

IN THE INCOME TAX APPELLATE TRIBUNAL
“C” BENCH : BANGALORE

BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER
AND SMT. BEENA PILLAI, JUDICIAL MEMBER

ITA No.314/Bang/2019
Assessment year : 2013-14

M/s. Davanam Constructions Private Limited, No.148, Surveyor Street, Basavanagudi, Bengaluru – 560 004. PAN: AABCD 3880H	Vs.	The Deputy Commissioner of Income Tax, Circle 2(1)(2), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Nitesh Ranjan, CA
Respondent by	:	Shri H. Kabila, Addl.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	27.08.2021
Date of Pronouncement	:	07.09.2021

ORDER

Per Chandra Poojari, Accountant Member

This appeal by the assessee is directed against the order dated 17.12.2018 of the CIT(Appeals)-2, Bengaluru for the assessment year 2013-14 on the following grounds :-

	Grounds of Appeal	Tax effect relating to each ground of appeal
1.	The order of the Ld. Commissioner of Income Tax (Appeals) is opposed to law, facts and circumstances of the case.	- NA -

2.	The order is passed in haste, without providing sufficient and reasonable opportunity of being heard.	- NA -
3.	The order is passed against the principle of natural justice and thus liable to be quashed.	- NA -
4.	On the facts and circumstances of the case and in law, the Ld. CIT(A) erred in confirming the action of Ld. Assessing Officer in respect of disallowance of Rs.40,46,607/- under section 36(1)(iii) of the Act.	Rs. 12,50,402/-
5.	The Ld. Assessing Officer has grossly erred in not appreciating the fact that the borrowings were specifically utilized for the "purpose of the business" as required by section 36(1)(iii) of the Act.	
6.	The Ld. CIT(A) and the Ld. Assessing Officer has failed to comprehend the fact that the Appellant had advanced interest free loans to its subsidiary, Amethyst Hospitality (P) Ltd, on the grounds of commercial expediency and the same was utilized by Amethyst Hospitality (P) Ltd for their business operations.	
7.	The Ld. CIT(A) and the Ld. Assessing Officer has failed to appreciate the fact that the transaction was in the nature of shareholders' activity or stewardship activities.	
8.	The Ld. CIT(A) erred in upholding the levy of interest by the Ld. AO under section 234B & 234C of the Act.	Rs. 4,54,563/-
Total tax effect		Rs.17,04,965/-

2. The facts of the case are that there was a disallowance of Rs. 40,46,607/- by invoking the provisions of Section 36 (i) (iii) r.w.s. 37 of Income Tax Act, 1961 [the Act]. The assessee submitted that an amount of Rs. 7.1 Crores was transferred to subsidiary Amethyst Hospitality (P) Ltd

and Rs.6.9 Crores was used for investment in its subsidiary Davanam Constructions Sdn Bhd, Malaysia. Out of the amounts advances to Amethyst Hospitality (P) Ltd., Rs. 1.9 Crores was for investments and Rs. 5.22 Crores was given as interest free advance for its business. The proportionate financial costs on interest free advances made to the subsidiary (Amethyst Hospitality Private Limited) of Rs. 5.22 crores was disallowed which worked out to an amount of Rs. 40,46,607/- u/s 36(1)(iii) r.w.s 37 of the Act and added to the income. The Assessing Officer on examination has held that the amount spent by the assessee on its subsidiary in Malaysia is allowable, as it is in the same line of business and there is some commercial expediency in advancing the amount to it. But the subsidiary, Amethyst Hospitality Private Limited, is in hospitality business and there is no connection whatsoever between the assessee's business of 'land development and construction' and hospitality done by the other company. In such circumstances, the payment of interest by the assessee on loans which were utilized by its subsidiaries for some other unrelated field of business is not allowable as per AO.

3. On appeal, the CIT(Appeals) observed that as per the facts on record by the AO vis-à-vis the proposition of law laid down by the Supreme Court in Dalmia's case that since the sister concern was a subsidiary and the assessee company being the holding company had interest in its subsidiary, hence the loan advanced to subsidiary was out of commercial expediency. From the perusal of the balance sheet, he found that there was increase in loans and fixed assets, therefore it could not be said that assessee was having sufficient interest free funds available with it. Moreover the subsidiary is totally in different line of business which is land development and construction and hospitality and it cannot be said that there was commercial expediency. Therefore keeping in mind the proposition of law laid down by the Supreme Court, the CIT(A) held that the

AO was justified in disallowing the proportionate financial costs on interest free advances made to the subsidiary u/s.36(1)(iii) r.w.s. 37 of the Act. Against this, the assessee is in appeal before us.

4. The Id. AR submitted that the borrowings were specifically utilized for the purpose of business as required u/s. 36(1)(iii) of the Act. The assessee had advanced interest free loans to its subsidiary, Amethyst Hospitality (P) Ltd. on the commercial expediency and the same was utilized by the subsidiary for its business operations. The transaction was in the nature of shareholders activity or stewardship activities.

5. The Id. DR submitted that the assessee has advanced interest-free loan to its subsidiary out of borrowed funds and has not derived any business advantage by advancing such a huge amount and there was no commercial expediency to advance such loan. Being so, it is not a business expenditure to allow as a deduction u/s. 36(1)(iii) r.w.s. 37 of the Act.

6. We have heard both the parties and perused the material on record. In this case, the assessee advanced an amount of Rs.7.1 crores to Amethyst Hospitality (P) Ltd. and Rs.6.9 crores to Davanam Constructions Sdn Bhd, Malaysia. With regard to amount advanced to the subsidiary, Davanam Constructions, the AO allowed the interest on loan holding that there was commercial expediency. However, with regard to the amount advanced to Amethyst Hospitality (P) Ltd. which is in hospitality business the AO observed that there was no connection between assessee's business of land development and construction and the hospitality business done by the subsidiary, as such payment of interest such loan was disallowed by the AO and the CIT(Appeals). We have carefully gone through the financial statements of M/s. Amethyst Hospitality (P) Ltd. for the year ended 31.3.2013 at page 282 of PB which shows as under:-

Particulars	As on 31.3.2013	As on 31.3.2012
Note 9		
<u>Long-term Loans and Advances</u>		
<u>Unsecured, Considered Good</u>		
Loans and Advances to Related Parties	2,33,77,864	2,24,50,981
Deposits	6,00,000	-
Capital Advances	8,00,00,000	19,27,99,870
	10,39,77,864	21,52,50,851

7. It shows that after receiving the loan from the assessee, the said subsidiary Amethyst Hospitality (P) Ltd. advanced to related parties, the cumulative balance in the year was Rs.2,33,77,864. This is the closing balance as on 31.3.2013. The assessee has not furnished the details of day to day balance in that account. Even considering this balance, it is clear that the amount of loan received from the assessee by Amethyst Hospitality (P) Ltd. was not at all used for business purposes. In other words, it was in turn advanced by Amethyst Hospitality (P) Ltd. to related parties without any interest.

8. Before us, the assessee strongly relied on the judgment of Supreme Court in *S.A. Builders v. CIT, 288 ITR 1 (SC)* wherein it was held that though interest expenditure may not have been incurred under any legal obligation, but it is allowable as business expenditure, if it was incurred on grounds of commercial expediency. Thus, whether the business funds was diverted for interest free loans to subsidiaries, the main criterion for allowability of those funds are based on whether it was on grounds of commercial expediency or not. The phrase "*commercial expediency*" has following important trites as established by this case law (*supra*):-

- (1) Such purpose as is expected by the assessee to advance for its business purpose.

- (2) Measures taken for preservation, protection or advancement of its business expenditure.
 - (3) To be distinct from the personal interest of its directors or partners, as the case may be.
 - (4) There has to be nexus between the advancement of interest free funds and business interest of the assessee. Some business objective should be sought to have been achieved by extending such interest free advances, when the assessee company is itself borrowing funds for running its business.
 - (5) Under section 36(1)(iii) of the Act, the ultimate use of funds is important. It may not be relevant as to whether the advances have been extended out of borrowed funds or interest free funds or mixed funds which includes borrowed funds. The test to be applied in such cases is not the source of funds, but the purpose for which the advances are extended.
9. In the present case, though the assessee advanced interest bearing funds to Amethyst Hospitality (P) Ltd., the assessee has not been able to establish any commercial expediency to such advancing of interest free loan to this company and both the companies are in different line of business. Further, after receiving the loan from assessee company, Amethyst Hospitality (P) Ltd. used the same funds to advance to the related parties from year to year as seen from its annual accounts reproduced in earlier para. Being so, the CIT(Appeals) rightly held that the assessee company and subsidiary are in two different business being land development & construction and hospitality and the assessee has not been able to establish any business advantage derived by the assessee by advancing such loan to Amethyst Hospitality (P) Ltd. In such

circumstances, we are of the opinion that the CIT(Appeals) is justified in sustaining the addition made by the AO by invoking the provisions of section 36(1)(iii) of the Act.

10. In the result, the appeal of the assessee is dismissed.

Pronounced in the open court on this 7th day of September, 2021.

Sd/-
(BEENA PILLAI)
JUDICIAL MEMBER

Sd/-
(CHANDRA POOJARI)
ACCOUNTANT MEMBER

Bangalore,
Dated, the 7th September, 2021.

/Desai S Murthy /

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.