

**IN THE INCOME TAX APPELLATE TRIBUNAL
AMRITSAR BENCH, AMRITSAR**

**BEFORE DR. M. L. MEENA, ACCOUNTANT MEMBER
AND SH. ANIKESH BANERJEE, JUDICIAL MEMBER**

I.T.A. No. 451/Asr/2019
Assessment Year: 2013-14

Asstt. Commissioner of
Income Tax, Circle-3
Srinagar

(Appellant)

Vs. M/s Saifco Cement Pvt. Ltd.
Kral Sangri Brain Nishat,
Srinagar

[PAN: AAECs 8832M]

(Respondent)

C.O. No. 6/Asr/2022
(Arising out of ITA No. 451/Asr/2019)
Assessment Year: 2013-14

M/s Saifco Cement Pvt. Ltd.
Opp. Post Office Batwara
Srinagar, J & K

[PAN: AAECs 8832M]

(Appellant)

Vs. Asstt. Commissioner of
Income Tax, Circle-3
Shah House, Srinagar J&K

(Respondent)

Appellant by : None

Respondent by: Sh. Rajiv Wadhera, Sr. DR

Date of Hearing: 25.07.2023

Date of Pronouncement: 23.08.2023

ORDER

Per Dr. M. L. Meena, AM:

Both the captioned appeals have been filed by the Revenue and Cross Objection filed by the assessee against the order of the Ld. Commissioner of Income Tax (Appeals)-1, Amritsar dated 18.03.2019 in respect of Assessment Year: 2013-14.

2. The revenue has raised the following grounds of appeal:

- "1. The Ld. CIT (A) -1, Ludhiana has erred in deleting the addition of Rs. 18247239/- made by the A.O on a/c of disallowance of interest u/s 36(i) (iii)*
- 2. The Ld. CIT(A) has erred in deleting the addition of Rs. 431620/- on a/c of 10% of disallowance expenses under the heads of Telephone expenses, Tour & travelling expenses, General/ Misc. Expenses, entertainment expenses, vehicle repair & maintenance amount of Rs. 4316220/-."*

3. The CO has raised the following grounds of appeal:

- "1 a. That the order passed by Id. CIT(A) is judicious and based on merits and facts of the case which has been discussed in the appeal order passed.*
- b. That the second appeal has been wrongly filed since the assessee's assessed income for the year is net Loss of Rs.2,46,81,686/- even after adjusting of the impugned additions of Rs.1,86,78,859/- made u/s 143(3).*

c. That since tax effect before & after the addition of Rs.18247239/- is Zero contrary to tax effect of Rs.5547620/- claimed by the Id. AO.

2. *That the ground No. 2 is on account of adhoc additions of business expenses amounting to Rs.431620/-.*

b. That the Tax effect on these adhoc additions of Rs.431620/- has been wrongly calculated at Rs.616402/- in the petition filed by the appellant.

c. That since the adhoc additions do not sustain judicial scrutiny therefore needs to be dismissed.

3. *That in view of –NIL- tax effect on account of these additions the eligibility to prefer appeal before the Hon'ble Bench is nonest.*

f. That the second appeal filed on frivolous grounds is fit to be dismissed.

4. The adjournment application filed by the assessee is rejected being found devoid of merits. Since, the main appeal has been filed by the department, therefore, it is decided to hear the Id. DR and adjudicate the appeal of the department in CO on the merits of the case after considering the material available on record and the impugned order.

5. The department has challenged the order of the Id. CIT(A) in deleting the addition of Rs.1,82,47,239/- made by the AO on account of disallowance of interest u/s 36(1)(iii) and the addition of Rs. 431620/- on a/c of 10% of disallowance expenses out of other expenses.

6. The assessee company has been engaged in the manufacturing of Portland cement since 2003. The AO stated that during the year relevant, it had advanced interest free loans to its sister concern M/s Saifco Hillcrest Hotels P Ltd and also borrowed interest bearing loans both secure and unsecure. The assessee explained that the advances had been made out of personal overdraft of the directors sanctioned by the bank and out of interest free loans and advances received from the distributors, friends and relatives in the company and the interest on these personal overdrafts have already been voluntarily surrendered and added back to the returned income by the assessee to the tune of Rs 3,45,40,887/- in the computation of income. Thus, the finances with the available company which have been advanced to the sister concern without any bearing on financial position of the assessee company was the following-

	Share capital	Rs. 46649455/-
1.	Personal overdraft of directors on which interest have already been surrendered and disallowed in the computation by the assessee	Rs. 273324855/-
2.	Interest free advance other than trade payable received from distributors of the company against future sales	Rs 11184747/-
3.	Interest free security deposit from distributors	Rs.9292500/-
4.	Interest free unsecured loans from relatives & friends	<u>Rs.2300702/-</u>
	Total	Rs.443352259/-

The AO however being not satisfied with the reply of the assessee held that there is known excess use of borrowed funds for the purpose of business to claim deduction of interest u/s 36(I)(iii) of the act. Hence proportionate interest of Rs 182,47,239/- was disallowed following decision in the case of Abhisekh Industries Ltd.

7. The assessee being aggrieved with the Assessment Order, went in appeal before the Ld. CIT(A) who has granted relief to the assessee by observing as under:

Decision- I have considered the assessment order and the written submission of the appellant. Assessee had advanced interest free loans to its sister concern M/ s Saifco Hillcrest Hotels P Ltd and also borrowed interest bearing loans both secure and unsecure. The finances with the available company which have been advanced to the sister concern without any bearing on financial position of the assessee company was the following-

1. Share capital	Rs. 46649455/-
2. Personal overdraft of directors on which interest have already been surrendered and disallowed in the computation by the assessee	Rs. 273324855/-
3. Interest free advance other than trade payable received from distributors of the company against future sales	Rs 11184747/-
4. Interest free security deposit from distributors	Rs.9292500/-
5. Interest free unsecured loans from relatives & friends	<u>Rs.2300702/-</u>
Total	Rs.443352259/-

As explained by the appellant, the average outstanding balance of loans given to the sister concern had been minimum at Rs 36.31 crore and maximum at Rs 44.31 crores during the year which on average basis is around Rs 40.31 crore at any given time. The appellant rightly submitted that these average advances of Rs 40.31 crore is lesser than the interest free funds of Rs 44.34 crore available with the appellant as above.

The balance sheet analysis of the appellant distinctly shows mixed of- free funds and interest bearing funds availed by the appellant which have been used to repay the loan of the .sister concern in J&K bank. The appellant had already voluntarily surrendered and added back interest on loan amounting to Rs 345,40,887/- to the profit determined in P&L account.

Therefore in view of the above facts and circumstances of the case further disallowance of interest of Rs 182,47,239/- u/s 36(1)(iii) of the act is uncalled for and deleted.

(iii) The ground of appeal no. 4 is against disallowance of Rs 431,620/- out of expenses. The AO had disallowed 10% of the expenses claimed under heads telephone, tour and travelling, general/miscellaneous expense, entertainment, vehicle repairing amounting to Rs 431,620/- on the ground that some bills of the above expenses were not available and were not properly vouched. No salary register maintained.

Decision- The appellant had disallowed 10% of the expenses claimed under heads telephone, tour and travelling, general/miscellaneous expense, entertainment, vehicle repairing amounting to Rs 431,620/- on the ground that some bills of the above expenses were not available and were not properly vouched. No salary register maintained. The appellant had maintained books of accounts, bills and vouchers as admitted by the AO in the assessment order.

However the AO had disallowed 10% of the expenses claimed under the above heads without pointing out even a single item of expenditure under these heads which was not properly vouched or which was not available with the assessee. Therefore such a disallowance @ 10% of the expenses claimed in the P&L account under the heads tour and travelling, general/miscellaneous expense, entertainment, vehicle repair and maintenance is unsustainable and deleted. However personal use of telephone by the assessee company is ruled out and

therefore the disallowance out of telephone for personal use by the company is deleted.

8. The revenue being aggrieved with the appellate impugned order in appeal before us. The Ld. DR submitted that the CIT (A) -1, Ludhiana has erred on facts of the case in deleting the addition of Rs. 18247239/- made by the A.O on a/c of disallowance of interest u/s 36(i) (iii) besides deleting the addition of Rs. 431620/- on a/c of 10% of disallowance expenses under the heads of Telephone expenses, Tour & travelling expenses, General/ Misc. Expenses, entertainment expenses, vehicle repair & maintenance amount of Rs. 4316220/-. He has filed a written synopsis to support the contention raised before us while presenting the revenue appeal on facts and law applicable. The written synopsis of the DR is reproduced as under:

Written Submission:

“It is respectfully submitted to the Hon’ble Bench of ITAT, Amritsar that the department have filed appeal before your goodself wherein the following grounds of appeal has been raised:-

- (i) The Ld. CIT(A)-1, Ludhiana has erred in deleting the addition of Rs. 1,82,47,239/- made by the Assessing Officer(AO) on account of disallowance of interest u/s 36(i)(iii) of the Income-tax Act, 1961.
- (ii) The Ld. CIT(A) has erred in deleting the addition of Rs. 4,31,620/- on account of 10% of disallowance expenses under the head of Telephone expenses, Tour & Travelling

expenses, General/Misc. Expenses, entertainment expenses, vehicle repair and maintenance amount of Rs. 43,16,220/-.

2. During the course of proceedings before the Hon'ble Bench of ITAT, Amritsar, the Hon'ble Bench directed to submit the written submission on the grounds of appeal filed by the department.

2.1 In this regard, it is humbly submitted that with regard to ground of appeal no. 1, your goodself kind attention is drawn to para no. 3 of the assessment order u/s 143(3) of the Income tax Act, 1961 dated 25.02.2016 of the Assessing Officer(AO)wherein the AO has mentioned that the assessee company has advanced interest free loans to its sister concern namely M/s Safico Hillcrests Hotels Pvt Ltd. and at the same time, the assessee company has borrowed interest bearing loans, both secured and unsecured, and keeping in view these facts, the Authorized Representative(AR) of the assessee company was show caused as to why the proportionate interest paid advances made of the sister concern may not be disallowed and added to the returned income of the assessee company.

In response to this show cause, the assessee company submitted that these advances have been made out of personal overdraft of Directors sanctioned by the bank and out of the interest free loan & advances received from the distributors, friends & relatives in the company. The interest on these personal overdrafts had already been voluntarily surrendered and added back to the returned income by the assessee company to the tune of Rs.3,45,40,887/- in the computation of income for the year under consideration. Since these advances have been only routed through the books of assessee company for the reason the repayment could be ensured from surplus revenues of the assessee company. In support of its contention, the assessee company hadsubmitted that the finances available with the company from which the said advances had been made to the sister concern as under:-

Sr. No.	Description	Amount(in Rs.)
1.	Share Capital	4,66,49,455/-
2.	Personal overdraft of Directors on which interest has already surrendered and disallowed in computation voluntarily by the assessee company.	27,33,24,855/-
3.	Interest free advances other given trade payable received from distributors of the company against future sales	1,11,84,747/-
4.	Interest free security deposit from distributors	92,92,500/-
5.	Interest free unsecured loans from relatives and friends	23,00,702/-
	Total	44,33,52,259/-

The assessee company further submitted that the average advances to the sister concern for the year works out to Rs. 44,38,05,521/- which had been met out of the above surplus funds available with the company and the assessee company had already surrendered interest on bank borrowing debit in P & L A/c to the extent of advances given to the sister concern, therefore, no further disallowance called for. However, the AO has held that the funds borrowed for the purpose of business had been advanced for non-business purpose which call for disallowance of interest u/s 36(1)(iii) of the Income-tax Act, 1961. Hence proportionate interest of Rs. 1,82,47,239/- was disallowed following decision in the case of Abhishek Industries Ltd. Here it is pertinent to point out that in the scrutiny assessment order u/s 143(3) of the Income tax Act, 1961 dated

25.02.2016, the AO had duly mentioned month-wise balance of the sister concern of the assessee company in the books of accounts of the assessee company as per the details given hereunder in **TABLE-“A”** and had charged the interest @ 13% claimed to be paid by the assessee company on bank loans and unsecured loans in its books of accounts and thus the AO had added the balance interest of Rs. 1,82,47,239/- u/s 36(1)(iii) of the Income-tax Act, 1961 as per the calculation given in **TABLE -“B”**.

TABLE-“A”

S.No.	Month	Balance of M/sSafico Hillcrests Hotels Private Ltd.(in Rs.)	Interest @ 13%(in Rs.)	Amount to be added back(in Rs.)
1	April, 2012	408273172/-	4422959/-	4422959/-
2	May,2012	407117228/-	4410437/-	4410437/-
3	June, 2012	395924728/-	4289185/-	4289185/-
4	July,2012	404499979/-	4382083/-	4382083/-
5	August, 2012	402130229/-	4356411/-	4356411/-
6	Sep.2012	398963090/-	4322100/-	4322100/-
7	October, 2012	420921397/-	4559982/-	4559982/-

8	Nov. 2012	443109077/-	4800348/-	4800348/-
9	Dec. 2012	412152856/-	4464989/-	4464989/-
10	Jan.2013	408424273/-	4424596/-	4424596/-
11	Feb.2013	408137690/-	4421492/-	4421492/-
12	March, 2013	363096397/-	3933544/-	3933544/-
	Total			52788126/-

TABLE-“B”

Sr. No.	Description	Amount (in Rs.)
1.	Total interest components added back	5,27,88,126/-
2.	Interest Components already added back by the assessee company in its computation of Income	3,45,40,887/- -
3.	Balance Interest is to be added back now	1,82,47,239/-

Aggrieved against the order of the AO, the assessee company filed appeal before the Ld. CIT(A) who in para no. 5(ii) of his order dated 18.03.2019 had deleted the said disallowance of interest of Rs. 1,82,47,239/- u/s 36(i)(iii) of the Income-tax Act, 1961 made by the AO by holding that the average outstanding balance of loans given to the sister concern namely M/s Safico Hillcrests Hotels Private Ltd. had been minimum at Rs.36.31 crore and maximum at Rs.44.31 crores during the year which on average basis is around Rs. 40.31 crores and these average advances of Rs 40.31 crores is lesser the interest free fund of Rs. 44.34 crores available with the appellant as above and the balance sheet analysis of the appellant distinctly shows mixed of free funds and interest bearing funds availed by the appellant which have been used to repay the loan of the sister concern in J&K Bank. The appellant had already voluntarily surrendered and added back interest on loans amounting to Rs. 3,45,40,887 to the profit determined in P&L account.

However, the Ld. CIT(A) had erred in deleting the addition of Rs. 1,82,47,239/- made by the Assessing Officer(AO) on account of disallowance of interest u/s 36(i)(iii) of the Income-tax Act, 1961 on account of interest bearing funds advanced to the sister concern in view of the following glaring facts:-

- (i) That the assessee company had voluntarily surrendered the interest on bank borrowing debited in P&L A/c to the extent of advances given to the sister concern namely M/s Safico Hillcrests Hotels Private Ltd. by voluntarily adding the amount of Rs. 3,45,40,887/- in its computation of income for the year under consideration. This means that the assessee company had admitted that the interest bearing funds have been advanced to the sister concern and the said advances given to the sister concern are without any business or commercial expediency. Thus, by voluntarily surrendering the interest on bank borrowing debited in P&L A/c to the extent of advances given to the sister concern, the assessee company had admitted that the said advances given to sister concern

are for non-business purpose and hence, the borrowed funds have not been utilized for the business purpose by the assessee company.

However, during the course of appellate proceedings before the Ld. CIT(A), the AR had argued that the advances given to the said sister concern namely M/s Safico Hillcrests Hotels Private Ltd. were out of interest free funds available with the assessee company and to substantiate his claim, the AR made details of such funds to show that such funds are more than the average advances given to said sister concern. It needs to be pointed out here that generalized calculation of interest free funds will not help the cause of the assessee company as it is important to emphasize here that the object of the provisions under section 36(1)(iii) of the Income-tax Act, 1961 is not to enable an assessee to make a large borrowing and create a liability for payment of interest thereon not only in the year in which the borrowing was made, but also in the subsequent years as well, keep the loan outstanding and, thereafter, divert the amount borrowed by taking it out of the business by giving it interest-free to others, but continue to pay interest out of the income of the business and claim the amount of interest paid as a business expenditure. **The payment of interest on the amount not used in business cannot be regarded as business expenditure as the business does not derive any benefit from the outgoing by way of interest on an amount which is no longer used in the business, but had been diverted from the business.** This provision, therefore, cannot be construed as enabling an assessee to burden the business with interest even while taking the amount initially borrowed for the business, but subsequently taken out of the business by diverting it as interest-free loans to others. **It is also relevant to point out here that the amount borrowed for the business remains a liability for the business till its discharge.** The fact that the amount borrowed may have been invested in the purchase of machinery

or utilized as working capital or used in any other way does not in any way affect the liability for repayment of the amount borrowed. So long as the money borrowed is used in the business, interest paid on such borrowing is a proper charge on the business and is allowable as expenditure. Under section 36(1)(iii) of the Income-tax Act, 1961, the amounts diverted not being used for the purposes of the business, interest relating to the amount diverting out of the business cannot be treated as permissible deduction in the computation of income. The legislative language of section 36(1)(iii) of the Income-tax Act, 1961 is very clear as expression **“borrowed for the purpose of the business”** is used. Any view to contrary would not in the least sub-serve the object of the legislative provision, but it would only open the gates for the assessee to borrow merrily and after ostensibly using it in the business for a short period and at a subsequent point of time divert the funds in whole or part, for non-business purpose and continue to claim the interest on the borrowing as a deductible item of expenditure. The objects of the section would not in any way be advanced by the adoption of such a view. If a business for which the interest paid is claimed as a deduction had not benefited during the year from the capital borrowed by such borrowed amount being used in the business, such interest cannot be regarded as expenditure for the purposes of the business.

- (ii) That no such business or commercial expediency in advancing the interest free loan to the sister concern had been proved by the appellant in the present case. In this connection, the reliance is placed on the following case laws in favour of revenue:-
- (a) The **Hon'ble Supreme Court In the case of S.A. Builders Ltd. vs. Commissioner of Income-tax (Appeals), Chandigarh reported at [2007] 158 Taxman 74(SC)** has held as under:-

"Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital - Assessment years 1990-91 and 1991-92-Whether borrowed fund advanced to a third party should be for commercial expediency, if it is sought to be allowed under section 36(1)(iii) - Held, yes - Assessee borrowed fund from bank and advanced part of it to its sister concern (a subsidiary) as interest-free loan - Assessing Officer disallowed interest under section 36(1)(iii) on borrowings to extent those were advanced to subsidiary - Tribunal as well as High Court upheld order of Assessing Officer - Whether since neither High Court nor Tribunal and other authorities had examined whether amount advanced to sister concern was by way of commercial expediency, matter was to be remanded to Tribunal for afresh decision in accordance with law- Held, yes

- (b) The Hon'ble **Madras High Court** in **the case of K. Somasundaram & Bros. vs. Commissioner of Income-tax reported at [1999] 238 ITR 939 (MAD.)** has held as under:-

"Section 36(1)(iii) of the Income-tax, Act, 1961:- Interest on capital borrowed - Deduction on-Assessment years 1978-79 and 1979-80 - Whether for claiming deduction of Interest on capital borrowed, it is necessary that capital so borrowed should not only be invested in business but that amount borrowed continues to remain in business-Held, yes-Whether in cases where borrowed amounts are not invested in business at all but diverted for other purposes, interest paid on such borrowed amounts are not allowable -Held. yes - Whether where assessee had invested borrowed funds in execution of contracts and after amount realized on said execution, it lend substantial part of those funds interest-free to relatives of partners, interest paid on capital borrowing to extent of amounts diverted could not be claimed for deduction as item of business expenditure -Held, yes"

- (c) The Hon'ble High Court of Gujarat in the case of **CIT v. Cornerstone Exports (P.) Ltd. reported at (2016) 67 taxmann.com 345 (Gujarat)/[2016] 238Taxman 465(Gujarat)** has held asunder:

“Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital - Assessment year 1995-96 - Assessee-company borrowed certain sum from various group companies and such funds were advanced to other group companies at much lower Interest rate than Interest rate on borrowed funds- It claimed deduction under section 36(1)(iii) on Interest paid on borrowings-Whether though section 36(1)(iii) permits deduction of interest paid on capital borrowed for purpose of business or profession and expression 'for purpose of business is wider than expression for purpose of earning income', assessee has to point out business expediency which prompted assessee to make advances at a lower rate of interest - Held, yes - Whether since action of assessee company to make advances at a lower rate of interest than Interest rate at which it borrowed such funds was not shown to be in any, manner actuated by business expediency, such component of Interest was rightly disallowed -Held, yes [Paras 13 and15](In favour of revenue)”

- (d) The Hon'ble **Tribunal Bench of Mumbai in the case of MLL Logistics {P} Ltd. vs. ACIT reported at (2022] 137. taxmann.com 466/194ITD 787/93 ITR (Trib) 513 (Mum-Trib)** has been held as under:

“Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital (General) - Assessment year 2013-14 - Whether where assessee failed to furnish any evidence to demonstrate that interest expenditure claimed as deduction was incurred for purpose of business. since onus was entirely on assessee to establish on record that interest expenditure claimed as deduction was incurred for purpose of business, claim for deduction u/s36(1)(iii) could not be allowed - Held, yes”

- (e) The Hon'ble **Punjab & Haryana High Court in the case of C. R. Auluck and Sons (P.) Ltd. Vs. Commissioner of Income-tax[2014] 49 taxmann.com 21 (Punjab & Haryana)** has held as under:

"Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital (Interest-free loan to sister concern) - Assessment year 2005-06 - Assessee and its sister concern had taken independent credit limits from bank - Assessee along with two group concerns stood guarantor to credit limits advanced to sister concern - Sister concern had gone into huge loss and its bank account was proposed to be declared as non-performing asset - Assessee took a loan from bank and gave interest-free advances to sister concern - Whether there was no commercial expediency in advancing loan by assessee to sister concern and, therefore, interest attributable to such loan was to be disallowed under section 36(1)(iii) - Held, yes [Paras 7 & 11][In favour of revenue]"

- (f) The **Hon'ble High Court of Karnataka in the case of CIT vs. K.s. Dattatreya [2011] 197 taxman 151** has held that-

"as a revisional authority commissioner appeals can revise not only the ultimate computation arrived at but every process which lead to the ultimate computation or assessment".

- (g) The **Hon'ble Kerala High Court in the case of Vs SubramonlaAiyr vs.CIT [1978] 113 ITR 685** held that-

"the power conferred on Appellate Authority by Section 246 which is exercised in accordance with procedure with Section 250 indicate and amplitude and width which is no less wide than that of an /TO and the Appellate Authority could substitute the order of the/TO by one of his own."

- (iii) That in the assessment order u/s 143(3) of the Income tax Act, 1961 dated 25.02.2016, the AO has rightly calculated the interest according to month wise balance of the sister concern of the assessee company in the books of accounts of the assessee company as per the details given in TABLE-"A" supra which is more rational method of calculating the interest than the average outstanding balance of loans given to the sister concern with minimum at Rs. 36.31 crore and maximum at Rs.44.31 crores during the year as relied upon by the Ld. CIT(A) in his said order as the maximum and minimum balance represent a particular point of time and relates to two extremes i.e. maximum and minimum whereas month-wise balance of outstanding balance is more appropriate method of determining the amount of advance outstanding with the sister concern.
- (iv) That in the said assessment order dated 25.02.2016, the AO has rightly calculated the disallowance of interest @ 13% claimed to be paid by the assessee company on bank loans and unsecured loans in its books of accounts. The assessee company has not provided the basis as well as the rate of interest etc. at which the calculation has been made with respect to voluntarily adding the amount of Rs. 3,45,40,887/- in its computation of income for the year under consideration on account of interest bearing funds advanced to the sister concern.

In view of the above factual & legal position discussed above, the disallowance of interest amounting to Rs. 1,82,47,239/- u/s 36(i)(iii) of the Income-tax Act, 1961 has been rightly made by the AO in said assessment order dated 25.02.2016 which is hereby requested to be restored.

9. Per contra the counsel for the defendant assessee submitted in support of the cross objection that the order passed by Id. CIT(A) is judicious and based on merits and facts of the case; that the second appeal has been wrongly filed since the assessee's assessed income for the year is net Loss of Rs.2,46,81,686/- even after adjusting of the impugned additions of

Rs.1,86,78,859/- made u/s 143(3) and that since tax effect before & after the addition of Rs.18247239/- is Zero contrary to tax effect of Rs. 5547620/- claimed by the Id. AO. As regards to the additions of Rs.431620/-, it contends that since the adhoc additions do not sustain judicial scrutiny therefore needs to be dismissed.

10. We have heard the rival contentions, perused the material on record, impugned order, written submission and case law cited before us. Admittedly, the assessee company has advanced interest free loans to its sister concern namely M/s Safico Hillcrests Hotels Pvt Ltd. and at the same time, the assessee company has borrowed interest bearing loans, both secured and unsecured. Keeping in view these facts, the Authorized Representative(AR) of the assessee company was show caused as to why the proportionate interest paid advances made of the sister concern may not be disallowed and added to the returned income of the assessee company.

11. From the data presented in Table A and B as above, it is noted that the AO has examined and analyzed the facts regarding funds borrowed by the appellant company for the purpose of business had been advanced for

non-business purpose which call for disallowance of interest u/s 36(1)(iii) of the Income-tax Act, 1961. Accordingly, proportionate interest of Rs. 1,82,47,239/- was disallowed following decision in the case of Abhishek Industries Ltd. The Ld. DR has pointed out that in the scrutiny assessment order u/s 143(3) of the Income tax Act, 1961 dated 25.02.2016, the AO had duly mentioned month-wise balance of the sister concern of the assessee company in the books of accounts of the assessee company as per the details given hereinabove TABLE-"A" and had charged the interest @ 13% claimed to be paid by the assessee company on bank loans and unsecured loans in its books of accounts and thus the AO had added the balance interest only of Rs. 1,82,47,239/- u/s 36(1)(iii).

12. The DR argued that the CIT(A) was not correct in observing that the average advances of Rs 40.31 crores to sister concern is lesser the interest free fund of Rs. 44.34 crores available with the appellant and that the balance sheet analysis of the appellant distinctly shows mixed of free funds and interest bearing funds availed by the appellant which have been used to repay the loan of the sister concern in J&K Bank.

13. From the written submission and contentions raised by the Id. DR, it seems that the Ld. CIT(A) had grossly erred in deleting the addition of Rs. 1,82,47,239/- made by the Assessing Officer(AO) on account of disallowance of interest u/s 36(i)(iii) of the Income-tax Act, 1961 on account of interest bearing funds were being advanced to the sister concern. The following glaring facts pointed out by the Ld. DR renders the impugned order perverse to the facts on record:

1. That the assessee company had voluntarily surrendered the interest on bank borrowing debited in P&L A/c to the extent of advances given to the sister concern namely M/s Safico Hillcrests Hotels Private Ltd. by voluntarily adding the amount of Rs. 3,45,40,887/- in its computation of income for the year under consideration. Meaning thereby that it is an admitted fact on record that the assessee company had admitted that the interest bearing funds have been advanced to the sister concern and the said advances given to the sister concern are without any business or commercial expediency. Thus, by voluntarily surrendering the interest on bank borrowing debited in P&L A/c to the extent of advances given to the sister concern, the assessee company had admitted that the said advances given to sister concern are for non-business purpose and hence, the borrowed funds have not been utilized for the business purpose by the assessee company.

2. The AR had argued during the course of appellate proceedings before the Ld. CIT(A), that the advances given to the said sister concern namely M/s Safico Hillcrests Hotels Private Ltd. were out of interest free funds available with the assessee company and to substantiate his claim. In our view, the generalized calculation of interest free funds will not help the cause of the assessee company as it is important to emphasize here that the object of the provisions under section 36(1)(iii) of the Income-tax Act, 1961 is not to enable an assessee to make a large borrowing and create a liability for payment of interest thereon not only in the year in which the borrowing was made, but also in the subsequent years as well, to keep the loan outstanding and, thereafter, divert the amount borrowed by taking it out of the business by giving it interest-free to others, but continue to pay interest out of the income of the business and claim the amount of interest paid as a business expenditure. In view of that matter **the payment of interest on the amount not used in business cannot be regarded as business expenditure as the business does not derive any benefit from the outgoing by way of interest on an amount which is no longer used in the business, but had been diverted from the business.** Thus, this provision, therefore, cannot be construed as enabling an assessee to burden the business with interest even while taking the amount initially borrowed for the business, but subsequently taken out of the business by diverting it as interest-free loans to others. **It is also relevant to point out here that the amount borrowed for the**

business remains a liability for the business till its discharge.

The fact that the amount borrowed may have been invested in the purchase of machinery or utilized as working capital or used in any other way does not in any way affect the liability for repayment of the amount borrowed.

3. As far as the money borrowed is used in the business, interest paid on such borrowing is a proper charge on the business and is allowable as expenditure. Under section 36(1)(iii) of the Income-tax Act, 1961, the amounts diverted not being used for the purposes of the business, interest relating to the amount diverting out of the business cannot be treated as permissible deduction in the computation of income. The legislative language of section 36(1)(iii) of the Income-tax Act, 1961 is very clear as expression “**borrowed for the purpose of the business**” is used. If a business for which the interest paid is claimed as a deduction had not benefited during the year from the capital borrowed by such borrowed amount being used in the business, such interest cannot be regarded as expenditure for the purposes of the business.

4. Lastly, there was no such business or commercial expediency in advancing the interest free loan to the sister concern had been proved by the appellant in the present case.

14. The Hon'ble Supreme Court In the case of S.A. Builders Ltd. vs. Commissioner of Income-tax (Appeals), Chandigarh reported at [2007]

158 Taxman 74(SC) has held as under:-

"Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital – Assessment years 1990-91 and 1991-92-Whether borrowed fund advanced to a third party should be for commercial expediency, if it is sought to be allowed under section 36(1)(iii) - Held, yes - Assessee borrowed fund from bank and advanced part of it to its sister concern (a subsidiary) as interest-free loan - Assessing Officer disallowed interest under section 36(1)(iii) on borrowings to extent those were advanced to subsidiary - Tribunal as well as High Court upheld order of Assessing Officer - Whether since neither High Court nor Tribunal and other authorities had examined whether amount advanced to sister concern was by way of commercial expediency, matter was to be remanded to Tribunal for afresh decision in accordance with law- Held, yes

15. The Hon'ble **Madras High Court in the case of K. Somasundaram & Bros. vs. Commissioner of Income-tax reported at [1999] 238 ITR 939 (MAD.)** has held as under:-

“Section 36(1)(iii) of the Income-tax, Act, 1961:- Interest on capital borrowed – Deduction on-Assessment years 1978-79 and 1979-80 –Whether for claiming deduction of Interest on capital borrowed, it is necessary that capital so borrowed should not only be invested in business but that amount borrowed continues to remain in business-Held, yes-Whether in cases where borrowed amounts are not invested in business at all but diverted for other purposes, interest paid on such borrowed amounts are not allowable -Held. yes – Whether where assessee had invested borrowed funds in execution of contracts and after amount realized on said execution, it lend substantial part of those funds interest-free to relatives of partners, interest paid on capital borrowing to extent of amounts diverted could not be claimed for deduction as item of business expenditure -Held, yes”

16. The Hon'ble High Court of Gujarat in the case of **CIT v. Cornerstone Exports (P.) Ltd. reported at (2016) 67 taxmann.com 345 (Gujarat)/[2016] 238Taxman 465(Gujarat)** has held asunder:

“Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital - Assessment year 1995-96 - Assessee-company borrowed certain sum from various group companies and such funds were advanced to other group companies at much lower Interest rate than Interest rate on borrowed funds- It claimed deduction under section 36(1)(iii) on Interest paid on borrowings-Whether though section 36(1)(iii) permits deduction of interest paid on capital borrowed for purpose of business or profession and expression 'for purpose of business is wider than expression for purpose of earning income', assessee has to point out business expediency which prompted assessee to make advances at a lower rate of interest - Held, yes - Whether since action of assessee company to make advances at a lower rate of interest than Interest rate at which it borrowed such funds was not shown to be in any, manner actuated by business expediency, such component of Interest was rightly disallowed -Held, yes [Paras 13 and 15](In favour of revenue)”

17. Again, **Mumbai Tribunal in the case of MLL Logistics {P} Ltd. vs. ACIT reported at (2022) 137. taxmann.com 466/194ITD 787/93 ITR (Trib) 513 (Mum-Trib)** has held similar view as under:

“Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital (General) - Assessment year 2013-14 - Whether where assessee failed to furnish any evidence to demonstrate that interest expenditure claimed as deduction was incurred for purpose of business. since onus was entirely on assessee to establish on record that interest expenditure claimed as deduction was incurred for purpose of business, claim for deduction u/s 36(1)(iii) could not be allowed - Held, yes”

18. The Hon'ble **Punjab & Haryana High Court in the case of C. R. Auluck and Sons (P.) Ltd. Vs. Commissioner of Income-tax[2014] 49 taxmann.com 21 (Punjab & Haryana)** has held as under:

“Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital (Interest-free loan to sister concern) - Assessment year 2005-06 - Assessee and its sister concern had taken independent credit limits from bank - Assessee along with two group concerns stood guarantor to credit limits advanced to sister concern - Sister concern had gone into huge loss and its bank account was proposed to be declared as non-performing asset - Assessee took a loan from bank and gave interest-free advances to sister concern - Whether there was no commercial expediency in advancing loan by assessee to sister concern and, therefore, interest attributable to such loan was to be disallowed under section 36(1)(iii) - Held, yes [Paras 7 & 11][In favour of revenue]

19. In the present case, the AO has rightly calculated the interest according to month wise balance of the sister concern of the assessee company in the books of accounts of the assessee company as per the details given in TABLE-“A”, as above which is more rational method of calculating the interest then the average outstanding balance of loans given

to the sister concern with minimum at Rs. 36.31 crore and maximum at Rs.44.31 crores during the year as relied upon by the Ld. CIT(A) in the impugned order because the maximum and minimum balance represent at particular point of time and relates to two extremes i.e. maximum and minimum whereas month-wise balance of outstanding balance is more appropriate method of determining the amount of advance outstanding with the sister concern.

20. Since, the assessee company has not provided the basis as well as the rate of interest etc. adopted for calculation with respect to voluntarily addition of the amount of Rs. 3,45,40,887/- in its computation of income for the year under consideration on account of interest bearing funds advanced to the sister concern and hence, the AO has rightly calculated the disallowance of interest @ 13% claimed to be paid by the assessee company on bank loans and unsecured loans in its books of accounts in the said assessment order dated 25.02.2016.

21. Considering the factual matrix and legal position as discussed above, we hold that the impugned order of the Ld. CIT(A) suffers from infirmities and perversities to the facts on record and therefore, the disallowance of interest amounting to Rs. 1,82,47,239/- u/s 36(i)(iii) of the

Income-tax Act, 1961 has been held to be rightly made by the AO. Accordingly, the impugned of the CIT appeal is reversed and that of the assessing officer is restored on the issue of disallowance of interest under section u/s 36(i)(iii) of the Income-tax Act, 1961.

22. Next ground is regarding adhoc disallowance of 10% out of the expenses claimed under heads telephone, tour and travelling, general/miscellaneous expense, entertainment, vehicle repairing amounting to Rs 431,620/- on the ground that some bills of the above expenses were not available and were not properly vouched. No salary register maintained. The appellant had maintained books of accounts, bills and vouchers as admitted by the AO in the assessment order, however he failed to produce the same under the pretext that these were lost in flood. The AO had disallowed 10% of the expenses claimed under the above heads without pointing out even a single item of expenditure under these heads which was not properly vouched or which was not available with the assessee. Therefore, such a disallowance @ 10% of the expenses claimed in the P&L account under the heads tour and travelling, general/miscellaneous expense, entertainment, vehicle repair and

maintenance is unsustainable and deleted. Similarly, personal use of telephone by the assessee company is ruled out and therefore the disallowance out of telephone for personal use by the company is deleted by the CIT(A).

22.1 The Ld DR submitted that for un-vouched expenses, no explanation was offer to justify these expenses before the AO. Therefore, in order to cover the leakage of Revenue, the AO disallowed 10% of above expenses claimed under various heads. Accordingly, an addition of Rs.4,31,620/- is made and added back to the returned income of the assessee company.

22.2 Keeping into consideration the plea of the assessee company that the records are not available due to loss by floods and the admitted fact that, the AO has not pointed out specific expenditure of personal use and merely holding that to cover possible leakage of revenue it was reasonable in making only 10% disallowance of the expenses under the above mentioned various heads amounting to Rs. 4,31,620/- is not permissible under the mandate. Accordingly, this ground of the department is rejected.

23. In the result, the appeal of the Department and CO of the Assesse is partly allowed.

Order pronounced in the open court on 23.08.2023

**Sd/-
(Anikesh Banerjee)
Judicial Member**

**Sd/-
(Dr. M. L. Meena)
Accountant Member**

GP/Sr.PS

Copy of the order forwarded to:

- (1) The Appellant:
- (2) The Respondent:
- (3) The CIT(Appeals)
- (4) The CIT concerned
- (5) The Sr. DR, I.T.A.T.

True Copy
By Order