IN THE INCOME TAX APPELLATE TRIBUNAL
DIVISION BENCH'A', CHANDIGARH

BEFORE SMT. DIVA SINGH, JUDICIAL MEMBER
AND DR. B.R.R. KUMAR, ACCOUNTANT MEMBER

ITA No.991/Chd/2013
(Assessment Year : 2010-11)

M/s Kudu Industries A-15, Phase VII Focal Point Ludhiana	Vs.	The ACIT Circle I Ludhiana

PAN/TAN: AAHFK9436B

(Appellant) (Respondent)

Assessee by : Shri Ashwani Kumar
Department by : Smt. Chandrakanta

Date of hearing : 07.02.2018
Date of Pronouncement : 02/05/2018

O R D E R

PER DR. B.R.R. KUMAR, A.M.:

The present appeal has been filed by the Assessee against the order of the Ld. CIT(A)-I, Ludhiana dt. 31/07/2013.

2. In the present appeal Assessee has raised the following grounds:

> *"1. That order passed under section 250(6) of the Income Tax Act, 1961 by the Ld. CIT(A)-I, Ludhiana is against law and facts on the file in as much as he was not justified to arbitrarily uphold the disallowance of Rs. 64,76,825/- out of interest account by resort to provisions of section 36(1)(iii).*
>
> *2. That he was further not justified to arbitrarily uphold the disallowance of Rs. 1,55,382/- [although the same is not added separately as the entire amount of interest debited to Profit and Loss Account has already been disallowed under section 36(1)(iii)] out of interest account on the ground that the same required to be capitalized as the assets have not been put to use."*

3. The ground no. 2 is not pressed by the assessee and accordingly not required to be adjudicated.

4. Brief facts of the case are that the assessee is engaged in the business of manufacturing, trading, and job work of yarn and fabrics. During the assessment proceedings the Assessing Officer observed that the assessee had made interest free advances to three persons which apparently did not serve any business purpose. The assessee submitted before the AO that the payments had been made to Ritu Saluja and M/s Shiv Narayan Investment (P) Ltd. to meet their temporary requirements. Further advance to Sh. Rajesh Kumar is under the category of advance to employee. The AO relying upon the judgment of Hon'ble Punjab & Haryana High Court in the case of CIT Vs. Abhishek Industries 286 ITR 1 disallowed the interest expenditure of Rs. 64,76,825/-.

5. The Ld. CIT(A) considered the basis of AO's conclusion and the arguments of the AR during assessment as well as appellate proceedings. He held that the assessee has relied upon the fact that it has sufficient internal accruals to fund the impugned advances and the same could not be said to be out of the interest bearing funds. The facts of the case clearly show that the assessee company's funds comprise of interest bearing funds as well as non interest bearing funds and the advances free of interest to persons concerned have been made without any business purpose. Relying on the judgment of Hon'ble Jurisdictional High Court in the case of Abhishek Industries Ltd. 286 ITR 1. Ld. CIT(A) has confirmed the addition.

6. Before us the Ld. AR has submitted that they have sufficient internal approvals in the form of partners capital to the tune of Rs. 50.60 Crores for the year ending 2009 and Rs. 61.55 Crores for the year ending 2010. It was argued that since the sufficient own funds are available no disallowance on account of interest under section 36(1)(iii) is called for pertaining to the advances given for a short period of 2 to 181 days of the total amount of Rs. 1.13 Crores. Further he relied on the judgment of the Hon'ble jurisdictional High Court in the case of Bright Enterprises.

7. Ld. DR has submitted her arguments in writing and requested that the case may be remanded back to the Assessing Officer to compute correct disallowance. The relevant part of the arguments reads as under:

> *1. There are two parts to the disallowance made u/s 36(l)(iii) which are as under:*
> ** Disallowance of Rs. 64,76,825/- on account of advance made to sister concern*

** Disallowance of Rs. 1,55,382/- on account of capital work in progress (CWIP)*

2. During the course of hearing on 17.01.2018 the Ld. AR filed a paper book and heavily relied upon the Punjab and Haryana High Court decision in the case of M/s Bright Enterprises wherein it has been held that in case there was sufficient own funds then it will be presumed that own funds were used to advance loan to sister concern.

3. In this regard, it is submitted that Hon'ble High Court in Bright Enterprise has held that the presumption is there that own funds are used for making advances to sister concern and for making investments. Hence corollary inference can be drawn that interest bearing/loan funds were used for creating capital assets and for CWIP. If this corollary inference is taken into account then the whole of interest expenditure claimed in the profit and loss is liable for disallowance as only interest bearing funds/loan funds were used for CWIP.

4. The assessing officer while computing the disallowances u/s 36(l)(iii) for CWIP has not taken into account the decision of HC in the case of Bright Enterprises but has computed proportionate expenditure after taking into consideration the entire own funds/interest free funds. Kind attention is drawn to the calculation of the assessing officer at page 13 wherein ratio of borrowed funds to own funds i.e. 0.08 as multiplying factor was taken into account while computing the interest disallowance w.r.t. CWIP. It is submitted that if the decision of Bright Enterprises is applied then only interest bearing funds (and not own funds) will have to be taken into consideration and that the multiplying factor would be 1 and not 0.08. The calculation of interest disallowance by applying the ratio of Bright Enterprise thus ought to have been as under:

Interest disallowable is (page 14 of assessment order) :

20,26,71,733 x 11.50% x-fOrQ8)= Rs. 19,42,275/-12

5. In view of the above, it is submitted that in case Bright Enterprise decision is considered for giving relief to the assessee w.r.t. advances given to sister concern, then it is requested that the ratio of this decision may also be applied to disallowance w.r.t. CWIP and that the matter may be remanded back to AO to compute the interest disallowance u/s 36(l)(iii) presuming that only loan funds were used to CWIP.

6. It is submitted that I place my complete reliance on the assessment order and decision of CIT(A) on the issue of disallowance on both the parts i.e. advance and CWIP. The submission in para 5 above is without prejudice to the order of AO and CIT(A) and is made only in case the decision of Bright Enterprise is applied by Hon'ble Bench on the issue of interest disallowances on advances given to sister concern.

8. Rebutting the arguments of the Ld. DR, the Ld. AR submitted his written arguments as under:

The appellant is agitating against the action of the Ld. Commissioner of Income Tax (Appeals) in upholding the disallowance of interest amounting to Rs. 64,76,825/-by-resort to the provisions of Section 36(1)(iii) on account of advances made to sister concerns. The appellant had respectfully submitted that the total amount of advances made to sister concerns was to the tune of Rs. 15.27 crores as on 31.03.2010 and the opening balance was Rs. 9.02 crores whereas capital of Partners as on 31.03.2010 was to the tune of Rs. 61.56 crores and the opening capital was Rs. 50.62 crores. Thus, the total capital of the Partners was much more

than the amounts advances and under these circumstances, it was submitted that no disallowance out of interest account u/s 36(1)(iii) is warranted.

The Ld. Senior D. R. has filed written submissions and it has been argued that disallowance of interest is justified in as much as the capital-work-in-progress stood at Rs. 1.88 crores and the presumption was that the loan funds that is term loan was used in the investment of capital-work-in-progress. In reply, it is respectfully submitted that the appellant firm had made payment of interest only in respect of existing term loans raised from bank. Fact of the matter is that no loan was raised during the year under appeal rather during the relevant year repayment of term loan was made as will be evident from copy of term loan account enclosed.

Further, it is respectfully submitted that the amount of capital-work-in-progress includes amount of building under construction as well as electric installation. Perusal of both these accounts will reveal that there is an opening balance of Rs. 1,62,53,728/-which is on account of building under construction. Factually construction of the building had started during A/Y 2009-10 and perusal of term loan account will reveal that even during A/Y 2009-10 no fresh term loan was raised. Thus, from the facts mentioned above emerges that the term loan raised from the bank was not used for the purpose of building under construction / electrical installation, i.e. capital-work-in-progress. It may further be submitted that the balance under the head electric installation is only Rs. 11,71,716. During A/Y 2009-10, the appellant firm had repaid a part of the term loan.

In nutshell, it can safely be stated that no part of the borrowed funds was used in the investment in capital-work-in-progress. Thus, disallowance of interest made by the Ld. Assessing Office and upheld by the Ld. CIT(A) deserves to be deleted.

9. We have gone through the arguments taken by the Ld. DR and the counter arguments Ld. AR and we find that pertaining to the capital work in progress there is a opening balance of Rs. 1.62 Crores and during the assessment year 2009-10 no fresh term loan has been raised. Crisply to say that the disallowance of interest under section 36(1)(iii) on advances confirmed by the Ld. CIT(A) based on the judgment in the case of Abhishek Industries Ltd. (supra) or the arguments of Ld. DR that disallowance is to be upheld based on the principle that the assessee utilized mixed funds for investment cannot be upheld. The reliance that the funds utilized by the assessee are mixed funds and it cannot be distinguished whether surplus funds or borrowed funds are used for the said investments cannot be accepted in view of the further development of the judicial pronouncements on the issue. When the assessee has got own funds available at their disposal no disallowance is called for as enunciated in various judgments. In the case of Bright Enterprises Pvt. Ltd. Vs. CIT (Punjab & Haryana High Court in ITA No. 224/2013 dt. 24/07/2015 it was held that if there are interest free funds available then it will be presumed that these have been made out of interest free funds. Similar view was held in the case of CIT Vs. Kapsons Associates Investment Pvt.

Ltd. [2015] 381 ITR 204 (P&H) wherein, the Hon'ble Court has held that interest on investment in other properties not for business purpose cannot be disallowed if the assessee is having sufficient interest free funds at its disposal. Similar view was taken in the case of Hero Cycles Pvt. Ltd. 63 Taxman 308 (Supreme Court) 2015 by the Hon'ble Supreme Court held that no disallowance is called for.

10. Keeping in view the facts and circumstances of the case and the judicial pronouncements we hereby direct that the disallowance made under section 36(1)(iii) be deleted.

11. In the result, the appeal of the assessee is allowed.

Order pronounced in the open court.

Sd/-	**Sd/-**
(DIVA SINGH)	**(DR. B.R.R. KUMAR)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Dated : 02/05/2018
AG
Copy to:

1. The Appellant
2. The Respondent
3. The CIT(A)
4. The CIT
5. The DR