

**IN THE INCOME TAX APPELLATE TRIBUNAL RAIPUR BENCH,
RAIPUR**

**BEFORE : SHRI N.S.SAINI, ACCOUNTANT MEMBER
AND
SHRI PAVAN KUMAR GADALE, JUDICAL MEMBER**

**ITA No.160/RPR/2014
(Assessment Year :2010-2011)**

DCIT-1(1), Raipur-1	vs	Navbharat Press, Press Complex, G.E.Road, Raipur(C.G.)-492001
PAN No. : AADFN 0350 R		
(Appellant)	..	Respondent

Revenue by : Shri Ajit Kumar Laskar, DR
Assessee by : None(Written Submission)

**Date of Hearing : 12/01/2018
Date of Pronouncement 15/01/2018**

आदेश / O R D E R

Per Shri N.S.Saini, AM:

This is an appeal filed by the Revenue against the order of the CIT(A), Raipur, dated 12.06.2014 for the assessment year 2010-2011.

2. The Revenue has raised the following grounds :-

“1. Whether in law and on facts & circumstances of the case, the CIT(A) has erred in deleting the disallowance of interest u/s.36(1)(iii) of the Income Tax Act, 1961 of Rs.41,54,811/- as interest bearing funds were used for non-business purposes.”

3. Brief facts of the case are that the assessee is a partnership firm derives income from printing and publishing of Hindi Daily Newspaper “Nav Bharat” and English daily “Central Chronicle” from Raipur. The assessee filed its return of income declaring total income of Rs.1,85,77,530/-. Thereafter the AO framed the assessment u/s.143(3) of the Act determining the total income of the assessee at Rs.2,27,32,341/-.

During the assessment proceeding, the AO on perusal of partner's capital accounts, found that as on 01.04.2009 there was debit balance of Rs.115.25 lakhs in the case of Partner Shri Sameer Maheshwari. There was opening debit balance as on 01.04.2009 of Rs.100.97 lakhs appearing in the "Advance Income tax" account, which was not transferred to the partner's capital account in their profit sharing ratio. Some self assessment tax was also paid during the year under consideration, which was added to advance income tax account and this enhanced the balance to Rs.110.54 lakhs. It should have been ultimately transferred to partner's capital account in their profit sharing ratio, but this was not done. The AO observed that if this effect is given, the resultant figures of debit balance of partner Shri Sameer Maheshwari will go up to Rs.256.87 lakhs. Similarly, the balance of another partner will be covered into debit balance of Rs.11.91 lakhs instead of credit balance. The interest being fund received from banks and other parties were utilized in advancing interest free loans to partners for their personal purposes and there was no record to prove that advances to partner was for business purposes of the firm nor was there may commercial expediency. The A.O was not convinced with assessee's submissions and concluded that interest bearing funds were diverted for non-business purposes, hence, disallowed the corresponding expenditure. In this connection the A.O placed reliance on the following judgments:-

- (i) Ganpati Associates vs. 1TO (2010) 36, SOT 1 (2009) 121 TTJ 545 (Asr);
- (ii) CIT vs. MM. Nagalinga>Jadar Sons (2009) 318 ITR 210/222 CTR 518 (Ker);

- (iii) ACIT vs. Spray Engineering Devices Ltd. (2012) 23taxman.com 267/53 SOT 70;
- (iv) SA Builders Ltd, vs. CIT (2007) 158 Taxman 74 (SC);
- (v) Sree Rayalaseema Green Energy vs. DC1T (2012) 26 taxman.com 251 (Hyd);
- (vi) ACIT vs, Sarnrat Rice Mills'P. Ltd. (2012) 23 taxman.com 350/54 SOT 1 (Delhi);
- (vii) CIT Vs. Harrison's Malayalam Ltd. (2012) 25 taxman.com 546/210 Taxman.115 (Ker);

Accordingly, by applying rate of interest @ 12% p.a. on the debit balance of partner, the A.O disallowed interest expenditure of Rs.41,54,811/- u/s 36(1)(iii) of the Act.

4. On appeal before the CIT(A), the assessee submitted that the assessee is regular in filing his income tax return with its books of accounts audited u/s 44AB- AH the expenses and incomes are vouched. The A.O did not find any defect in the accounts. Therefore, any disallowance of expenses is unjustified. The assessee further contended that none of the partners have withdrawn any borrowed funds in the current year or in any prior years. The assessee also claimed that during the year under consideration there was cash profit receipts of Rs.246.07 lakhs against the withdrawals of Rs.194.03 leaving Rs.52.04 lakhs, which was sufficient to absorb the firm's tax. On the basis of the above position the assessee claimed that withdrawals made by the partners in no case involves any borrowed funds whether interest bearing or interest free and is entirely out of profits. The assessee also filed a chart showing borrowings from the banks and repayment made and claimed that there was no diversion of the interest bearing borrowed funds to the partners/sister concerned. The assessee filed one more chart showing

interest free unsecured funds from relatives and associates of the partners for the immediate business needs and submitted that assessee has not lent any interest free funds to any person or sister concern. The assessee further contended that a mere perusal of capital account alone can never lead to appropriate conclusion unless a comparative analysis of capital account verses the amounts borrowed is made. The A.O has not proved nexus between borrowings and withdrawals, hence, the addition made by the A.O is unjustified and unlawful. There is no violation of conditions laid down in section 36(1)(iii) of the Act. It was submitted that sufficient interest free funds were available with the assessee for withdrawals by partners and A.O was not justified in making addition. The assessee has admitted that withdrawals were made for personal purposes but it was out of the cash profits available and not out of any borrowed funds. Finally the assessee has relied on the following cases to support his various contentions.

- (i) CIT vs. Shakti Industries (2013) 35Taxman.com 16 (HC);
- (ii) JCIT vs. Beekey Engineering Corporation (2010) 38 DTR (Chhattisgarh) 289;
- (iii) CIT-III vs. R. L. Kalthia Engg. & Automobile Pvt. Ltd. (2013) 33 Taxman.com
- (iv) R. D. Joshi & Co. vs. CIT (2001) 171 CTR (MP);
- (v) CIT-1 vs. Kaitash Automobiles (2013) 37 taxman.com.62 (All);

5. The CIT(A) after considering the submissions of assessee has observed as under :-

“7. 1 have carefully gone through the assessment order and the submissions of the appellant. The only issue involved in this appeal is regarding disallowance of interest of Rs.41,54,811/-under section 36(l)(iii) of the Act on two prepositions by the AO, The interest was computed by

the AO on the debit balance of Advance Tax Account balance of Rs.1,10,54,514/- appearing on asset side of the Balance Sheet of the appellant as on 31.3.2010 along-with interest computation on the debit balance of the partners capital account on pro rata basis with daily rest at 12% per annum rate of interest.

8. For disallowance of interest on Advance tax account balance the appellant submitted about the facts relating to account head "Advance Tax Payment" maintained by it. All the payments made by the appellant firm against direct taxes including any amount of appellant's tax deducted by others and any demand of tax paid by the appellant is initially debited to this account. Thereafter, on completion of the assessment for a particular year, whole of the tax paid for the relevant year is transferred to the partner's capital account in their respective profit sharing ratio. The appellant is following this system of accounting for many years, which is duly vouched by generally accepted accounting principles and is also substantiated by the audited statements issued to the appellant by auditors. The system followed is also evidenced by one such transfer entry in respect of the assessment completed for the A.Y. 2007-2008 of Rs. 1630 lacs. In past assessments also, the system adopted by the appellant firm was accepted by the department and was not interfered with. Notwithstanding the above, the appellant has also been religiously following the fundamental accounting assumptions laid down vide Accounting Standards prescribed by the Income Tax Act under section 145 vide notification number SO 69(E) dated 25-01-1996. According to which, the accrual of debit of firm's tax to the partner's capital account is made only after the same is crystallized. Further, the practice is consistently followed in consonance of the principle of consistency under the cardinal accounting assumption of going concern. All these fundamental accounting assumptions are distinctly mentioned at clause 5 of the notification and elaborately defined at clause 6 of the same notification. For the principle of the consistency followed, the appellant relied on the judgement reported in [2013] 38 Taxmann.com 241 (High Court of Gujarat) in CIT II Vs. Patidar Oil Cake industries. The appellant further in its submission contended that, no borrowings were made for the

payment of taxes and consequently questions of any payment of interest on the same and consequently claiming it as an expense does not arise. In concluding the disallowance of interest u/s 36(1)(iii), the A.O has relied on the three cardinal principles governing the deduction under section 36(1)(iii). The A.O. herself at paragraph 4.1 of the order has observed that, "three conditions are required to be satisfied in order to enable the assessee to claim deduction in respect of interest on borrowed capital, namely: (1) that money (capital) must have been borrowed by the assessee. (2) That it must have been borrowed for the purpose of business or profession and (3) That the assessee must have paid interest on the said amount and claimed it as deduction u/s 36(1)(iii) - However, the AO failed to bring out any fact and instances of borrowings for payment of taxes and interest paid on such borrowings in the order. Hence, I am of the considered opinion that when any expenses of interest payment has not been claimed then its disallowance is not justified u/s 36(1)(iii) of the Act. In view of these facts, computation of interest on such debit balance of Advance tax account for which no borrowings were made is unjustified and therefore, the addition made on this account is deleted.

9. Secondly, the A.O computed interest on the debit balance of partners capital account and added the same to the returned income by disallowing the same from the total interest expenses claimed contending that, interest bearing funds received from the banks and others were utilized in advancing interest free loans to partners for their personal purposes. On the contrary, the appellant has submitted that, sufficient cash profits were available with the appellant for withdrawal by the partner. Appellant submitted following figures in their justification.

Position of Capital A/c of Sameer Maheshwari considering cash profit

(Rs. In Lacs)

Particulars	31.03.2006	31.03.2007	30.03.2008	31.03.2009	31.03.2010	Cumulative
Balance as per last Balance Sheet	0.00	-85.19	-27.43	10.24	142.83	0.00
Share in profit before depreciation	193.88	82.40	152.65	178.79	246.07	853.79
Sub Total	193.88	-2.79	125.22	189.03	388.90	853.79
Net Withdrawals During the Year	200.02	-0.25	113.14	-8.88	194.03	498.06

National debit Share in Firm Income Tax	79.5	24.89	1.84	55.08	13.03	173.89
Closing Balance	-85.19	-27.43	10.24	142.83	181.84	181.84

Position of Capital A/c of Nava Bharat Press (Raipur) Pvt. Ltd. Considering Cash Profit
(Rs.in Lacs)

Particulars	31.03.2006	31.03.2007	30.03.2008	31.03.2009	31.03.2010	Total
Balance as per last Balance Sheet	-25.83	0.86	10.42	42.13	72.81	-25.83
Share in profit before depreciation	48.47	20.60	38.16	44.70	6152	213.45
Sub Total	22.64	21.46	48.59	86.83	134.33	187.62
Net Actual withdrawals During Yr	2.02	4.81	6.00	0.25	15.00	28.08
National debit for Share in Firm Income Tax	19.76	6.22	0.46	13.77	3.26	43.48
Closing Balance	0.86	10.42	42.13	72.81	116.07	116.07

Appellant also stated that since the appellant is consistently following cash system of accounting, the above figures of profit share are actual cash profits generated from the business (i.e. without considering depreciation allowance deduction available as per IT Act since the same does not entail any physical cash outflow). I do find considerable force in the submission of the appellant that when this cash profit inflows are compared with the withdrawals of the partner, it is discernible that after deduction of withdrawals and also the share of notional debit in firm's tax, a surplus of Rs. 181.84 lacs remains reflected as closing balance. Even in the previous year relevant to assessment year 2010-2011, the withdrawals were Rs.194.03 Lacs against cash profit receipts of Rs. 246.07 lacs, leaving an abundant gap of Rs.52.04 Lacs sufficient to absorb the firm's tax. share of Rs.13.03 lacs in case of Capital account of Sameer Maheshwari. I am convinced with the explanation of the appellant that, the closing balance in case of other partner is Rs.116.07 lacs, enough to absorb firm's tax debit. I am convinced that there was sufficient non interest bearing funds available with the appellant firm for partner's withdrawal. The A.O has, in my considered view, disallowed the

interest without properly marshaling all the facts on record. This contention is well supported by various judgments cited above. The jurisdictional High Court of Chhattisgarh, in case of JCIT Vs. Beekay Engineering Corporation (2010) 325 ITR 384 (CG) has held that "Appellant firm had given interest-free advances to two members of HUF partner—ft is evident from the balance sheet of the appellant firm that there was sufficient fund in the account of the HUF as found by the Tribunal—-Besides, profit of Rs.46,81,943/- accrued to the firm in the relevant financial year—In these circumstances, the findings recorded by the Tribunal that no evidence is available on record to show that the borrowed funds were not utilized by the appellant for its own business but were diverted as advance to members of the HUF free of interest and, therefore, there is no justification in making part disallowance out of interest paid on borrowed funds". The Hon'ble Mumbai High Court in case of CIT Vs. Reliance Utilities & Power Ltd. 313 ITR 340 (Mum) has held that "The principal, therefore, would be that if there are funds available both interest free and overdraft and/ or loan taken, 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." Decisions of the Hon'ble Allahabad High -Court in the case of CIT Vs.Radico Khaitan Ltd. 274 ITR 354 (All), Hon'ble Delhi High Court in case of CIT Vs. Tin Box Co. 260 ITR 637 (Del) and Hon'ble Madras High Court in the case of CIT Vs. South India Corporation (Agencies) Ltd. 290 ITR 217 (Mad) are also in favour of the appellant. Looking to the facts and circumstances of the case as also decisions cited above, the disallowance of interest made by the A.O amounting to Rs.41,54,811/- cannot be sustained. Hence, the disallowance is deleted.

10. Another dimension of the argument of the appellant that payment of interest was commercially expedient has been examined. The appellant furnished the details of borrowed interest bearing funds for business in the current and prior years as under:

(Rs. In Lacs)

Sl.No.	Particulars of Loan	Purpose	Security offered	Interest paid (Rs.) in the year	Opening balance of the loan as at the beginning of year (Rs.)	Borrowings in the year	Repayment of the principle in the year	Amount of loan as at year end (Rs.)
Term Loans								
1.	ICICI/IDBI Bank Ltd	Machinery (purchased in prior year)	Partner's residential & commercial immovable property	23.53	156.34	Nil	12.64	143.70
2.	Corporation Bank	Newsprint (purchase in current year)	Rental Income of Firm and personal guarantee of partner	2.81	Nil	50.00	11.54	38.46
3.	HDFC Bank	Business Loan (prior years)	Personal Guarantee of Partner	1.28	11.19	Nil	7.16	4.03
4.	HDFC Bank Ltd. And IDBI Bank	Vehicle Loan	Hypothecation of vehicles & personal guarantee of partner	4.10	40.58	19.00	17.97	41.61
Working Capital Loan								
5.	Bank of Maharashtra	Business Loan	Partner's immovable property, personal guarantee of the partner and current assets of assessee firm	61.51	585.16	Nil	6.72	578.44
Unsecured Loan								
6.	From others		Personal goodwill of Partner	3.34	3.00	40.00	15.00	28.07

It has been argued that in case of the borrowings at serial numbers 1 to 4, the lenders have directly paid the loan disbursement amount to the supplier / dealer of the raw materials or capital assets. Thus, in any case contention of diversion of the interest bearing borrowed funds to the partners / sister concern by the appellant does not sustain. The appellant, for this proposition, relied on the judgement reported in. [2013] 36 CCH 352 (ITAT Delhi) in Metro Institute of Medical Sciences Pvt. Ltd. Vs. Dy. CIT. It has been further argued that the business loan borrowed from the lender at serial number 2 was necessitated, to obtain release of the bulk imported raw material consignment from the port after full payment. Since any delay in release of the import documents would have entailed heavy demurrage and penal charges, and therefore, as a matter of business prudence the funds were borrowed, which again were paid to supplier directly by the lending bank. The principal and interest repayment against this loan was promptly made by extending the rent income directly to the

lender bank's account, since they themselves were the tenants occupying the appellant's premises. Further the appellant also paid Rs.1 lac every month to reduce the interest liability at the earliest. It is seen that the unsecured interest bearing loans obtained as mentioned at serial number 6 have been directly received in the cash credit account of the appellant for further payment of the business expenditure. It is seen that the appellant has made repayment of Rs. 70.90 lacs worth principal amount, in respect of interest bearing loans during the relevant previous year. Considering the facts and evidences on record, in my considered view, the A.O has not established any nexus between interest bearing funds and diversion for non business purposes.

*It is seen that the partner has mortgaged his own fixed assets and has executed personal guarantees favouring financial institutions for obtaining loans for the purpose of business of the appellant firm. Thus, if the partner is in need of the funds, the only recourse available to the partner is to withdraw from the firm. If the firm had not allowed withdrawal of funds by the partner, the partner would have been constrained to dispose of the properties to meet his financial needs and this would have interrupted the credit facilities being enjoyed by the appellant firm. **In S. A. Builders Ltd. vs. Commissioner of Income Tax (Appeals) & ANR. (2006) 206 CTR (SC) 63J:(2007) 288 ITR 1 (SC):(2007) 158 Taxman 74 (SC)/ (2007) 158 Taxman 230 (SC)** the Apex Court held that interest on borrowed funds cannot be disallowed if the assessee has advanced interest-free loan to a sister-concern as a measure of commercial expediency. Relying on **Supreme Court** decision in **S.A. Builders Ltd. vs. CIT & Anr. (2006) 206 CTR (SC) 631 : (2007) 288 ITR 1 (SC)** it was held by Allahabad High Court in **CIT vs. Raj Kumar Singh & Co. (2007) 210 CTR (All) 483** interest paid by assessee on money borrowed for repayment of an interest-free advance was allowable as deduction. The assessee, as a prudent businessman, adopted the alternative of borrowing money from the market instead of liquidating its own assets. The same was held by the court as commercial expediency. Thus, I do find that it was commercially expedient for the appellant firm to allow withdrawal of funds b) the partner whose assets were being capitalized*

by the appellant firm. Looking to the facts and circumstances of the case as also decisions cited above, disallowance of Rs. 41,54,811/- u/s 36 (i)(iii) of the Act is unjustified and hence, deleted.”

6. We find that the DR relied on the order of AO. He could not point out any specific error in the order of CIT(A). The finding of CIT(A) that the assessee had sufficient non-interest bearing funds available with it for partners withdrawals, was not controverted by the DR by bringing any cogent and positive material on record. Further, the finding of CIT(A) that the payment of interest was commercially expeditent was examined by the AO in the current and prior years. Therefore, the contentions of AO for diversion of interest bearing borrowed funds to the partners of the sister concern of the assessee cannot be sustained, was also not controverted by the DR by brining any cogent and positive materials on record. Hence, we do not find any good and justifiable reason to interfere with the order of CIT(A), which is confirmed and the ground of appeal of the Revenue is dismissed.

7. In the result, appeal filed by Revenue is dismissed.

Order pronounced in the open court on this 15/01/2018.

Sd/-
(PAVAN KUMAR GADALE)

न्यायिक सदस्य / JUDICIAL MEMBER

Raipur; दिनांक Dated 15/01/2018

प्र.कु.मि/PKM, Senior Private Secretary

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant-
2. प्रत्यर्थी / The Respondent-
3. आयकर आयुक्त(अपील) / The CIT(A),
4. आयकर आयुक्त / CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, Raipur / DR, ITAT, Raipur

Sd/-
(N. S. SAINI)

लेखा सदस्य / ACCOUNTANT MEMBER

6. गार्ड फाईल / Guard file.

सत्यापित प्रति //True Copy//

आदेशानुसार/ BY ORDER,

(Senior Private Secretary)
Income Tax Appellate Tribunal, Raipur