

IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH "A", HYDERABAD
(Through Virtual Hearing)

BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER
AND
SHRI A. MOHAN ALANKAMONY, ACCOUNTANT MEMBER

ITA No.950/Hyd/2016		
Assessment Year:2009-10		
M/s. Talwar Auto Garages Pvt Ltd., Hyderabad. PAN: AAAC 8327 N	Vs.	DCIT, Circle-2(3), Hyderabad.
(Appellant)		(Respondent)
Assessee by:	Shri P. Murali Mohana Rao	
Revenue by:	Shri Sunil Kumar Pandey, DR	
Date of hearing:	06/01/2021	
Date of pronouncement:	07/01/2021	

ORDER

PER A. MOHAN ALANKAMONY, AM.:

This appeal is filed by the assessee against the order of the ld. CIT (A)-2, Hyderabad in appeal No. 0317/2014-15, dated 29/3/2016 passed U/s. 143(3) r.w.s 250(6) of the Act for the AY: 2009-10.

2. The assessee has raised fourteen grounds in its appeal however, the crux of the issue is that the Ld. CIT (A) has erred in confirming the order of the Ld. AO who had made addition of Rs. 25,71,531/- towards disallowance of interest with respect to the interest free loan extended to the Directors of the assessee-company.

3. The brief facts of the case are that the assessee is a Private Limited Company engaged in the business as Authorised Dealers for M/s. Eicher Motor India Limited for selling and servicing their vehicles, filed its return of income for the AY 2009-10 on 27/9/2009 declaring total income of Rs. 77,05,010/-. Thereafter, the case was taken up for scrutiny and the assessment was completed U/s. 143(3) of the Act on 30/6/2014 wherein the Ld. AO made the addition of Rs. 25,71,531/- towards disallowance of interest with respect to interest free loan extended to the Director of the assessee-company.

4. During the course of scrutiny assessment proceedings, it was observed by the Ld. AO that the assessee had outstanding receivables of Rs. 2,14,29,421/- from its Director. It was further revealed that the assessee-company had availed loan from bank for Rs. 1,18,34,513/- bearing interest. The assessee had argued before the Ld. AO that the amount was advanced to its Directors for construction of work-shop at Balanagar on the land owned by the Director who had executed hypothecation deed of the land to the assessee-company towards the loan extended to him and therefore, the transaction was for the business purpose of the assessee and hence the provisions of section 36(1)(iii) of the Act cannot be invoked for making addition by disallowing interest with respect to the interest free loan extended by the assessee. However, the Ld. AO opined that since the assessee had extended interest free loan to the Director of the assessee-company even when

the assessee-company was paying interest to the bank for the loan borrowed, the provisions of section 36(1)(iii) has to be invoked and accordingly, the interest @ 12% on the interest free loan extended to the Director of the assessee-company has to be disallowed. On appeal, the Id. CIT (A) confirmed the order of the Ld. AO by observing as under:-

“5.2. I have considered the above and I find that the action of the AO is justified in disallowing an amount of Rs. 25,71,531/- on the amount of Rs. 2,14,29,421/- advanced to its directors which was treated as not utilised for the purpose of assessee’s business. It is seen from the facts that the assessee has shown an amount of Rs. 2,14,29,421/- as receivable from its directors and the assessee has not charged any interest on the said advances. During the course of scrutiny, the assessee was asked to substantiate the nexus between the amounts advanced to the Directors and the purpose for which the same have been given to the Directors. In this regard, the assessee has furnished a deed of hypothecation cum works contract executed on 1/4/2007 by Sri Sunil Talwar in favour of M/s. Talwar Auto Garages for construction of auto garage. However, the AO noticed that the deed was not signed by the above two parties but signed by the AR of the assessee only. But for merely furnishing the deed of hypothecation cum works contract, the assessee has not furnished any evidence to substantiate its claim that the advances were given to its Directors for construction of auto garage. It is also seen that the assessee has availed loans from banks and debited interest on the amounts to the tune of Rs. 1,18,34,513/-. Thus, the assessee paid huge amounts by way of interest on account of heavy amounts advanced to its director bearing no relation whatsoever with the business purposes of the assessee. The AO was of the view that if the assessee had not advanced these amounts, the same would have been available to the assessee for its business purposes and to that extent, it may not have to be necessary to borrow from the banks or private parties.

5.3. After having gone through the above, I am of the considered view that during the appeal proceedings also, the AO has not established the nexus between the amounts advanced and the purposes for which the said advances are given to its directors. Therefore, the AO has rightly disallowed the proportionate interest @ 12% on the amount of Rs. 2,14,29,421/- advanced to the directors which works out to Rs. 25,71,531/-. Therefore, the said action of the AO is confirmed and the grounds raised in this regard are dismissed.”

5. At the outset, the Ld. AR submitted before us apart from the arguments advanced by the assessee before the Ld. Revenue Authorities that the assessee's capital and reserves more than the loan extended to the Director of the assessee-company which are interest free funds of the assessee company. It was therefore argued that the provisions of section 36(1)(iii) cannot be invoked in the case of the assessee and hence, it was pleaded that the disallowance of interest of Rs. 25,71,531/- may be deleted. The Ld. DR on the other hand vehemently argued in support of the orders of the Ld. Revenue Authorities and requested for confirming the same.

6. We have heard the rival submissions and carefully perused the materials on record, and we find merit in the submissions of the Ld. AR. On perusing the Balance Sheet of the assessee company it is evident that the assessee Company's paid-up equity share capital is Rs. 25,00,000/- and Reserves and surplus is Rs. 2,40,07,448/- aggregating to Rs. 2,65,07,448/- which is nothing but assessee's own non-interest-bearing fund. It is also apparent that the loan extended by the assessee company to its Director is only Rs.2,14,29,421/- which is much less than the interest free fund available with the assessee. There is no prohibition under the Act to conduct its entire business out of borrowed funds and to apply its own interest free fund to whatever purpose (business or non-business) as the assessee may deem fit. In this situation, it will be erroneous on the part of the Revenue to invoke the

provisions of section 36(1)(iii) of the Act and disallow interest on the interest free loan extended by the assessee company to any third party because the interest free loan is extended only out of the assessee's non-interest-bearing own fund. Therefore, we hereby direct the Ld. AO to delete the addition made for Rs. 25,75,531/- which was sustained by the Ld. CIT (A).

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

Pronounced in the open Court on Seventh January, 2021.

Sd/-
(P. MADHAVI DEVI)
JUDICIAL MEMBER

Sd/-
(A. MOHAN ALANKAMONY)
ACCOUNTANT MEMBER

Hyderabad, Dated: Seventh January, 2021.

OKK

Copy to:-

1.	M/s. Talwar Auto Garages Pvt Ltd C/o. P. Murali & Co., Chartered Accountants, 6-3-655/2/3, 1 st Floor, Somajiguda, Hyderabad – 500 082.
2.	DCIT, Circle-2(3), Hyderabad.
3.	The CIT (A)-2, Hyderabad.
4.	The Principal Commissioner of Income Tax-2, Hyderabad.
5.	The Departmental Representative, ITAT, Hyderabad.
6.	Guard File