

IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "D", MUMBAI

BEFORE SHRI M BALAGANESH (ACCOUNTANT MEMBER)

AND

SHRI PAVAN KUMAR GADALE (JUDICIAL MEMBER)

I.T.A No.5021/Mum/2019 - A.Y. 2013-14
I.T.A No.5022/Mum/2019 - A.Y. 2014-15

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| M/s Macrotech Developers Ltd (Successor to Ajitnath Hi-Tech Builders Private Limited), 412 Floor-4, 17G, Vardhman Chamber Cawasji Patel Road, Horniman Circle, Fort, Mumbai-400 001 PAN : AAGCA1122Q | vs | Deputy Commissioner of Income- tax, Central Circle 7(3), Mumbai Room No.655, 6 th Floor, Aayakar Bhavan, Maharshi Karve Road, Mumbai-400 020 |
| APPELLANT | | RESPONDENT |

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| Assessee represented by | Shri. Niraj Sheth.AR |
| Department represented by | Shri. T Shankar.DR |

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| Date of hearing | 10/05/2022 |
| Date of pronouncement | 23/05/2022 |

O R D E R

Per: PAVAN KUMAR GADALE (JM):

These are the appeals filed by the assessee against the separate orders of Commissioner of Income-tax (Appeals)-49, Mumbai passed u/s 143(3) r.w.s.

92CA(3) of the Act for A.Y.2013-14 and order u/s 143(3) and 250 of the Act for A.Y.2014-15.

2. Since the issues in these appeals are common and identical, hence are clubbed, heard and consolidated order is passed.

3. We shall take up the assessee appeal ITA No.5021/Mum/2019 (A.Y. 2013-14) as a lead case and facts narrated. The assessee has raised the following grounds of appeal:

(i). On the facts and circumstances of the case and in law, the learned CIT(A) has erred in confirming the disallowance of an amount of Rs.14,65,098/- out of interest expenses U/sec36(I)(iii) of the Income Tax Act 1961.

(ii). The appellant craves leave to add, amend, alter or delete the said ground of appeal.

4. The Brief facts of the case are that, the assessee company is engaged in business of real estate construction and development. The assessee has filed return of income for the assessment year 2013-14 on 30/09/2013 with a total loss of Rs.1,29,20,256/-. Subsequently, the case was selected for scrutiny under the CASS and notice u/s 143(2) and 142(1) of the Act along with a questionnaire was issued. In compliance, the Ld.AR of the assessee appeared from time to time and filed the requisite information and details. The Assessing Officer(A.O) on perusal of the Audited financial statements found that the assessee company has a land inventory at Bhiwandi and the income has been taxable under the head "Profits and gains of business and profession". Further the assessee submitted the details as per AIR information in respect of sales, details of expenses and the assessee is

a part of the Lodha Group. The A.O. found that the assessee has claimed interest as business expenditure u/s 36(1)(iii) of the Act. The Assessing Officer observed that the assessee has obtained loans at higher rate of interest and the same was provided to the sister concerns at lower rates.

5. Whereas the assessee has borrowed the funds on interest from the related parties in the range from @8.74% to 16% and the average borrowing rate is worked out @ 15.42% during the year as per the ledger accounts submitted. The assessee has obtained loan from M/s Suryakrupa Farms Pvt Ltd @16%pa and directly advanced to Lodha Developers @15.45% interest rate. The assessing officer in the assessment proceedings has called for the details and show cause for differential and proportionate interest disallowance u/s 36(1)(iii) of the Act. Whereas the assessee has submitted the details of interest charged at the average rate of cost of funds obtained from various related concerns. The AO found that the differential rate of interest is 0.55% being a difference of (16% - 15.45%). The assessee explained that the funds have been provided to the sister concerns for business purpose and there is a direct nexus of funds. But the A.O. was not satisfied with the explanations and worked out the differential interest of Rs.14,65,098/- and was disallowed u/s 36(1)(iii) of the Act.

6. On the second issue, the A.O. has made addition of excess depreciation claim of Rs.12,59,835/- and the addition of interest on late payment of TDS. Finally the AO has assessed the total loss of Rs.1,01,95,320/- and passed the order u/s 143(3) r.w.s. 92CA(3) of the Act dated 29/11/2016. Aggrieved by the order, the assessee has filed an appeal before CIT(A).

7. In the appellate proceedings, CIT(A) considered the grounds of appeal, findings of the AO, submissions of the assessee and material evidences in respect of disputed issue of disallowance of interest component being variable rate. But the CIT(A) has confirmed the disallowance of interest u/s 36(1)(iii) of the Act and whereas in other grounds of appeal, the CIT(A) has granted relief and partly allowed the assessee's appeal. Aggrieved by the order of the CIT(A), the assessee has filed an appeal before the Hon'ble Tribunal.

8. At the time of hearing, the Ld.AR submitted that the CIT(A) has erred in sustaining the disallowance u/s 36(1)(iii) of the Act in respect of interest component considering that there is no commercial expediency in lending to sister concerns. The Ld.AR emphasized that the assessee being part of Lodha group has obtained loans at different rates as mentioned in the assessment order ranging from Interest rate@ 8.7% to 16% and weighted average of interest component has been worked out @ 15.42%. The contention of the Ld.AR that there is a direct nexus of funds obtained from the parties and the funds are utilized for the purpose of business. The Ld.AR substantiated the submissions with the paper book and judicial decisions and prayed for allowing the appeal.

9. Contra, the Ld.DR submitted that there is no commercial expediency and the A.O. has worked out the differential interest @0.55% based on the information submitted by the assessee and the CIT(A) has accepted. The A.O. has calculated the disallowance u/s 36(1)(iii) applying the differential interest rate in the assessee's case and supported the order of the CIT(A).

10. We have heard the rival submissions and perused the materials on record. The sole crux of the disputed issue envisaged by the Ld.AR that both the A.O and CIT(A) have erred on the principle of charging the differential interest on the loans advanced by the assessee to its sister concerns. The Ld.AR emphasized that the interest claimed has to be allowed u/s 36(1)(iii) of the Act and relied on the assessee's submissions before the CIT(A) on the interest component dealt at page 3 Para 6.1 of the CIT(A) order read as under:-

6.1 "Aggrieved, the assessee filed this appeal and made the following submissions:

1. "Ground No. 1: Disallowance of interest expense of Rs. 14,65,098 u/s 36(1)(iii) of the Act,

Facts of the case:

1.1 During the year under consideration the Appellant had taken loans from associate companies and extended loans to other associate companies. The weighted average cost of borrowing as worked out by the appellant was 15.42%. During the year under considered the appellant had taken a loan from M/s.Suryakrupa Farms and Constructions Pvt Ltd @ 16%. Also the company had advanced loan to M/s.Lodha developers Pvt Ltd @ 15.45%.

1.2 The Assessing Officer has held that there is a direct nexus between loan taken from M/s Suryakrupa Farms and Constructions Pvt Ltd @ 16% and loan advanced to M/s Lodha developers Pvt Ltd @ 15,45%, thereby disallowing an amount of interest expense of Rs.14,65,098/- under section 36(1)(iii) of the Act without taking into consideration that the weighted average cost of borrowing for the appellant is 15.42% and that for the purpose of disallowance under section 36(1)(iii) weighted average cost of borrowing is to be considered.

Section 36(1)(iii) is a code in itself:

1.3 As stated in the statement of Facts and Grounds of Appeal, Appellant claimed deduction of the said interest expense of Rs.14,65,098/- strictly in accordance with the provisions of Section 36(1)(iii) of the Act. For the sake of brevity, the relevant portion of Section 36(1)(iii) of the Act is reproduced below:

"(iii) the amount of interest paid in respect of capital borrowed for the purposes of the business or profession:

Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of accounts or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.

Explanation.....(emphasis supplied)"

1.4 On plain reading of the Section it is clear that provisions of Section 36(l)(iii) of the Act provides for following three conditions before interest can be allowed as deduction:

- There should be 3 borrowing;
- Capital must have been borrowed for business purposes;
- Interest should have been paid or payable in respect thereof.

Your goodself would appreciate that Section 36(l)(iii) of the Act is a code in itself. The only requirement of the provision is that the funds should have been borrowed and utilized for the purpose of business. An assessee is entitled to claim interest paid on borrowed capital provided that the capital is used for business purpose irrespective of what may be the result of using the capital which the assessee had borrowed.

1.5 We submit that the appellant has during the year under consideration taken loan from various entities at different rates. On the basis of loan taken during the year from various entities the weighted average borrowing cost works out to 15.42% (Working enclosed herein as Annexure 1). The appellant has advanced loan to M/s. Lodha Developers Pvt Ltd @ 15.45%. It can be seen from the above that the appellant has rightly charged rate of interest 15.45% which is well above the weighted average borrowing rate of 15.42%, thereby causing no loss to the revenue authorities.

1.6 Further, the Assessing Officer has failed to appreciate that while the assessee has borrowed from M/s Suryakrupa Farms and Constructions Pvt Ltd at the rate of 16%, he has completely ignored the fact that the assessee has borrowed from other group companies at a much lower rate (i.e. ranging from 8.75% to 15.45%). Nevertheless, the interest has been charged by the assessee company at the weighted average borrowing rate, without going into the specific borrowing rate of each and every loan. The Appellant company would like to submit that the advances has been taken from W/s, Suryakrupa Farms and Constructions Pvt Ltd for procurement of land for purpose of business and there is no nexus between amounts received from M/s. Suryakrupa Farms and Constructions Pvt Ltd and advanced to M/s. Lodha Developers Pvt Ltd. A summary of advance received from M/s. Suryakrupa Farms and Constructions Pvt Ltd and loan given to Lodha Developers Pvt Ltd. is enclosed as Annexure 2. This clearly shows that there is no nexus between advance received for procurement of land from M/s Suryakrupa Farms and Constructions Pvt Ltd and loan given to Lodha Developers Pvt Ltd.

1.7 This connection, reliance is placed on the decision of the **Honourable Supreme Court** in the case of **Hero Cycles (P) Ltd vs Commissioner of Income-tax (Central) Ludhiana [(2015) 63 taxmann.com 308(SC)]**, wherein the apex court upheld the primary right of any businessman/organization to plan and conduct his/its business, thereby effectively negating any attempt by the revenue to step into the shoes of the businessman and sit in judgement on business decisions, particularly with regards to judging the reasonableness of any expenditure and the commercial expediency or correctness of any decision, (Decision enclosed herein as Annexure 3)

1.8 Further reliance is also placed on the decision of **Income Tax Appellate Tribunal, New Delhi** in the case of **Global Capital Ltd. V. Deputy Commissioner of Income-tax, Circle 12(1), New Delhi [2009] 117 ITD 251 (Delhi)** and decision of **High Court of Madhya Pradesh** in case of **D & H Sacheron Electrodes (P.) Ltd. V. Commissioner of Income-tax (1984) 17 Taxman 379 (MP)** wherein disallowance u/s 36(l)(iii) were deleted.

1.9 Further reliance is also placed on the decision of the **Honourable Supreme Court** in the case of **S.A, Builders Ltd. Vs. Commissioner of Income Tax (Appeals) (2007) (SC)**, wherein the

*apex court held that the deduction for interest expense in respect of monies borrowed which have been advanced to sister concern at zero rate of interest is allowed if it was commercial expedient to do so. The Apex court also held that the expression "for the purpose of business or profession" is far wider than the expression "for the purpose of earning profits". Thus any interest expenditure incurred for the purpose of business is allowed under section 36(I)(iii). (Decision enclosed herein as **Annexure 4**)*

*1.10 We further submit that since the funds were advanced by the appellant to M/s Lodha Developers Pvt Ltd which is the ultimate holding company and subsequently the said funds were used by M/s Lodha Developers Pvt Ltd for the purpose of its business, the test of commercial expediency as laid down by the **Honourable Supreme Court** in the case of **S.A. Builders Ltd. Vs. Commissioner of Income Tax (Appeals) (2007) (SC)** is fulfilled and thus the appellant can rightfully claim deduction of 1 interest expense paid in respect of loan borrowed in respect of such advances.*

*1.11 In the case of M/s. **Snowtex Investment Ltd (I.T.A No. 356/Kol/2012) dated 6.11.2015**, wherein the Hon'ble Kolkata IT AT has held that :-*

*"It is further submitted that **there is no bar against advancing of loan interest-free or at a low rate of interest. There may be very many considerations, including 1 business considerations, for not charging interest or charging interest at a low rate.** Dispute between the Revenue and the assessee often arises when money is borrowed with interest and loan is advanced interest-free or at a low rate of interest. In such 3 case the tendency of the AO generally is to disallow the interest paid on the money borrowed either in full or proportionately depending upon the quantum of loan advanced and interest, if any, charged. But whether the assessee charged interest on loan advanced or not is not at all a relevant consideration for determining allowability of interest paid under section 36(I)(iii) of the Act As already explained, the relevant consideration is whether the moneys have been borrowed for the purposes of business or profession and whether interest paid.*

***In the interest of maintain good business relation, interest-free loans or loans at a low rate of interest may be given to others with whom the assessee has business relation or with whom he expects to establish business connection or with whom he has other business obligations, present or past.** There may be many other reasons also, both business or non-business. If Interest-free loan or loan at a low rate of interest is given for business consideration out of the capital borrowed with interest then also the borrowing would be for the purposes of business, and interest paid on the borrowed capital would be allowable as deduction under section 36(I)(iii) of the Act. (Emphasis Added)*

*1.12 Your Honour has decided similar issue in favour of the Assessee in the case of M/s **Aasthavinayak Real Estate Pvt Ltd for AY 2014-15 vide order dated 21-05-2018**, a copy is attached as **Annexure -5**.*

In the light of the above submissions, your Honour will appreciate that the Assessing Officer has wrongly disallowed the interest expenses of Rs.14,65,098/- in accordance with the provisions of Section 36(I)(iii) of this Act even though the amounts had been lent at the weighted average borrowing cost. Accordingly, we submit your Honour to allow the deduction of interest expenses under Section 36(I)(iii) of the Act in entirety."

11 .Whereas the CIT(A) has overlooked the facts that the assessee company is involved in development and construction of real estate projects and there is always financial crunch therefore, the funds are collected from the related parties/ sources at a interest rate varying from @ 8.7% to 16% pa and indeed, these funds are provided again to the other sister concerns for business purpose. This practice is being continued by the assessee from the earlier years. The Ld. AR referred to page 38 of the paper book on the weighted average borrowing cost workings for providing the loans to the sister concern. The contentions of the Ld.AR that the assessee has obtained these loans wholly and exclusively for the purpose of business and there is no ambiguity that these funds are diverted. The Ld.AR explained the reasoning, chargeability, utilization of the funds and the interest component variability. The Ld.AR substantiated that the funds are utilized for the business and has referred to the Audited financial statements and the schedules where the assessee is engaged in the business and disclosed revenue from operations and the interest component placed at pages 26-27 of the paper book. Further the interest paid to the sister concerns has been subjected to TDS as per the provisions of the Act and after set off of interest income; the net interest component expenditure was allocated to the cost of projects. The Ld.AR relied on the following judicial decisions as under:-

(1) Hero Cycles (P) Ltd vs CIT (2015) 63 taxmann.com 308 (SC) the proposition that –

“Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital (Interest free loans) - Assessment year 1988-89 - Whether once it is established that there is nexus between expenditure and purpose of business (which need not necessarily be business of assessee itself), revenue cannot justifiably claim to put itself in arm-chair of businessman or in position of Board of Directors and assume role to decide how much is reasonable expenditure having regard to

circumstances of case - Held, yes -Assessee filed its return claiming deduction of interest paid on borrowed sums from Bank under section 36(1)(iii) - Assessing Officer finding that assessee had used borrowed funds for giving interest free loans to its subsidiary company and directors, rejected assessee's claim - High Court upheld order of Assessing Officer - It was noted that advance to subsidiary company became imperative as a business expediency in view of undertaking given to financial institutions by assessee to effect that it would provide additional margin to subsidiary company to meet working capital for meeting any cash losses - Insofar as loans to directors were concerned, said loans were granted out of assessee's own surplus funds - Whether in view of aforesaid, impugned order passed by High Court was to be set aside - Held, yes [In favour of assessee]"

(2) S.A. Builders Ltd vs CIT SLP Nos.21707-21710/2004

"We wish to make it clear that it is not our opinion that in every case interest on borrowed loan has to be allowed if the assessee advances it to a sister concern. It all depends on the facts and circumstances of the respective case. For instance, if the Directors of the sister concern utilize the amount advanced to it by the assessee for their personal benefit, obviously it cannot be said that such money was advanced as a measure of commercial expediency. However; money can be said to be advanced to a sister concern for commercial expediency in many other circumstances (which need not be enumerated here). However, where it is obvious that a holding company has a deep interest in its subsidiary, and hence if the holding company advances borrowed money to a subsidiary and the same is used by the subsidiary for some business purposes, the assessee would, in our opinion, ordinarily be entitled to deduction of interest on its borrowed loans.

In view of the above, we allow these appeals and set aside the impugned judgments of the High Court, the Tribunals and other authorities and remand the matter to the Tribunal for a fresh decision, in accordance with law and in the light of the observations made above.

We also make it clear that we are not setting aside the order of the Tribunal or other Income Tax authorities in relation to the other points dealt with by these authorities, except the point of deduction of interest on the borrowed funds."

(3) Taparia Tools Ltd vs Joint CIT, Nashik (2015) 55 taxmann.361

"Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital (Upfront interest charges) - Assessment year 1996-97 - Assessee-company issued debentures for a period of 5 years - Apart from option of half yearly periodical interest, debenture holders were given another option to accept one time upfront discounted interest payment - Assessee was following mercantile system of accounting - It filed its return claiming deduction of upfront interest charges paid during relevant year - However, said amount was shown as deferred

revenue expenditure in books of account to be written off over a period of five years - Assessing Officer thus allowed only 1/5th of payment as deduction - Whether since assessee made actual payment, and course of action adopted by assessee was in consonance with provisions of Act, merely because a different treatment was given in books of account could not be a factor which would deprive assessee from claiming entire expenditure as a deduction - Held, yes [Para 19] [In favour of assessee]”

(4) Sumangala Developers & Farms Pvt Ltd vs the ACIT ITA No.182/Mum/2016

“7. We find from the facts that the AO has not disputed the genuineness of payment of interest receipt, interest on the loan borrowed and amount advanced. The only issue raised by the lower authorities is that the assessee has not taken these advances for business purposes. We find that once the AO has allowed part of interest for particular year, the genuineness is established. Secondly, even the purpose is also established. For this, the assessee has produced the resolution passed by Board of Directors of assessee company dated 26.09.2010, which clearly states that these loans secured or unsecured are for the purpose of the business. The copy of resolution was placed on record. Hence, the purpose is established. Even otherwise, we are of the view that the AO did not even dispute the upfront payment interest in the part of the year and once this is the position, the interest cannot be disallowed. We allow the claim of the assessee and this issue is accordingly allowed.”

12. We considering ratio of judicial decisions and the facts envisaged by the Ld.AR duly substantiated with the material evidences and the main objects of the assessee’s business is real estate development and construction activities. The assessee has obtained these loans for the purpose of providing advances to the sister concerns, where the construction projects are in progress and the assessee is able to substantiate the commercial expediency as the main objects of the assessee is not to earn interest, but to engage in real estate and construction activities. Therefore the action of the CIT(A) that there is no commercial expediency is not tenable and is not supported with any findings except relying on the facts that the higher rate of interest has been paid on loans borrowed. The Ld.AR explained the accounting concept on the weighted average rate of interest

considering the variability of interest rate range from @8.75% to 16% though this approach cannot be incorporated in the audited financial statements but the reasonableness and explanations to provide the loans to sister concerns cannot be over looked and the group transfers between one sister concern to another sister concern as per requirement of funds. The Ld.AR submissions are realistic and duly supported by the material information and is appreciated. Accordingly, we do not find merits in the findings of the CIT(A) and we rely on the judicial decisions and commercial expediency explained by the Ld.AR that the assessee's business activities as a going concern and the construction projects are in progress. Any delay in project construction activities due to financial crunch will increase the overheads of the projects. Accordingly, we set aside the order of CIT(A) on this disputed issue and direct the Assessing officer to delete the addition and allow the grounds of appeal of the assessee.

ITA No.5022/Mum/2019 (A.Y. 2014-15)

13. As the facts and circumstances in this appeal are identical to ITA No.5021/Mum/2019 (except variance in figures) and the decision rendered in above paragraphs will apply mutatis mutandis for this appeal also. Accordingly, allow the grounds of appeal in favour of the assessee.

14. In the result, both the appeals filed by the assessee are allowed.

Order pronounced in the open court on 23/05/2022

Sd/-
(M. BALAGANESH)
ACCOUNTANT MEMBER
Mumbai, Dt : 23rd May, 2022

Sd/-
(PAVAN KUMAR GADALE)
JUDICIAL MEMBER

Pavanan

प्रतिलिपि अग्रेषितCopy of the Order forwarded to :

1. अपीलार्थी/The Appellant ,
2. प्रतिवादी/ The Respondent.
3. आयकर आयुक्त(अ)/ The CIT(A)-
4. आयकर आयुक्त CIT
5. विभागीय प्रतिनिधि, आय.अपी.अधि., मुंबई/DR, ITAT,
Mumbai
6. गार्ड फाइल/Guard file.

BY ORDER,

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Asstt. Registrar / Senior Private Secretary
ITAT, Mumbai