

आयकर अपीलीय अधिकरण, 'ए' न्यायपीठ, चेन्नई
IN THE INCOME TAX APPELLATE TRIBUNAL, 'A' BENCH, CHENNAI
श्री महावीर सिंह, उपाध्यक्ष एवं श्री जी. मंजुनाथ, लेखा सदस्य के समक्ष
BEFORE SHRI MAHAVIR SINGH, VICE-PRESIDENT
AND SHRI G.MANJUNATHA, ACCOUNTANT MEMBER

आयकरअपीलसं./I.T.A.No.3358/Chny/2019

(निर्धारणवर्ष / Assessment Year: 2005-06)

The Assistant Commissioner of Income Tax, Circle-I(1) Chennai-34.	Vs	M/s. TCP Ltd. 10, TCP SapthagiriBhavan Karpagambal Nagar, Mylapore, Chennai-600 004.
		PAN: AACT 3615K
(अपीलार्थी/Appellant)		(प्रत्यर्थी/Respondent)

अपीलार्थीकीओरसे/ Appellant by	:	Mr. G.Johnson, Addl.CIT
प्रत्यर्थीकीओरसे/Respondent by	:	Mrs.S.Vidya, C.A

मुनवाईकीतारीख/Date of hearing	:	06.07.2021
घोषणाकीतारीख /Date of Pronouncement	:	09.08.2021

आदेश / ORDER

PER G.MANJUNATHA, AM:

This appeal filed by the Revenue is directed against the order of the learned CIT(A)-18, Chennai dated 13.09.2019 and pertains to assessment year 2005-06.

2. The Revenue has raised the following grounds of appeal:-

"1. The order of the learned Commissioner of Income Tax (Appeals) is erroneous on facts of the case and in law.

2. Whether on the facts and in the circumstances of the case, the Id. CIT(A) was correct in deleting the interest disallowance of Rs.4,39,58,399/-?

3. Whether on the facts and in the circumstances of the case, the Id. CIT(A) was correct in not appreciating the fact that the general reserve and balances in Profit and Loss account cannot be considered as liquid cash available for immediate disbursement?

4. Whether on the facts and in the circumstances of the case, the Id. CIT(A) was correct in not appreciating the fact that the general reserve and balances in P&L account being non-liquidable, immediate source for interest free advances is from its CC account held with bank, an interest bearing borrowing?

5. For these grounds and any other ground including amendment of grounds that may be raised during the course of the appeal proceedings, the order of learned CIT(Appeals) may be set aside and that of the Assessing Officer be restored.”

3. Brief facts of the case are that the assessee is a domestic company engaged in the business of manufacture and sale of chemicals and generation of power filed its return of income for the assessment year 2005-06 on 31.10.2005 declaring total income of ₹ Nil under the normal provisions of Income Tax Act, 1961 and book profit of Rs.35,10,88,600/- u/s.115JB of the Act. The assessment for impugned assessment year has been completed u/s.143(3) of the Act, on 28.12.2017 and determined total income of Rs.30,26,90,998/- by making additions towards disallowance of proportionate interest

towards diversion of interest free funds to related parties without charging any interest.

4. The assessee carried the matter in appeal before the learned CIT(A) and the learned CIT(A) for the reasons stated in his appellate order dated 13.09.2019 and by following the decision of ITAT., Chennai in assessee's own case for assessment year 2004-05 in ITA No.1629/Chny/2018 dated 08.05.2019, deleted additions made by the Assessing Officer towards disallowance of proportionate interest by holding that no interest bearing funds has been used for advance loans to related parties and consequently, proportionate interest incurred on loans cannot be disallowed. Aggrieved by the learned CIT(A) order, the Revenue is in appeal before us.

5. The learned DR appearing for the Revenue submitted that learned CIT(A) has erred in deleting interest disallowance without appreciating fact that the assessee has diverted interest bearing funds to related parties for non-business purposes and hence, proportionate interest relating to diversion of funds needs to be disallowed. The learned DR further submitted that

learned CIT(A) was not correct in holding that the assessee has given loans out of its own funds being general reserves without appreciating the fact that general reserve and balance of profit & loss account cannot be considered as liquid cash available for immediate disbursement.

6. The learned AR for the assessee, on the other hand, submitted that the issue is squarely covered in favour of the assessee by the decision of ITAT in assessee's own case for assessment year 2004-05 in ITA No.1629/Chny/2018, where the Tribunal by following decision of the Hon'ble Bombay High Court in the case of CIT Vs. Reliance Utilities & Power Ltd. (313 ITR 340) held that when mixed funds are used for giving loans and advances, a general presumption goes in favour of the assessee that loans and advances are given out of its own funds, and consequently, no disallowance can be made towards proportionate interest expenses.

7. We have heard both the parties, perused material available on record and gone through orders of the authorities below. The issue is squarely covered in favour of the assessee

by the decision of the Tribunal in assessee's own case for assessment year 2004-05, where the Tribunal by following mixed funds theory in light of the decision of Hon'ble Bombay High Court in the case of CIT Vs. Reliance Utilities & Power Ltd. (supra), held that when interest free loan is extended they are firstly sourced out of interest free funds and if it is not sufficient to cover up the entire extent of interest free loan, the balance is met out of interest bearing funds. The Tribunal further noted that in the present case, the assessee has sufficient own funds being share capital, reserves and balance in profit & loss account, which is sufficient to cover loans given to related parties without any interest and hence, no interest could be disallowed for diversion of funds to related parties. The relevant findings of the Tribunal are as under:-

"6. We have heard the rival submissions and carefully perused the materials on record. From the facts of the case, it is apparent that the loan extended by the assessee company to its sister concerns are less than the aggregate of the assessee's equity share capital, general reserves, accumulated profits and Reserves and the same is not in dispute. It is also apparent that the assessee company has been consistently utilizing the cash generated from equity share capital, general reserves, accumulated profits and surplus for its business purposes. During the relevant assessment years it appears that

the assessee company has obtained interest bearing loan and passed on the same to its sister concerns as interest free loans. From the above facts, it is obvious that the assessee company might have diverted its interest bearing funds to its sister concerns as interest free loan. Nevertheless it is also pertinent to mention that the assessee's own funds such as equity share capital, general reserves, accumulated profits and surplus are much more than the interest free loan extended to the assessee's sister concern. As pointed out by the Ld.AR there is no prohibition under the Act for the assessee company to conduct its business entirely out of borrowed funds and in such situation, the interest expenditure incurred by the assessee is allowable as deduction as per the provisions of the Act. Further the assessee company is also at liberty to deploy its entire interest free funds in whatsoever manner it deems fit subject to the sanctions granted under the Memorandum of Association of the assessee company and yet carry out its business sourced from interest bearing funds. In an identical situation in the case CIT vs. Reliance Utilities And Powers Ltd., reported in 313 ITR 340 wherein the assessee had equity share capital of Rs.180 crores, reserves & surplus — Rs,120.80 crores, depreciation reserves of Rs.95.39 crores aggregating to Rs.398.19 crores, the Assessing Officer had recorded a finding that the sum of Rs.213 crores was invested out of the assessee's own funds and Rs.147 crores was invested out of borrowed funds and therefore disallowed interest amounting to Rs.4.4 crores calculated at 12% per annum for 3 months from Jan' 2000 to Mar' 2000, the Hon'ble Bombay High Court had held that:

“if there were funds available both interest free and overdraft and/or loans 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. In this case this presumption was established considering the finding of fact both by the Commissioner (Appeals) and the Tribunal. The interest was deductible.

6.1 Further in the case CIT vs. Hotel Savera reported in 239 ITR 795 wherein the facts were that:

“The assessee was a registered firm and its original assessment for the assessment year 1972-73, was completed allowing a certain amount of interest paid by the assessee on its borrowing for the purpose of business, Later, the Revenue audit pointed out that some of the moneys which the assessee had borrowed had been utilized for the advance of loans to a private limited company and on such lending no interest had been charged. Reassessment proceedings were started and a part of the interest was disallowed. The Tribunal found that the total amount in the partners’ capital and current account was greater than the amount advanced to the private company. The Tribunal found that the amount borrowed by the firm had been mixed with its own funds and hence the presumption was that the amount had been advanced by the firm on its own funds. It allowed deduction of the entire amount of interest on borrowed capital.

Subsequently the Hon’ble Jurisdictional Madras High Court held that

“there was a total amount credited in the partners’ capital as well as current account. A sum of Rs,10,95,010 was arrived at in the partner’s account after taking note of all the drawings made by them and the losses that were incurred in the business for the year ended on March 31,1972. Even after debiting the

drawings and the loss in the business, the Jcts showed that there were sufficient funds with the firm to cover the entire advance to the private limited company. The Revenue had not made any attempt before the Tribunal to show that the firm had paid interest on the amount outstanding in the accounts of the partner. There was no finding either by the assessing authority or by the Appellate Assistant Commissioner or by the Tribunal that the firm had paid interest to the partners on the credit balance. In such a situation, the position that remained was that the firm had its own funds as well as borrowed funds. It was not clear that the firm had not advanced money out of its own funds and in the absence of any materials to indicate that the firm had advanced moneys to the private limited company out of funds borrowed for business purposes. the presumption would arise, where there was a common fund, that the money advanced came only out of its own funds. The Tribunal was right in holding that no part of the interest should be disallowed especially in the absence of any finding that the money borrowed was advanced to the private limited company free of interest.

6.2 Further on similar situation this Bench of the Tribunal on identical situation in the case M/s. TIL Healthcare Pvt. Ltd. in ITA No. 2416/Chny/2017 vide order dated 17.04.2018 following the decision of the Hon'ble Jurisdictional Madras High Court in the case CIT vs. Hotel Savera and the decision of the Hon'ble Bombay High Court in the case CIT vs. Reliance Utilities & Power Ltd., deleted the addition made by the Ld.AO when the assessee had interest free funds such as share capital and reserves & surplus in excess to the interest free loan extended based on the presumption that interest free loan was extended sourced from its interest free funds.

6.3 *It is a well known fact that when funds are pooled in together they get intrinsically mixed up and cannot be physically identified as to from which source such funds have been sourced. It is akin to a situation when a pile of water is accumulated from different source then the identity of the source loses its characteristics. In such situation various higher Judiciary has held that when funds from different source such as non interest bearing source(own source) and interest bearing source such as equity share capital, general reserves, accumulated profits, Reserves and interest bearing loan received are mixed up by way of introducing them in the books of accounts then there is a presumption that when interest free loan is extended they are firstly sourced out of interest free funds and if it not sufficient to cover up the entire extend of interest free loan the balance is met out of interest bearing funds. In the case of the assessee, the assessee's equity share capital, general reserves, accumulated profits and Reserves exceeds the interest free loan extended during the relevant assessment years and the same is not in dispute. Therefore the facts in the case of the assessee are identical to the case decided by the Hon'ble Jurisdictional Madras High Court, Hon'ble Bombay High Court, and the Chennai Benches of the Tribunal cited herein above. Hence respectfully following the decision of the higher Judiciary we hereby direct the Ld.AO to delete the addition made by disallowing the proportionate interest towards the interest free loan extended for all the relevant assessment years in appeal before us. It is also pertinent to mention that the decision cited by the Ld. DR in the case K.Somasundram & Bros supra has no application to the case of the assessee because there is no finding in that case regarding the equity share capital, general reserves, and*

accumulated profits and Reserves of the assessee company to be in excess of the interest free loan extended.”

8. In this view of the matter and consistent with the view taken by the co-ordinate Bench, we are of the considered view that there is no error in the findings recorded by the learned CIT(A) to delete disallowances made by the Assessing Officer towards proportionate interest and hence, we are inclined to uphold findings of the learned CIT(A) and dismiss appeal filed by the Revenue.

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

Order pronounced in the open court on 9th August, 2021

Sd/-
(महावीर सिंह)
(Mahavir Singh)
उपाध्यक्ष/ Vice-President

Sd/
(जी. मंजुनाथ)
(G. Manjunatha)
लेखा सदस्य / Accountant Member

चेन्नई/Chennai,
दिनांक/Dated 9th August, 2021
DS

आदेश की प्रतिलिपि अग्रेषित/Copy to:

1. Appellant
2. Respondent
3. आयकर आयुक्त (अपील)/CIT(A)
4. आयकर आयुक्त/CIT
5. विभागीय प्रतिनिधि/DR
6. गार्ड फाईल/GF.