriving at such a finding, a nexus between the borrowings from the banks and other financial

institutions by the assessed and lending it to its subsidiary companies must be found out, but such nexus must also be found out from the materials

on record only.

In United Breweries'' case (supra), whereupon the Income Tax Officer has placed reliance, the Mysore High Court held :

There was no material for the Tribunal to come to the conclusion, that the assessed-company carried on its business through the agency of its

subsidiaries and that the business carried on by the subsidiaries was not their own but that of the assessed-company. Hence, the part of the capital

borrowed by the assessed and advanced by it to its subsidiaries free of interest was not borrowed for purposes of its own business and the interest

on such borrowing was not an admissible deduction u/s 36(1)(iii).

In Roopchand Chabildass & Sons'' case (supra), whereupon also the Income Tax Officer has placed reliance, the Madras High Court held :

... As the amount borrowed was not utilized for purposes of business of the assessed, the interest paid on it was not allowable u/s 10(2)(iii) either

in the assessment of the firm or of the partners in their individual capacity.

8. In this view of the matter, the first question must be answered in the negative, i.e., in favor of the revenue and against the assessed.

Re. : Question No. 2 :

Facts :

9.1 The assessed claimed a deduction of Rs. 2,97,000 on account of commission paid to three parties for organizing and supervising sales of its

product, i.e., cement :

Rs.

n Cement Distributors Ltd. 1,55,000

n Ganesh Trading Corpn. 90,000

n Vishnu Agencies 72,000

Total 2,97,000

9.2 Income Tax Officer disallowed the above expenditure on the ground that these payments were made in violation of the government policy

under which the system of sole-selling agencies in cement industry was abolished and observed as under :

The institution of sole-selling agency in cement has been abolished by the Government of India. Cement Distributors Ltd. who were the sole-

selling agent of assessed-company, ceased to be so with effect from 1-4-1976. This institution was abolished because in the eyes of government,

no service of sole-selling agent was considered necessary in cement sales. In this connection, it may be stated that cement is a controlled

commodity, its sales are regulated by government and assessed is not to run here and there in search of cement customers. It was precisely in view

of this reason that system of sole-selling agency in cement has been abolished by government.

In order to circumvent and frustrate this policy of government that assessed has continued the institution of selling agency though in a different form

and under different name with effect from 1-4-1976, i.e., immediately after the termination of sole-selling agency system, assessed has appointed

the above three parties as "Market Supervisors".

The nature of service rendered by these parties is same as that of sole-selling agent. assessed in its reply dated 11-1-1980, has itself admitted that

these parties were appointed to fill the void caused by the termination of sole-selling agency system.

Since the payment earlier made to selling agent was disallowed, the payment now made to these market supervisors is also disallowed in

computing the total income of the assessed.

9.3 Commissioner (Appeals) upon considering various documents brought on record by the revenue as well as by the assessed, deleted the

disallowance of Rs. 2,97,000 holding :

17. Having regard to the submissions made and evidence regarding services rendered by the three parties brought on record, I am of the view that

it has to be held that the payments in question represented expenditure incurred wholly and exclusively for the purpose of the business within the

meaning of section 37(1). It is no doubt correct that the system of sole selling agency was abolished by government. Yet it is quite evident that the

new arrangements made with Cement Distributors Ltd. and the other two parties did not violate or run counter to the said government decision.

After all the actual running of the business has to be done by the businessman himself and in the case of the appellant-company it had to make

some sort of temporary marketing arrangements in order to exercise control over the stockists in the matter; it was done when it had no marketing

organization of its own to take over such functions with immediate effect. In other words, the payments in question were fully justified on the

grounds of actual needs of the company''s business and practical considerations. Moreover by many appellate orders for the earlier assessment

years 1974-75 to 1976-77, the disallowances of commission paid to Cement Distributors Ltd. were deleted. The amounts of commission paid in

those years were quite substantial so that I find there is merit in the learned representative''s contention that the new arrangement with effect from

1-4-1976 was as a matter of fact very economical to the appellant-company. In other words, there is and can be no question of the payments to

the outside agencies as claimed being regarded as excessive or unreasonable. Lastly, the Income Tax Officer himself has not indicated any doubt

as regards the genuineness of the payments in question and/or the actual rendering of the services by the three parties to the appellant-company.

On the basis of all these reasons, I would allow the contention and delete the disputed disallowance of Rs. 2,97,000.

9.4 Thereafter, the revenue preferred an appeal before the Tribunal wherein the Tribunal having regard to the policy decision of the Central

Government noticed :

20. The last ground pertains to the allowance of commission paid to Cement Distributors Ltd. of a sum of Rs. 2,97,000. In fact, the whole amount

has not been paid to Cement Distributors Ltd. only but to three parties as follows :

Rs.

n Cement Distributors Ltd. 1,35,000

n Ganesh Trading Corpn. 90,000

n Vishnu Agencies (P) Ltd. 72,000

The Income Tax Officer disallowed the claim on the ground that the system of sole-selling agency in cement having been abolished by the

government, Cement Distributors Ltd. ceased to be the sole-selling agent of the company with effect from 1-4-1976. However, with immediate

effect the assessed-company appointed the above three parties as market supervisors. The Income Tax Officer held that the government had

abolished the sole-selling agency system since no services of sole-selling agents were considered necessary in cement sales, which was a controlled

commodity. The assessed had, however, appointed the market supervisors to render the same services as were alleged to have been rendered by

the sole-selling agents. Since the payments earlier made to the sole-selling agents had been disallowed by the Income Tax Officer, he disallowed

the payment made to the market supervisors also.

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23. The department is aggrieved and is in appeal. We have heard the learned departmental representative and the counsel for the assessed at

length. We are unable to agree with the learned Commissioner (Appeals) that the new arrangement of payment to market supervisors does not

really run counter to the abolition of sole-selling agency by the government. In fact, cement is a controlled commodity and has most of the time

been a scarce commodity. The cement dealers function purely in a seller''s market and not in a buyer''s market. The buyers get in a bag of cement

what the seller gives. The beggars, that is exactly the position of the buyer in respect of the cement and the supplier or the manufacturer is the real

boss in the system. The list furnished of the job done by the market supervisors in para 15 is really more in the nature of a cosmetic than in the

nature of actual services required and rendered though the correspondence on record shows that some services were rendered. We are satisfied

that the payment made to Cement Distributors Ltd., which is a sister concern of the assessed at the rate of Rs. 15,000 per month and Vishnu

Agencies (P) Ltd. at the rate of Rs. 8,000 per month was ad hoc and not commensurate with the services rendered by them. It is clear that the

assessed-company has tried to frustrate the government policy and circumvented it by paying huge amounts under different names. It is immaterial

that the payments to the Cement Distributors were allowed in earlier years by the Tribunal. Sole-selling agencies were abolished as a matter of

public policy, for cement, obviously for the reasons discussed that no services of sole-selling agents were required for a scarce and controlled

commodity. Looking to the facts stated above, we hold that the payment made to the three market supervisors should be allowed only to the

extent of the half, i.e., Rs. 7,500, Rs. 5,000 and Rs. 4,000 per month, respectively, which is reasonable and commensurate with the services

rendered. The sum of Rs. 1,48,500 shall, Therefore, stand disallowed.

10. The question, which, in our opinion, should have been posed by the Tribunal, was as to whether having regard to the Cement Control Order

made by the Central Government in exercise of its power conferred upon it u/s 3 of the Essential Commodities Act, 1955, such an arrangement

was permissible in law ?

The learned Tribunal, in our opinion, having regard to the aforementioned finding committed a serious error in directing payment to the extent of 50

per cent of the claim. Once it is held that the arrangement entered into by the assessed with the firms in question was entered into with a view to

defeating the policy decision of the Government of India as regards abolition of the sole-selling agency, in our considered view, no amount

whatsoever could have been allowed. If the arrangements entered into by the assessed with the alleged market supervisors were vocative of the

statutory provisions and against public policy, the same cannot be encouraged for any purpose whatsoever, far less for evasion of tax.

11. In this view of the matter, the second question also must be answered in the negative, i.e., in favor of the revenue and against the assessed.

12. This reference is answered and disposed of, accordingly, without any order as to costs.