

**IN THE INCOME TAX APPELLATE TRIBUNAL
“A”BENCH: BANGALORE**

**BEFORE SHRI N. V. VASUDEVAN, VICE PRESIDENT AND
SHRI B. R. BASKARAN, ACCOUNTANT MEMBER**

ITA No.1248/Bang/2019
Assessment Year:2014-15

M/s. Bagadia Properties Private Limited, 1097 (Old) 58 (New), 18 th B Main Road, 5h Block, Rajajinagar, Bengaluru – 560 010. PAN NO : AADCB 3328 E	Vs.	ITO, Ward – 1(1)(3), Bengaluru.
APPELLANT		RESPONDENT

Appellant by	:	Shri. Shivarama Iyer, CA
Respondent by	:	Shri. Sankar Ganesh, JCIT(DR)(ITAT), Bengaluru.

Date of Hearing	:	10.03.2022
Date of Pronouncement	:	31.05.2022

O R D E R

PER B.R. BASKARAN, ACCOUNTANT MEMBER:

The assessee has filed this appeal challenging the order dated 01-03-2019 passed by Ld CIT(A)-1, Bengaluru and it relates to the assessment year 2014-15. Though the assessee has raised many grounds, all of them are related to a single issue, viz., disallowance of interest expenses relating to Non-Convertible debentures.

2. The facts relating to the case are stated in brief. The assessee is undertaking the business of real estate development and builders. The assessee filed its return of income for AY 2014-15 declaring a total income of Rs.3,52,160/-. The AO disallowed part of interest expenses amounting to Rs.1,50,73,571/-. The Ld CIT(A) granted

marginal relief. However, he treated the appeal as dismissed. Aggrieved, the assessee has filed this appeal before us.

3. The facts that relate to the interest disallowance are discussed in brief. The assessee is following "Project completion method" for disclosing income from sale of flats. During the year under consideration, the assessee had completed three projects named Alta Vista, Soring Dale and Villa Grande. Depending upon the sold area, the assessee had offered income from these projects. One project named "Splendour" was under construction and the assessee has just started another project named "Chandra layout", wherein not much expenses have been incurred.

4. The AO noticed that the assessee had issued "Non-convertible Debentures" (NCD) amounting to Rs.20.00 crores on private placement basis to M/s Religare Finvest Limited during the year under consideration. The trustees for issue of NCDs was M/s IDBI Trusteeship Services Limited. The debentures carried interest rate of 18% p.a.. The interest expenditure booked for the year under consideration was Rs.1,51,89,032/-. The assessee had also incurred professional expenses on issue of NCD of Rs.70,50,887/-. Accordingly, the AO took the total expenses relating to NCD at Rs.2,22,39,919/- (Rs.1,51,89,032/- + Rs.70,50,887/-).

5. The AO asked the assessee to furnish the details of utilisation of funds and noticed that the assessee has, inter alia, used the funds for the following purposes:-

(a) Land advances and supplier advances	-	Rs.2,76,59,346/-
(b) Loans to Subsidiary Companies	-	Rs.9,20,76,774/-

		Rs.11,97,36,120/-
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The AO took the view that the interest relatable to “Land advances and supplier advances” cannot be claimed as general business expenditure and it should be allocated to the projects for which funds are used. In respect of Loans to subsidiary companies, the AO took the view that the interest-bearing advances have been diverted to give interest free loans to subsidiary companies. Accordingly, the AO took the view that the interest relatable to Rs.11.97 crores, referred above, is liable to disallowed. We have noticed earlier that the AO had taken the total expenses relating to NCD at Rs.2,22,39,919/-. Further, he has taken the view that the interest pertaining to Rs.11.97 crores is liable to be disallowed. Accordingly, the AO computed the proportionate disallowance of interest & professional charges as under:-

$$\begin{array}{r} 11,97,36,120 \\ \hline 20,00,00,000 \end{array} \times 2,22,39,919 = \text{Rs. } 1,33,14,608$$

6. Out of the remaining interest & professional charges relating to NCD, the AO took the view that the interest pertaining to uncompleted project, viz., “Splendour” should be included in the relevant work-in-progress. The AO worked out the same at Rs.17,58,963/-. Accordingly, the AO worked out the total disallowance to be made out of interest & professional charges on NCD at Rs.1,50,73,751/- (Rs.1,33,14,608/- + Rs.17,58,963/-) and disallowed the same. During the course of assessment proceedings, the assessee has furnished a statement titled as “Computation of Work in Progress after allocation of Finance Cost”. In that statement, the assessee has allocated the interest on NCD between the “completed projects (to the extent of flats sold)” and “unsold flats & incomplete projects”. The assessee has worked out the interest on NCD to be charged to P & L account at Rs.1,09,04,325/- and the remaining amount to be included in WIP at Rs.42,84,707/-. The AO has observed in the assessment order that the assessee has

voluntarily offered for addition of the above said amount of Rs.42,84,707/-. However, the AO did not make any such addition, since he held that the disallowance of Rs.1,50,73,751/- made by him would encompass the above said amount of Rs.42,84,707/-.

7. In the appellate proceedings, the Ld CIT(A) examined the break-up details of Land advances and supplier advances. The land purchase advances was Rs.1,15,00,000/- and the remaining amount of advance pertaining to supplier advances was Rs.1,54,03,008/-. The Ld CIT(A) took the view that the supplier advances should be considered as pertaining to on-going project "Splendour". Accordingly, the Ld CIT(A) directed the AO to disallow interest on NCDs pertaining to "Loans to subsidiaries amounting to Rs.9,30,76,776/- and land purchase advances of Rs.1,15,00,000/-. However, it is not clear as to whether the Ld CIT(A) has allowed interest expenditure pertaining so supplier advances of Rs.1,54,03,008/-, which is considered as relating to on-going project of Splendour. The Ld CIT(A) rejected all other contentions raised by the assessee.

8. We heard rival contentions and perused the record. The main contention of the assessee is that the loan funds borrowed by issuing NCDs, have been borrowed for general business purposes and hence interest expenditure is allowable u/s 36(1)(iii) of the Act, since the assessee has satisfied with the conditions mentioned in that section. However, the case of the revenue is that the assessee has diverted its interest-bearing funds to its subsidiary companies as interest free loans and also diverted funds for giving advances for purchase of lands and to other suppliers. According to the assessing officer, the about cited usage of loan funds cannot be considered as "for the purposes of business" of the assessee. Hence the proportionate

interest pertaining to the above diverted amounts has been disallowed. Further, it was held that the interest pertaining to on-going project 'Splendour' should be included in "Work in Progress". Accordingly, the AO has disallowed the proportionate interest expenses on the above said principles only.

9. There cannot be any dispute that the intention of assessee in raising borrowed funds by issuing NCDs was for the purpose of business. The interest expenditure on borrowed funds is allowed under sec. 36(1)(iii) and it reads as under:-

"the amount of interest paid in respect of capital borrowed for the purposes of the business or profession"

The moot question, in the instant case, is whether the said borrowed funds were used for the purpose of business or not. As noticed earlier, the case of the tax authorities was that the borrowed funds have been diverted for non-business purposes. We notice that the AO, Ld CIT(A) have made detailed discussions and the replies given by the assessee are also lengthy. In our view too much of general discussions have been made by all. However, ultimately what is disallowed is the proportionate interest expenses pertaining to

- (i) funds diverted to give advances;
- (ii) funds diverted to sister concerns and
- (iii) interest relatable to on-going projects.

Accordingly, we proceed to examine the various issues by carefully considering the facts and circumstances of the case. Accordingly, in our considered view, the issues that require to be adjudicated in this appeal are:-

- (a) Whether the interest on NCD and Professional charges for issuing NCD are required to be aggregated for computing disallowance?

- (b) Whether advances given for purchase of land and to the suppliers are for business or non-business purposes.
- (c) Whether the interest free loans given to subsidiary companies are to be considered as for non-business purposes.
- (d) Any interest expense is to be apportioned to the on-going project Splendour.
- (e) Whether the assessee has agreed for voluntary disallowance of Rs.42,84,707/-.

10. The first issue relates to the quantum of expenditure that is required to be considered for computing disallowance. We noticed earlier, the AO has computed the aggregate amount of interest expenditure pertaining to NCD as Rs.2,22,39,919/-, which consisted of interest expenses of Rs.1,51,89,032/- and professional charges for issuing NCD of Rs.70,50,887/-. There cannot be any dispute that interest expenses are allowed u/s 36(1)(iii) and the professional charges are allowed as deduction u/s 37(1) of the Act. Hence, in our view, the AO was not correct in aggregating the professional charges incurred on issuing NCDs as part of interest expenditure and thus disallowing proportionate expenses thereof. There should not be any dispute that the professional charges have been incurred for issuing NCDs and hence these expenses have been incurred prior to the giving interest free loans to subsidiary companies. If the interest free loans were not given to the subsidiaries, then the AO shall have allowed professional charges fully in terms of sec. 37(1) of the Act. Since the professional charges has been incurred prior to the giving of loans to subsidiaries, in our view, it is allowable as deduction fully, there is no reason to disallow a portion of the same merely on account of the reason that the interest bearing funds have been used for giving interest free loans. Hence, what is relevant u/s 36(1)(iii) is the

interest expenditure only and not any other expenditure. Accordingly, we are of the view that the professional charges of Rs.70,50,887/- is fully allowable as deduction u/s 37(1) of the Act. Accordingly, we direct the AO exclude the above said amount in computing proportionate disallowance of interest expenses, i.e., the amount of Rs.70,50,887/- should be allowed fully.

11. The next issue is whether advances given for purchase of land and to the suppliers are for business or non-business purposes?. The aggregate amount of 'advances' considered by the AO for computing interest disallowance is Rs.2,76,59,346/-. The break-up details of the above said amount are given by the assessee before Ld CIT(A) as under (page 199 of the paper book): -

Security deposits, land advances and advance towards expenses	- 2,40,11,922
Advance for land	- 1,15,00,000
Advances squared off during the year	- (57,78,785)
Staff advances recovered	- (10,58,790)

	2,86,74,347
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We notice that the assessee has not given break-up details for exact amount. Be that as it may, we notice that all these advances are related to the business of the assessee, i.e., real estate development and builders. The assessee, being a real estate developer and builder, is required to identify the land parcels and give advances for purchases of the land in its on-going business activities in order to continue its business. There should not be any doubt that, in the business of the assessee, the land constitutes stock in trade, since without land, the assessee cannot promote new projects. Other advances like security deposits, advance to staffs etc., are also related to the business activities of the assessee. i.e., all these advance payments are related to the 'general business activities'

carried on by the assessee. Hence the interest expenditure pertaining to these advances cannot be considered as for non-business purposes. The Ld CIT(A) has taken the view that interest pertaining to the advances given for purchase of land is required to be included in WIP when the project starts. In our view, this is not correct proposition. As noticed earlier, the land parcels are stock in trade in the hands of the assessee and hence the interest expenditure pertaining to the use of loan funds for purchase of land should be allowed as normal business expenditure u/s 36(1)(iii) of the Act. The question of allocation of interest expenditure may arise after the commencement of any specific project and further if the nexus between the loan funds and project cost is established. The Ld CIT(A) has further presumed that other advances are related to the on-going project Splendour. We notice that there is no material on record to support such kind of presumption. The break-up details of advances given by the assessee shows that they are given for general business purposes. Accordingly, we are of the view that the tax authorities are not justified in disallowing proportionate interest expenses relating to advances for supplies and land purchase. Accordingly, we set aside the order passed by Ld CIT(A) on this issue and direct the AO to delete the disallowance of interest expenditure pertaining to advances.

12. The next issue is whether the interest free loans given to subsidiary companies are to be considered as for non-business purposes. In view of our decision rendered in the preceding paragraphs, the interest expenditure on NCDs of Rs.1,51,89,032/- alone to be considered for computing disallowance, if any, u/s 36(1)(iii) of the Act. Now the question that arises is whether the interest free advances given to subsidiaries are to be considered as

for non-business purposes?. The break-up details of fresh advances given to the subsidiary companies are furnished below:-

1. Brixstone Realty P Ltd	-	4,11,03,355
2. Ingeltown Construction P Ltd	-	2,06,00,000
3. Shanders Properties & Infrastructure P Ltd	-	4,07,574
4. Shanders Real Estate Developers P Ltd	-	2,99,65,845

		9,20,76,774
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The contention of the assessee before the tax authorities is that all these subsidiary companies are also engaged in the real estate business and hence there is commercial expedience in given these advances to them. Accordingly, it was contended these advances have been given for the purpose of business of the assessee. In support of this proposition, the assessee has relied upon the decision rendered by Hon'ble Supreme Court in the case of S.A Builders Ltd vs. CIT (284 ITR 1). In particular, the assessee has relied upon the following observations made by Hon'ble Supreme Court in the above said case:-

"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.”

It can be noticed that the Hon’ble Supreme Court has made it clear that it cannot be always presumed that the loans given to subsidiary companies are for business purposes. It is required to be proved that the subsidiary company has used the interest free loans for some business purposes. Then, as held in the case of S A builders (supra), the test of commercial expediency/ business purposes would get satisfied. In the instant case, we notice that the assessee has not furnished the details of utilisation of impugned interest free loans by the respective subsidiary companies. Without those details, it will not be possible for anyone to find out whether there was commercial expediency or business purpose in giving these interest free loans. Accordingly, in our view, this aspect requires examination at the end of the AO. Accordingly, we restore this issue to the file of the AO. We direct the assessee to furnish the details as to how the interest free loans have been used by the concerned subsidiary companies to the AO. The AO shall examine the details in accordance with the ratio laid down by Hon’ble Supreme Court in the case of S A Builders case (supra). In the event that the AO comes to the conclusion that the loans have been used by the subsidiary companies for non-business purposes, then the interest disallowance should not be computed proportionately, i.e., since the rate of interest paid on NCDs is 18% p.a., the interest disallowance should be computed on time basis for the actual period of usage of funds for non-business purposes.

13. The next issue is whether any portion of interest expense is to be apportioned to the on-going project Splendour. We noticed earlier that the AO has apportioned interest expense of Rs.17,58,563/- towards on-going project “Splendour” and has disallowed the same. The AO has not given the basis/workings as to how he arrived at the

above said amount of Rs.17,58,563/-. In our view, the allocation of proportionate interest expenditure to the on-going project may be right, provided the nexus between the borrowed funds and its utilisation for the project is established. The case of the assessee is that the funds borrowed through the issue of NCDs have been utilised for general business purposes and not specifically for the project "Splendour". However, the assessee has also not furnished the details in support of the above said contentions. As stated in the earlier paragraph, the apportionment of interest, if required, is to be done for the actual period of usage of funds for the above said project and not proportionately. Since this issue requires re-examination in the light of discussions made supra by considering the relevant details, we set aside this issue also to the file of AO for examining it afresh.

14. The ld D.R submitted that the assessee has voluntarily surrendered a sum of Rs.42,84,707/- and hence the said addition should be sustained. In the earlier paragraphs, we have granted relief in respect of certain issues and restored certain issues to the file of the AO. We have also noticed that the assessee was also not very specific in replying to various queries. Hence, it is not clear as to whether the assessee has agreed to allocating a portion of interest expenditure to the work in progress or not? We notice that the AO himself has worked out the interest allocable to Project Splendour at Rs.17,58,963/-. However, he observes that the assessee has worked out the allocable interest at Rs.42,84,707/-. In any case, in view of our decisions on various issues, all the workings will undergo change and further there may not be any situation to make voluntary surrender, since our directions will take care of every aspect. Accordingly, we restore this issue also to the file of the AO.

15. In the result, the appeal filed by the assessee is treated as partly allowed.

Pronounced in the open court on the date mentioned on the caption page.

Sd/-
(N.V. VASUDEVAN)
Vice President

Sd/-
(B. R. BASKARAN)
Accountant Member

Bangalore,
Dated 31st May, 2022.
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Copy to:

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

By order

Asst. Registrar,
ITAT, Bangalore.