आयकर अपीलीय अधिकरण, 'डी' न्यायपीठ, चेन्नई

IN THE INCOME TAX APPELLATE TRIBUNAL
'D' BENCH, CHENNAI

श्री महावीर सिंह, उपाध्यक्ष एवं श्री मनोज कुमार अग्रवाल, लेखा सदस्य के समक्ष

BEFORE SHRI MAHAVIR SINGH, VICE PRESIDENTAND
SHRI MANOJ KUMAR AGGARWAL, ACCOUNTANT MEMBER

आयकर अपील सं./**ITA No.:204/CHNY/2019**

निर्धारण वर्ष/**Assessment Year: 2011 - 2012**

Kothari Sugars and Chemicals Ltd., 115, Mahatma Gandhi Road, Nungambakkam, Chennai – 34.	Vs.	The JCIT, Company Range II, Chennai – 34.
PAN : AABCK 2495F (अपीलार्थी/Appellant)		(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/Appellant by : Shri Vikram Vijayaraghavan, Advocate
प्रत्यर्थी की ओर से/Respondent by : Shri D. Hema Bhupal, JCIT

सुनवाई की तारीख/Date of Hearing : 04.07.2022
घोषणा की तारीख/Date of Pronouncement : 06.07.2022

आदेश /O R D E R

PER MAHAVIR SINGH, VP:

This appeal by the assessee is arising out of the order of the Commissioner of Income Tax (Appeals)-8, Chennai in I.T.A. No.133/14-15 dated 03.10.2018. The assessment was framed by the Joint Commissioner of Income Tax, Company Range II, Chennai for the assessment Year 2011-12 u/s.143(3) of the Income Tax Act, 1961, (hereinafter 'the Act') vide order dated 28.03.2014.

2. The first issue in this appeal of assessee is as regards to the order of CIT(A) confirming the action of AO in disallowing the amount of Rs.556.88 lakhs on account of corporate guarantee for the loan taken by assessee's subsidiary Kothari International Trading Ltd., (KITL) for defaulting in its loan obligation to Oman International Bank. For this, assessee has raised following two grounds:-

> 2. The Commissioner of Incometax (Appeals) ought to have allowed the payment to bank in settlement of guarantee given to subsidiary.
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> 3. The Commissioner of Incometax (Appeals) ought to have appreciated that the repayments have been offered to tax in the subsequent years from Assessment years 2012-13, 2013-14, 2014-15 and 2015-16 resulting in double taxation of the same income.

3. Brief facts are that the assessee company is engaged in the business of manufacture of sugar and allied products. The assessee during the year under consideration debited an amount of Rs.556.88 lakhs to the profit & loss account towards payment made to Oman International Bank S.A.O.G towards corporate guarantee given for its sister concern Kothari International Trading Ltd., (KITL), wholly owned subsidiary of the assessee company. The AO required the assessee to explain the nature of payment and justify claim of payment made by it. The assessee explained that the payment of Rs.556.88 lakhs made on the order Debt Recovery Appellate Tribunal in connection with settlement of loan given by Oman International Bank to KITL, a wholly

owned subsidiary of the assessee company. The assessee explained vide letter dated 27.01.2014 that a sum of Rs.556.88 lakhs was paid to Debts Recovery Appellate Tribunal (DRAT), Mumbai by Kothari Sugars and Chemicals Ltd. (KSCL) for discharging its liability towards the corporate guarantee given to Oman International Bank S.A.O.G (OIB) in respect of advances given to its wholly owned subsidiary, Kothari International Trading Ltd. (KITL) by the OlB. This sum has been debited to the profit and loss account of KSCL during AY 2011-12. KITL approached Oman International Bank (OIB) during 1996 for its working capital requirements. In Feb, 1996, OIB sanctioned credit facilities for Rs.6.00 crores and the sanctioned facilities had been renewed during Oct, 1997 to Rs.8.00 crores i.e. Rs.4.00 crore towards LCs and Rs.4.00 crore towards Packing Credits and Foreign Bills discounting. During July 2000, KSCL had executed a Corporate Guarantee for Rs.6.00 crore as security against loan facilities availed by KITL. KITL obtained packing credits for its suppliers/supporting manufacturers against the export orders and discharged the loan obligation by exports. KITL had availed a major portion of its packing credits loan for the two major supporting manufacturers, M/s Anusha International Ltd. and M/s Sivananda Steels Ltd. who stopped the production and failed to supply against the export order. This caused immense hardship to KITL for its further exports and settling the outstanding loans from OIB. KITL could not

repay the loans obtained from OIB, hence OIB proceeded against KITL before DRT, Mumbai by filing a suit for recovery in the year 2001 and obtained a decree on 18.08.2003. OIB has also filed a suit against KSCL for recovery of loan from KSCL as KITL has not paid the amount as per the decree awarded in favour of OIB in a case against KTL. KSCL filed miscellaneous application for stay of all proceedings and the DRT, Mumbai vide its order dated 10.07.2006 stayed all further proceedings. Against the decree passed by DRT, Mumbai, KITL fled an appeal before the DRAT, Mumbai. In the said appeal, KITL had expressed its willingness for one time settlement. The Hon'ble DRAT, Mumbai vide its order dated 26.09.2010 had passed an order allowing the appeal. Since KITL could not settle the dues, KSCL being the Corporate Guarantor for the loan amount and KITL being the wholly owned subsidiary, settled the dues of the OIB on behalf of KITL as one time settlement. The said corporate guarantee executed by KSCL for Rs. 6.00 crores had been shown as contingent liability in KSCL annual reports. Based on the order of the DRAT, Mumbai a sum of Rs.5,56,88,144/- was paid to DRAT, Mumbai by KSCL for discharging its liability towards the corporate guarantee given to OIB, in respect of advances to its wholly owned subsidiary, Kothari International Trading Ltd., by the bank. This sum has been debited to P&L Account.

3.1 The AO after considering the assessee's submissions found not acceptable for the reason that transaction is not clearly related or connected with any business operations of the assessee and according to him, this payment can only be considered as a non-business advance given to the subsidiary in the capacity of corporate guarantee. Further, the AO observed that the payments are towards loan settlement of the subsidiary company and therefore, this expenditure is on capital account and not on revenue account. Therefore, he holds that this payment is a balance sheet item and not profit & loss account item. According to him, the assessee is engaged in the business of manufacture of sugar and related products and these payments made to DRAT, Mumbai is in no way connected to the revenue generation of the assessee's business. Therefore, he held that this is the liability of its sister concern which was borne by the assessee and thus, the payment incurred fall in the category of non-business expenses and therefore, the same is disallowed u/s.37(1) of the Act.

3.2 The assessee before AO also argued that subsequently the payments were received from KITL and were offered as income and the AO has not considered the same because, income has been offered in subsequent years and hence, it does not prevent from any

disallowance of current assessment year. Aggrieved, assessee preferred appeal before CIT(A).

4. The CIT(A) confirmed the action of AO by observing in para 6 of his order, as under:-

> "6. As above, the Apex Court has held that the expenditure claimed by the assessee within one year should have a relation to the incomes being offered by the assessee on regular basis. In the instant case, the corporate guarantee given relates to the investment made by the assessee company in its subsidiary company. To this extent, the expenditure incurred is related to the capital investment made in the case of a subsidiary company. The dividend from the subsidiary company is not liable to tax in the hands of the shareholder. What remains is only the prospect of capital appreciation in the value of shares held by the holding company. To this extent, the expenditure incurred in the discharge of corporate guarantee can be said as being related to the capital appreciation in the value of shares of the subsidiary company. To this extent, the expenditure also assumes capital nature. Considering the above, the expenditure claimed of Rs.556.88 lakhs cannot be allowed as revenue expenditure u/s 37(1) of the I.T. Act. The grounds of appeal on this issue is rejected.

Aggrieved, now the assessee is in appeal before the Tribunal.

5. Before us, the ld.counsel for the assessee reiterated the facts what was brought before the AO and CIT(A). There is no dispute about the facts and genuineness of payment. But, only dispute is that the corporate guarantee given relates to the investment made by the assessee in its subsidiary company and hence, payment incurred in relation to capital investment made in subsidiary company and

therefore, expenditure also assumes the character of capital. Hence, not allowable u/s.37(1) of the Act. The CIT(A) also noted that although the assessee company has offered the corresponding amount in subsequent years on the sum being received from its subsidiary, the subsequent event to this assessment year will not substantially determine the allowability or otherwise of any expenditure. Therefore, he confirmed the action of the AO. The ld.counsel stated that the subsidiary KITL obtained packing credit for its supplies/supporting manufacturers against the export orders and discharged the loan obligation by exports. The ld.counsel stated that KITL had availed a major portion of its packing credits for the two major supporting manufacturers namely Anusha International Ltd., and Sivananda Steels Ltd, who stopped production and failed to supply against the export order. Therefore, the assessee could not settle the outstanding loan taken from Oman International Bank and assessee paid the corporate guarantee given to bank. The ld.counsel stated that this issue is considered by the Hon'ble Supreme Court in the case of S.A. Builders Ltd., vs. CIT(A), 288 ITR 1 and he drew our attention to para 28 to 32 as under:-

> 28. It is true that the borrowed amount in question was not utilized by the assessee in its own business, but had been advanced as interest free loan to its sister concern. However, in our opinion, that fact is not really relevant. What is relevant is whether the assessee advanced such amount to its sister concern as a measure of commercial expediency.

29. Learned counsel for the Revenue relied on a Bombay High Court decision in Phaltan Sugar Works Ltd. Vs. Commissioner of Wealth-Tax (1994) 208 ITR 989 in which it was held that deduction under Section 36(1)(iii) can only be allowed on the interest if the assessee borrows capital for its own business. Hence, it was held that interest on the borrowed amount could not be allowed if such amount had been advanced to a subsidiary company of the assessee. With respect, we are of the opinion that the view taken by the Bombay High Court was not correct. The correct view in our opinion was whether the amount advanced to the subsidiary or associated company or any other party was advanced as a measure of commercial expediency. We are of the opinion that the view taken by the Tribunal in Phaltan Sugar Works Ltd (supra) that the interest was deductible as the amount was advanced to the subsidiary company as a measure of commercial expediency is the correct view, and the view taken by the Bombay High Court which set aside the aforesaid decision is not correct.

30. Similarly, the view taken by the Bombay High Court in Phaltan Sugar Works Ltd. vs. Commissioner of Wealth-Tax (1995) 215 ITR 582 also does not appear to be correct.

31. We agree with the view taken by the Delhi High Court in CIT vs. Dalmia Cement (Bharat) Ltd. (2002) 172 CTR (Del) 188 : (2002) 254 ITR 377 that once it is established that there was nexus between the expenditure and the purpose of the business (which need not necessarily be the business of the assessee itself), the Revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the board of directors and assume the role to decide how much is reasonable expenditure having regard to the circumstances of the case. No businessman can be compelled to maximize its profit. The income tax authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. The authorities must not look at the matter from their own view point but that of a prudent businessman. As already stated above, we have to see the transfer of the borrowed funds to a sister concern from the point of view of commercial expediency and not from the point of view whether the amount was advanced for earning profits.

32. 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.

5.1 Further, the ld.counsel for the assessee drew our attention to the Co-ordinate Bench decision in the case of ACIT vs. W.S. Industries (India) Ltd., 9 ITR 596 and drew our attention to para 11 to 13 as under:-

"11. Upon careful consideration we find that assessee had incurred a sum of Rs.13.07 crores towards discharge of corporate guarantee given to the lenders of its subsidiary companies. In this connection, WSI has also given advance of Rs. 6.11 crores. The subsidiary company of the assessee was supplying materials which were important for the assessee's business. In such circumstances, all the action of the assessee i.e. giving corporate guarantee as well as advances are incidental to the business of the company. When the writing off of the advances has been allowed by the Revenue as business expenditure, there is no reason why the amount spent towards discharge of corporate guarantee should be treated any differently. The AO's plea that the said expenditure has not resulted in any income is devoid of cogency as the incurring of expenditure was very much incidental to the interests of the business of the assessee. Hon'ble apex Court in the case of CIT vs. Walchand & Co. (P) Ltd. (1967) 65 ITR 381 (SC) has held that in applying the test of commercial expediency whether the expenditure was wholly and exclusively laid out for the purpose of the business, reasonableness of the expenditure has to be adjudged from the point of view of businessman and not of the Revenue.

12. Hon'ble apex Court in the case of CIT vs. Indian Bank Ltd. (1965) 56 ITR 77 (SC) had held that there is no need to examine whether the expenditure or allowance which is permissible must be capable of producing taxable income.

13. We further find that in the articles and memorandum of association of the assessee, it has been clearly mentioned in clause No. 50 of the objects, that it was one of the assessee's business to give guarantees-financial or otherwise and/or to provide security to any person either on behalf of the company or on

behalf of others on such terms and conditions as the company shall determine. Hence, giving corporate guarantee duly had the sanction of articles and memorandum of association of the company and as such it was a part of the assessee's business."

5.2 The ld.counsel in view of the above two decisions of Hon'ble Supreme Court and Co-ordinate Bench of this Tribunal stated the corporate guarantee given by assessee is for the commercial expediency and incidental to the business of the assessee company. The assessee making payment of defaulting of loan being corporate guarantor amounting to Rs.556.88 lakhs is deductible.

6. On the other hand, the ld.Senior DR only relied on the assessment order and the order of CIT(A). The ld. Senior DR particularly referred to para 4 of the AO and he read out from the same that the corporate guarantee can be considered as non-business advance given to subsidiary in the capacity of corporate guarantor and there is no business expediency for the assessee or not linked to assessee's business and hence, cannot be claimed as deduction.

7. We have heard rival contentions and gone through facts and circumstances of the case. We noted that the assessee company has incurred expenditure and debited this amount of Rs.556.88 lakhs towards payment on account of corporate guarantee on defaulting of loan by KITL, assessee's sister concern or subsidiary towards payment

directed by Debt Recovery Appellate Tribunal. In such consideration, we are of the view that all the actions of the assessee i.e., providing corporate guarantee for the assessee's sister concern for obtaining loan from Oman International Bank is incidental to the business of the assessee company and when a payment is made towards defaulting in loan and directed by Debt Recovery Appellate Tribunal, the same is spent towards discharge of corporate guarantee, the same should be treated differently and should be allowed as deduction. We further noted that the assessee has made sincere attempt for recovery and this amount was recovered subsequently as noted by AO as well as by the CIT(A) and even before us, as pointed by ld. counsel, the assessee has offered the amount in subsequent assessment year. This fact is germane from the orders of lower authorities and not denied by the Revenue before us. Once this is the position and in view of judgment of Hon'ble Supreme Court in the case of S.A. Builders Ltd., *supra,* we allow the claim of assessee.

8. The next issue in this appeal of assessee is as regards to the order of CIT(A) confirming the action of AO in disallowing expenses relatable to exempt income by invoking the provisions of section 14A of the Act read with Rule 8D of the Income Tax Rules, 1962 (hereinafter the 'Rules'). For this, assessee has raised following Ground No.3:-

3. The Commissioner of Incometax (Appeals) erred in confirming the addition of Rs.16,78,957/- under Section 14A without considering the fact that the investments were not made entirely out of interest bearing funds and that the Appellant had substantial own funds for investments.

9. Brief facts are that the assessee earned dividend income of Rs.70.22 lakhs and claimed the same as exempt. The assessee suo-motto disallowed expenses on account of interest and finance charges of Rs.7,33,878/- but according to AO under Rule 8D(2)(ii) interest disallowances comes to Rs.6,57,000/- and under Rule 8D(2)(iii) i.e., 0.5% of average value of investment, disallowance of administrative expenses comes to Rs.17,55,835/-, balance amount was disallowed at Rs.16,78,957/-. Aggrieved, assessee preferred appeal before CIT(A), who also confirmed the action of AO.

10. Now before us, the ld.counsel for the assessee as well as ld. Senior DR, both agreed that matter can be restored back to the file of the AO for verification of availability of interest free funds in the shape of share capital and reserves and other interest free funds with the assessee for making disallowance of interest under Rule 8D(2)(ii). Both agreed that for making disallowance of administrative expenses under Rule 8D(2)(iii) 0.5% of average value of investment should be taken only for the value of investments or instruments which give raise to exempt income only and no other investment should be taken for

computing this disallowance. Both agreed for the above proposition. Hence, we remand this issue back to the file of the AO and orders of lower authorizes on this issue is set aside for framing fresh assessment.

11. The ld.counsel also drew our attention to additional alternative ground raised in the appeal in regard to corporate guarantee claimed. Since, we have already adjudicated the issue on merits in favour of assessee allowing the appeal of assessee on this issue, we did not go into the alternative additional ground. Hence the same has become infructuous and dismissed.

12. In the result, the appeal of the assessee is partly allowed for statistical purpose.

Order pronounced in the open court on 6th July, 2022 at Chennai.

Sd/-	Sd/-
(मनोज कुमार अग्रवाल)	(महावीर सिंह)
(MANOJ KUMAR AGGARWAL)	**(MAHAVIR SINGH)**
लेखा सदस्य/ACCOUNTANT MEMBER	उपाध्यक्ष /VICE PRESIDENT

चेन्नई/Chennai,
दिनांक/Dated, the 6th July, 2022

RSR
आदेश की प्रतिलिपि अग्रेषित/Copy to:

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