

**IN THE INCOME TAX APPELLATE TRIBUNAL, 'B' BENCH  
MUMBAI**

**BEFORE: SHRI M. BALAGANESH, AM  
&  
SHRI RAVISH SOOD, JM**

**ITA No.5305/Mum/2019  
(Assessment Year :2013-14)**

**&**

**ITA No.5306/Mum/2019  
(Assessment Year :2014-15)**

M/s. Bada Saab Design Pvt. Ltd., 501, Krystal, 206, Waterfield Road, Bandra (W) Mumbai	Vs.	Income Tax Officer – 12(1)(3) Mumbai 1 <sup>st</sup> Floor, Aayakar Bhavan M.K.Road, Mumbai-400020
<b>PAN/GIR No.AACCB9445K</b>		
<b>(Appellant)</b>	..	<b>(Respondent)</b>

Assessee by	Shri B.V. Jhaveri
Revenue by	Shri Tharian Oommen
<b>Date of Hearing</b>	<b>09/03/2021 &amp; 04/06/2021</b>
<b>Date of Pronouncement</b>	<b>15/06/2021</b>

**आदेश / O R D E R**

**PER M. BALAGANESH (A.M):**

These appeals in ITA Nos. 5305/Mum/2019 & 5306/Mum/2019 for A.Y.2013-14 & 2014-15 arise out of the order by the Id. Commissioner of Income Tax (Appeals)-20, Mumbai in appeal No. CIT(A)-20/IT-

10198/2016-17 & CIT(A)20/IT-10515/2016-17 respectively dated 28/06/2019 (Id. CIT(A) in short) against the order of assessment passed u/s.143(3) of the Income Tax Act, 1961 (hereinafter referred to as Act) dated 10/03/2016 & 22/12/2016 respectively by the Income Tax Officer-12(1)-3, Mumbai (hereinafter referred to as Id. AO).

As identical issues are involved in both the appeals, they are taken up together and disposed of by this common order for the sake of convenience. With the consent of both the parties, the facts of Asst Year 2013-14 are taken up for adjudication and the decision rendered thereon would apply with equal force for Asst Year 2014-15 also except with variance in figures.

2. The only effective issue to be decided in this appeal of the assessee is as to whether the Id CITA was justified in upholding the interest disallowance made u/s 36(1)(iii) of the Act in the facts and circumstances of the case. The interconnected issue involved therein is as to whether the Id CITA was justified in treating the interest income from debentures to be taxed under the head 'income from other sources' as against 'income from business' offered by the assessee in the facts and circumstances of the case.

3. The brief facts of this issue are that the assessee is a private limited company carrying on business of dealing in garments. The assessee company had filed its return of income for the Asst Year 2013-14 on 30.9.2013 declaring total loss of Rs 6,81,41,247/-. The Id AO observed that assessee had taken loan of Rs 33 crores from M/s Indiabulls Financial Services Ltd (IBFSL in short) and paid interest thereon in the sum of Rs 4,68,55,519/-. The Id AO also observed that assessee company had

invested in debentures of KA Hospitality Pvt Ltd and earned interest income on debentures in the sum of Rs 99,00,000/-. We find that the assessee had claimed deduction towards net interest of Rs 3,69,55,519/- ( 4,68,55,519 – 99,00,000) u/s 36(1)(iii) of the Act in the return of income. This interest was disallowed by the Id AO u/s 36(1)(iii) of the Act on the ground that the borrowings were utilized for non-business purposes under the head 'income from business' and accordingly reduced the business loss claimed by the assessee thereon.

4. In first appeal, the Id CITA upheld the action of the Id AO in disallowing the interest u/s 36(1)(iii) of the Act . But the Id CITA proceeded to treat the interest income on debentures amounting to Rs 99,00,000/- to be taxed under the head 'income from other sources' and accordingly disallowed interest paid on borrowed funds u/s 36(1)(iii) of the Act to the tune of Rs 4,68,55,519/-. This action resulted in enhancement of income by Rs 99 lacs by the Id CITA. Aggrieved, the assessee is in appeal before us.

5. The Id AR argued that the borrowed funds from IBFSL were utilised by the assessee by investing in 3300000 debentures of KA Hospitality Pvt Ltd of Rs 100 each and that these debentures are convertible into equity and accordingly it is a business decision taken in long term interest by the assessee company to subscribe to convertible debentures. He submitted that KA Hospitality Pvt Ltd is engaged in the business of bringing uber-luxury stand-alone world class restaurants and serving authentic cuisine in India. He further stated that considering the profile of M/s. KA Hospitality Pvt. Ltd. and opening of Hakkasan and Yauatcha Restaurants in India by signing Master Franchise Agreements with M/s. Hakkasan Limited, the assessee company decided to invest

Rs.33 crores in convertible debentures of M/s. KA Hospitality Pvt. Ltd, so that the assessee company can eventually participate in the equity of M/s. KA Hospitality Pvt. Ltd. He also submitted that on the said borrowings from IBFSL, the assessee company paid interest of Rs 17,04,247/- for the period from 19.3.2012 to 31.3.2012 relevant to Asst Year 2012-13 and received interest income on debentures amounting to Rs 10,849/- in Asst Year 2012-13. The net interest paid for Asst Year 2012-13 amounting to Rs 16,93,398/- was disallowed by the Id AO u/s 36(1)(iii) of the Act. He stated that the Id CITA had deleted this disallowance made towards net interest u/s 36(1)(iii) of the Act for the Asst Year 2012-13 vide his order in Appeal No. CIT(A)-20/DCIT-12(1)(2)/IT-83/2015-16 dated 29.6.2017 and that the revenue had not preferred further appeal before this Tribunal against the said order. Hence the fact of borrowings and its utilization was accepted by the revenue as meant for business purposes.

5.1. The Id AR further argued that majority of shareholders of assessee company and KA Hospitality Pvt Ltd are common and assessee company itself is holding 8.55% of shares in KA Hospitality Pvt Ltd. Hence he argued that the assessee had only invested in convertible debentures of its sister concern. It was also argued that the assessee company is authorised to diversify its business and to carry on another business of Hospitality as per its objects clause in Memorandum of Association. He further argued that this investment decision was further approved by the Board of Directors of the assessee company. He placed reliance on the decision of *Hon'ble Andhra Pradesh High Court in the case of CIT vs Peninsular Investment Ltd reported in 29 taxmann.com 422 (AP)*. The Id AR also placed

reliance on the decision of *Hon'ble Jurisdictional High Court in the case of PCIT vs. Khyati Realtors P. Ltd reported in 108 taxmann.com 449( Bom) dated 30.4.2009.*

5.2. The Id AR further argued that the fact of investment in convertible debentures in a company as business investment, could also be looked into from a different perspective. He stated that M/s KA Hospitality Pvt Ltd had a very bright future in Restaurant Business and therefore, the investment in debentures of M/s. KA Hospitality Pvt. Ltd. was a business decision taken on the grounds of commercial expediency of the assessee company. In support of this, he placed reliance on the decision of *Hon'ble Supreme Court in the case of S A Builders Ltd vs CIT reported in 288 ITR 1 (SC).*

5.3. The Id AR also filed a written reply on 4.6.2021 in response to the queries raised by the bench wherein it was stated that the hospitality business was carried on only by M/s KA Hospitality Pvt Ltd and not by the assessee and that the assessee company had merely invested in convertible debentures thereon. Since M/s KA Hospitality Pvt Ltd had incurred losses upto Asst Year 2018-19, the assessee company did not receive any income from hospitality business other than interest on debentures. It was also stated that the assessee company, in order to meet its financial crisis, sold about 50% of its debentures in Financial Year 2017-18 at Rs 117.50 per debenture and earned long term capital gains thereon, which was duly offered to tax in Asst Year 2018-19. It was also stated that M/s KA Hospitality Pvt Ltd on 22.3.2017 had extended the date of conversion of debentures into equity shares for a

further period of 5 years and therefore the debentures were not converted into equity. It was further stated that the fixed assets of M/s KA Hospitality Pvt Ltd had increased from Rs 51.79 crores in Asst Year 2012-13 to Rs 89.26 crores in Asst Year 2018-19 which proves that the huge investments were made for creating business assets for running restaurant business from the funds received from subscription of debentures.

5.4. Per Contra, the Id DR vehemently defended the orders of the lower authorities by stating that the revenue had not preferred any appeal before this tribunal for the Asst Year 2012-13 due to low tax effect on disputed issues thereon by following the CBDT Circular. Hence as such the plea of the assessee has not been accepted by the revenue in Asst Year 2012-13. Moreover, the assessee has conveniently chosen to invest in debentures of its sister concern i.e M/s KA Hospitality Pvt Ltd by using the borrowed funds, which had yielded only 3% return in the form of interest on debentures, whereas the interest paid on its borrowings were several times more than the interest received. Hence this is a scheme adopted by the assessee to divert its borrowed funds to its sister concern and also enjoy the benefit of paying lesser taxes in its hands.

6. We have heard the rival submissions and perused the materials available on record. We find that there is absolutely no dispute that the borrowed funds of Rs 33 crores from IBFSL had been utilized in investment in convertible debentures of M/s KA Hospitality Pvt Ltd (sister concern) of the assessee company. At the outset, we find that the borrowings were made in Asst Year

2012-13 and utilization of the same by way of making investment in convertible debentures of M/s KA Hospitality Pvt Ltd was also made in Asst Year 2012-13. The assessee had paid interest of Rs 17,04,247/- for the period 19.3.12 to 31.3.12 relevant to Asst Year 2012-13 and received interest income on debentures of Rs 10,849/- in Asst Year 2012-13. The net interest paid for Asst Year 2012-13 amounting to Rs 16,93,398/- was disallowed by the Id AO u/s 36(1)(iii) of the Act which was deleted by the Id CITA. The Id DR pointed out that the revenue could not prefer any appeal before this tribunal against this order on the ground of low tax effect on disputed issue due to circular issued by CBDT. Accordingly, we hold that the issue of allowability of interest paid on loans need to be examined independently in Asst Year 2013-14 de hors the fact of non-filing of appeal by the revenue before us for Asst Year 2012-13.

6.1. It is not in dispute that the assessee had earned interest income on debentures investment at the rate of 3% per annum amounting to Rs 99 lacs during the year under consideration. The same rate of return was stated to be earned in subsequent years also on the value of debentures held in respective years. It is a fact that the assessee is paying interest on its borrowings at an approximate rate of 14% interest per annum. Hence there arises a controversy as to whether any prudent businessman would borrow money at the rate of approximately 14% and invest in debentures to earn interest at the rate of 3%. Even though the investment in convertible debentures was made by the assessee in its sister concern, it is for the assessee to prove that either it or its sister concern was benefitted out of the investment

made in convertible debentures. Originally the investment in convertible debentures were made only for a period of 5 years by the assessee. It is a fact on record that on 22.3.2017, M/s KA Hospitality Pvt Ltd had extended the date of conversion of debentures into equity shares by further 5 years. Moreover, it is also a fact on record, as is evident from the submissions made by the assessee on 4.6.2021 that M/s KA Hospitality Pvt Ltd had incurred losses upto Asst Year 2018-19. Hence already the funds of the assessee company (by way of investment in debentures) had been locked with M/s KA Hospitality Pvt Ltd from March 2012 onwards. Infact as per the submissions of the assessee on 4.6.2021, the assessee, in order to meet its financial crisis, had sold 50% of its debentures in Asst Year 2018-19 and declared long term capital gains thereon. Here comes the aspect of business prudence in making investment in convertible debentures in sister concern. Despite knowing the fact that M/s KA Hospitality Pvt Ltd was incurring huge losses continuously, the assessee company chose to sell only 50% of its debentures in Asst Year 2018-19 thereby continuing to have the financial strain in its books. It is a fact on record, that despite the fact that M/s KA Hospitality Pvt Ltd had indeed opened various retail outlets having international brands in various Tier I cities upto 2017, it was still incurring only losses and assessee company was not able to get any benefit or return other than meagre return of interest on debentures at the rate of 3%. It is also fact on record that the assessee is dealing in garments and that the Hospitality industry is totally new stream of activity to the assessee. That `s why it is dependent on its sister concern. In the instant case, since its sister concern was already in the said

industry with well established international brands thereon, the assessee has chosen to make investment in debentures in its sister concern by using borrowed funds. Then what is the benefit that is derived by the assessee by making this investment (other than meagre debenture interest of 3%) would become crucial for the purpose of our adjudication of allowability of interest paid u/s 36(1)(iii) of u/s 57(iii) of the Act. We feel that the overall benefit derived by the assessee out of this investment needs to be looked holistically and should be brought on record. Though the fixed assets of M/s KA Hospitality Pvt Ltd had increased substantially, we find that there is no finding given by the Id CITA to prove that the said increase in fixed assets had happened out of amounts received from assessee in the form of debenture investment. We find that this finding would be crucial for adjudication of the issue in dispute. Further, we find that no finding is given by the Id CITA to prove that M/s KA Hospitality Pvt Ltd was benefitted out of the amounts received in the form of debenture investment by using the said funds for the purpose of its business. Without this finding, the ratio laid down by the Hon'ble Apex Court in the case of SA Builders Ltd reported in 288 ITR 1(SC) cannot be applied directly. Hence the reliance placed on the same by the Id AR is totally misplaced at this juncture.

6.2. We further find that the Id AR had placed reliance on the decision of *Hon'ble Andhra Pradesh High Court in the case of CIT vs Peninsular Investment Ltd reported in 29 taxmann.com 422 (AP)* in support of its contentions. On perusal of the said decision, we find that in that case, that assessee was engaged in the business of investment in shares and loans were borrowed

from one group company to make investment in shares of other group company. Since that was a case of investment company, the interest paid on loans was allowed u/s 36(1)(iii) of the Act. Infact the Hon'ble High Court even held that holding of shares is also part of doing investment in shares. Whereas in the instant case, the debentures remained as such without getting converted into equity which is evident from the fact that on 22.3.2017, M/s KA Hospitality Pvt Ltd had extended the date of conversion of debentures into equity for a further period of 5 years. Hence we hold that the reliance placed on this decision would not advance the case of the assessee as it is factually distinguishable.

6.3. We further find that the Id AR had placed reliance on the decision of *Hon'ble Jurisdictional High Court in the case of PCIT vs Khyati Realtors P Ltd reported in 108 taxmann.com 449 (Bom)* in support of its contentions. On perusal of the said decision, we find that in that case , that assessee was engaged in the business of development of real estate as well as financing. Hence amount advanced in the sum of Rs 10 crores to Bhansali Developers for booking commercial space in an upcoming construction project, which eventually failed to materialize and subsequently the monies became irrecoverable, which was sought to be written off by that assessee. In that factual matrix of the case, the said write off of the sums were allowed as business loss by the Hon'ble Jurisdictional High Court. In the instant case, the assessee company is engaged in the business of garments and had made investment in convertible debentures in its sister concern engaged in hospitality industry. Moreover, there is no question of claiming of any write off as business loss in the

instant case before us. It is nobody's case that the investment in convertible debentures made by the assessee company in M/s KA Hospitality Pvt Ltd had become bad which requires to be written off and consequentially allowable as business loss. Hence the reliance placed on this decision by the Id AR would not advance the case of the assessee as it is factually distinguishable.

6.4. We find that the Id CITA had enhanced the income by treating the interest income on debentures of Rs 99 lacs to be taxed under the head "income from other sources" and disallow the entire gross interest paid on loans amounting to Rs 4,68,55,519/- u/s 36(1)(iii) of the Act. Since the aforesaid issue of allowability of interest paid is set aside to the file of the Id CITA as mentioned supra, this interconnected issue of interest income on debentures getting taxed as income from other sources is also set aside to the file of Id CITA for fresh adjudication in the light of aforesaid directions. The Id CITA is directed to give categorical finding on the aforementioned issues in a holistic way and then decide the issue of allowability of interest paid on loans and taxability of income head for interest income on debentures , in accordance with law. Needless to mention that the assessee be given reasonable opportunity of being heard. The assessee is also given liberty to file fresh evidences, if any, in support of its contentions. Accordingly, the grounds raised by the assessee are allowed for statistical purposes for both the assessment years 2013-14 and 2014-15.

**7. In the result, both the appeals of the assessee are allowed for statistical purposes.**

Order pronounced on 15/06/2021 by way of proper mentioning in the notice board.

**Sd/-  
(RAVISH SOOD)  
JUDICIAL MEMBER**

**Sd/-  
(M.BALAGANESH)  
ACCOUNTANT MEMBER**

Mumbai; Dated 15/ 06/2021  
KARUNA, *sr.ps*

**Copy of the Order forwarded to :**

1. The Appellant
2. The Respondent.
3. The CIT(A), Mumbai.
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//

BY ORDER,

(Asstt. Registrar)  
ITAT, Mumbai