IN THE INCOME TAX APPELLATE TRIBUNAL
JABALPUR BENCH, JABALPUR

BEFORE DR. B.R.R. KUMAR, ACCOUNTANT MEMBER
AND SHRI YOGESH KUMAR U.S., JUDICIAL MEMBER

I.T.A. No.263/JAB/2016
Assessment Year:2012-13

M/s J. P. Tobacco Products Pvt. Ltd., Seth Prahlad Bhai Patel Marg, Patharia Phatak, Damoh. PAN:AAACJ7141G	Vs.	Dy.C.I.T., Circle-Sagar.
(Appellant)		(Respondent)

I.T.A. No.127/JAB/2018
Assessment Year:2013-14

M/s J. P. Tobacco Products Pvt. Ltd., Seth Prahlad Bhai Patel Marg, Patharia Phatak, Damoh. PAN:AAACJ7141G	Vs.	Income Tax Officer-3, Sagar.

I.T.A. No.128/JAB/2018
Assessment Year:2014-15

M/s J. P. Tobacco Products Pvt. Ltd., Seth Prahlad Bhai Patel Marg, Patharia Phatak, Damoh. PAN:AAACJ7141G	Vs.	A.C.I.T., Circle-Sagar.

Appellant by	Shri Abhijeet Shrivastava, Adv.
Respondent by	Smt. Garima Chaudhary, CIT-DR
Date of hearing	20/11/2023
Date of pronouncement	21/11/2023

O R D E R

PER YOGESH KUMAR U.S., JM:-

The present appeals have been filed by the assessee against the different orders of ld. CIT(A)-1, Jabalpur dated 30.05.2016 & 26.03.2018.

2. At the outset, the ld. Counsel for the assessee submitted that the issue in this appeal is squarely covered in

assessee's favour vide order dated 22.09.2023 in ITA's No.93 & 94/Jab/2023 for the assessment years 2016-17 & 2017-18 in assessee's own case.

3. The ld. Sr. DR although supported the order of the AO but could not controvert the aforesaid contention of the ld. Counsel for the assessee.

4. We have considered the submissions of both the parties and perused the material available on the record. In the present case, it is noticed that an identical issue having similar facts was a subject matter of the assessee's appeal in ITA's No.93 & 94/Jab/2023, the relevant findings have been given in para 5 which read as under:

> The Ld.CIT(A) following the finding of Tribunal in the case of the assessee itself for earlier assessment years, has deleted the addition. For ready-reference, finding of Ld.CIT(A) in AY 2016-17 is reproduced as under:-
>
> 4.2. "I have considered the written submission of the Appellant and assessment order of the AO. It is observed that in the appellant case for A.Y. 2007-08, 2009-10, 2010-11 and 2011- 12 against the order of the ld. CIT(A), the appellant has filed appeal before the Hon'ble ITAT, Jabalpur Bench and the Hon'ble ITAT has vide order dated 27.04.2018 has held Interest payments to Directors and Shareholders as fair and allowable to the extent of 18%. Further, the Hon'ble ITAT has allowed the interest payments to Directors and Shareholders u/s 37(1) and also found it reasonable u/s 40(A)(2)(b) of the Act. Further, the appellant has also submitted the judgements in the case of group concerns of the appellant, wherein the Hon'ble Gujarat High Court has justified the deletion of addition on these grounds by the Hon'ble ITATS. Thus the Honourable Gujarat High court, took into consideration the Commercial Expediency of the Borrowing and belon Assessee's favour that the funds are used for Business purposes.
>
> 4.4 In view of above, I am inclined to concur with the findings given by the Hon'ble High Court and Hon'ble ITAT (supra) on the above mentioned issue and therefore, the disallowance made by the AO is hereby deleted. Thus, the grounds are allowed."

5. We have heard Ld. Authorized Representatives of the parties on issue in dispute and perused the relevant material available on record. The issue in dispute involved is the disallowance of interest paid to related parties. We find that Ld.CIT(A) has deleted the said disallowance following the binding precedents in the case of the assessee itself. For ready-reference, the finding of Tribunal in the case of the assessee in ITA

No217/Jab/2015 and others for AY 2007-08 and others dated 27.04.2018 is reproduced as under:-

> 18. "We have heard the rival contentions and perused the record placed before us and have gone through the decisions referred to and relied upon by the assessee. The issue before us is as to whether the assessee has rightly claimed the interest paid to directors and shareholders as business expenditure and whether the interest on Bank FDR interest is business income liable to be netted off against the interest expenditure.
>
> 19. We find that on account of notification relating to enhanced wages which was challenged before the Hon'ble Karnataka High Court, the liability was upheld by the Division Bench of the Hon'ble High Court against which special leave petition was filed before the Hon'ble Supreme Court which was admitted but stay was not granted. The assessee is having substantial Beedi manufacturing business in the State of Karnataka and on account of notification dated 24.10.1996 issued by the Govt. of Karnataka enhancing the wages of Beedi workers, the liability of wages rose to Rs.45.16 crores on 31.3.2006. As submitted by the learned counsel for the assessee that if the liability of interest for outstanding wages from 24.10.1996 for a period of ten years is worked out then the liability would reach to 100 crores. Undoubtedly, MOU was entered into setting the liability to lower amount but still some disputes continued. This fact goes un-rebutted that the assessee was under a continuous pressure for arranging the funds to pay the enhanced wages to Beedi workers It is evident that the assessee's main business is of Beedi manufacturing only and in case such liability has to be paid by the assessee and if the requested funds are not available to pay off then the business activity of the assessee would have been hindered.
>
> 20. We further find that the assessee has been consistently claiming the expenditure for the last many years and there has been no change in the facts and circumstances in which such claim has been made and the impugned interest expenditure has been consistently held to be business expenditure by the coordinate Bench in the assessee's own business in the past. Since financial year 1993-94 the assessee has been taking loans from the directors and shareholders and as on 31.3.2007 total unsecured loan balance from the directors and shareholders stood at Rs.65,93,68,125/-. As against this amount, the investment in FDR as on 31.3.2007 is Rs.93,09,55,960/-. These figures speak that the assessee has parked the funds in FDRS much more than the unsecured loans from directors and shareholders. This fact also proves that the assessee was keeping funds ready to use at times of business needs either to pay off the liabilities on account of enhanced wages or for other business purposes.
>
> 21. We further appreciate the fact that the assessee is always in need of large fund for procurement of raw materials such as Tobacco and Tendu leaves. The assessee needs huge working capital for the business. Tobacco is seasonal product and assessee purchases tobacco for the full year at whatever price. Tobacco being natural product and 100% dependent on rain, the price fluctuate erratically and hence the need of fund is uncertain and needs to carry huge funds is essential in the interest of business. In the same manner Tendu Patta is another major raw material which is being auctioned by the Government only. Government has introduced Tender system and the payment policy are subject to sudden changes which also supports the assessee's contention to maintain huge liquid funds with it.

22. The Coordinate Bench in assessee's own case for AY 2005- 06 vide ITA no.124/JAB/2008 and others, adjudicated the very same issue observing as follows:-

> "12. The next question for our decision is as to whether the loans taken from directors and shareholders were for business purpose or for making investment in FDRS and for that purpose consider it necessary to refer and consider the details placed at pages 89 and 90 of assessee's Paper Book, which are annexed as Annexure-I to this order.
>
> 13. After considering the rival submissions, facts, submissions and the chart placed at pages 89 and 90 of the Paper Book, correctness of which was not disputed by the ld.D.R. at the time of hearing, we are of the opinion that-
>
> (i) so far as loans amounting to Rs.1,59,20,000 raised during the previous year relevant to the assessment year 2005- 06 are concerned, the same having been used for payments towards purchase or business expenses have to be held to be for assessee's business purposes and therefore, interest at the rate of 18% on loans to that extent, is an allowable deduction under section 36(1)(iii) of the Act. Consequently, we hold so.
>
> (ii) So far as the loans raised in the previous years i.e. assessment years 2000-01 to 2004-05 are concerned, it is quite evident from the chart at page 89 that the amount of loans procured from directors was far less than the amount invested in FDRS and since the ld.D.R has not disputed the assessee's claim that loans procured in these years were also used for making purchase or making business expenses, the assessee's claim loans in excess of Rs.1,59,20,000 raised in previous years from directors and, shareholders were also for business purposes and therefore, payment of interest at the rate of 18% on the brought forward balance of loans was also an allowable deduction under section 36(1)(ii); Consequently, we hold so.

23. We further are of the view that every businessman has its own way to conduct the business. One cannot have a set bench mark or a process or a method which so as to guide a businessmen to conduct its affairs. In the instant case, the assessee was having readily available funds from its directors and shareholders, who also had surplus funds to park as loans for earning interest and the assessee also needed the funds without much paper formalities as well as less burden to pay them on immediate basis for making purchase of raw materials and to pay the statutory and contingent liabilities and it therefore rightly choose to take loans from the directors and shareholders. This act of the assessee, in our view, is for "commercial expediency". Hon'ble Apex Court in the case of S.A. Builders (supra) has defined commercial expediency to be a wider term observing as follows:-

> We have considered the submission of the respective parties. The question involved in this case is only about the allowability of the interest on borrowed funds and hence we are dealing only with that question. In our opinion, the approach of the High Court as well as the authorities below on the aforesaid question was not correct. In this connection we may refer to Section 3601/iii) of the Income Tax Act,

1961 (hereinafter referred to as the 'Act') which states that "the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession" has to be allowed as a deduction in computing the income tax under Section 28 of the Act.

In Madhav Prasad Jantia vs. Commissioner of Income Tax UP AIR 1979 SC 1291, this Court held that the expression "for the purpose of business" occurring under the provision is wider in scope than the expression for the purpose of earning income, profits or gains", and this has been the consistent view of this Court.

In our opinion, the High Court in the impugned judgment, as well as the Tribunal and the Income Tax authorities have approached the matter from an erroneous angle. In the present case, the assessee borrowed the fund from the bank and lent some of it to its sister concern (a subsidiary) on interest free loan. The test, in our opinion, in such a case is really whether this was done as a measure of commercial expediency.

In our opinion, the decisions relating to Section 37 of the Act will also be applicable to Section 36(1) because in Section 37 also the expression used is "for the purpose of business". It has been consistently held in decisions relating to Section 37 that the expression "for the purpose of business" includes expenditure voluntarily incurred for commercial expediency, and it is immaterial if a third party also benefits thereby. Thus in Atherton vs. British Insulated & Helsby Cables Ltd (1925)10 TC 155 (HL), it was held by the House of Lords that in order to claim a deduction, it is enough to show that the money is expended, not of necessity and with a view to direct and immediate benefit, but voluntarily and on grounds of commercial expediency and in order to indirectly to facilitate the carrying on the business. The above test in Atherton's case (supra) has been approved by this Court in several decisions e.g. Eastern Investments Ltd. vs. CIT (1951) 20 ITR 1, CIT us. Chandulal Keshavlal & Co. (1960) 38 ITR 601 etc. In our opinion, the High Court as well as the Tribunal and other Income Tax authorities should have approached the question of allowability of interest on the borrowed funds from the above angle. In other words, the High Court and other authorities should have enquired as to whether the interest free loan was given to the sister company (which is a subsidiary of the assessee) as a measure of commercial expediency, and if it was, it should have been allowed.

The expression "commercial expediency is an expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. The expenditure may not have been incurred under any legal obligation, but yet it is allowable as a business expenditure if it was incurred on grounds of commercial expediency. No doubt, as held in Madhav Prasad Jantia vs. CIT (supra), if the borrowed amount was donated for some sentimental or personal reasons and not on the ground of commercial expediency, the interest thereon could not have been allowed under Section 36/1) of the Act. In Madhav Prasad's case (supra), the borrowed amount was donated to a college with a view to commemorate the memory of the assessee's deceased husband after whom the college was to be named. It was held by this Court that

the interest on the borrowed fund in such a case could not be allowed, as it could not be said that it was for commercial expediency.

Thus, the ratio of Madhav Prasad Jantia's case (supra) is that the borrowed fund advanced to a third party should be for commercial expediency if it is sought to be allowed under Section 36(1)(ii) of the Act.

In the present case, neither the High Court nor the Tribunal nor other authorities have examined whether the amount advanced to the sister concern was by way of commercial expediency. It has been repeatedly held by this Court that the expression "for the purpose of business" is wider in scope than the expression " for the purpose of earning profits" vide CIT us. Malayalam Plantations Ltd. (1964) 53 ITR 140, CIT vs. Birla Cotton Spinning & Weaving Mills Ltd (1971) 82 ITR 166 etc. The High Court and the other authorities should have examined the purpose for which the assessee advanced the money to its sister concern, and what the sister concern did with this money, in order to decide whether it was for commercial expediency, but that has not been done.

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. 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)(i) 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.

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.

We agree with the view taken by the Delhi High Court in CIT vs. Dalmia Cement (Bhart) Ltd. (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.

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 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."

24. In light of the above judgment of Hon'ble Apex court, we are of the considered opinion that the act of assessee of taking loans from directors and shareholders and parking them as Bank FDR was purely for "commercial expediency and in the interest of business. We also find that the allegation of the Assessing Officer as well as the specific finding of the learned Commissioner of Income Tax (Appeals) that the alleged claiming of interest expenditure was just to avoid taxes and the learned Commissioner of Income Tax (Appeals) treated it as colorable device to evade taxes. Learned CIT (A) have final findings on this issue observing as follows;-

"4.3.14 Final appellate comments:

A colorable device can be ingeniously built in a otherwise legally acceptable arrangement/contract to subvert tax implications. The parties while adopting on acceptable legal form engage in a different transaction altogether. The intermediate steps serve no business purpose other than avoidance of tax. It is a pretense and a facade cleverly interumven into a legally acceptable commercial transaction.

This cannot be legally accepted.

The concept of colourable devise is a call to expose subterfuges, colourable devices and dubious methods in tax cases. It is a caution administered that lawful dues to the State cannot be withheld under schemes acquired off-the-shelf or through transactions that have no commercial or economic value or by taking certain pre-ordained steps

which are calculated to cancel out each other. The approach in such cases must be to take the entire transaction or arrangement as a whole and see if it makes any economic or commercial sense without attaching weight to the steps that go to make up the scheme, h of which may be legally valid. The genuineness of the arrangement has to be viewed not in relation to every step taken to achieve the result but in relation to the final result. This is only a different way of saying that one has to look at the truth of the transaction (and if permissible) by going behind the façade of documentation or the series of steps taken.

The classic and final word in this issue must belong to the observation of the house of lords in the case of Regina vs. Inland Revenue Commissioner (1995) 215 ITR 487 (HL). Para 39 (Relevant extract):

"Every tax Avoidance scheme involves a trick and pretence. It is the task of the Revenue to unravel the trick and duty of the court to ignore the pretence. With these remarks, the addition made in hereby confirmed."

25. However, we differ from the view of the ld. CIT(A) looking to the facts and circumstances wherein we find no iota of evidence or instance which could prove that there is a loss to the revenue because the assessee is paying taxes at the maximum rate of rate and the income declared in the assessment year 2007-08 is Rs.10.004 crs. as well as positive income has been declared for the remaining three assessment years and the directors and shareholders who have received the interest from the assessee company are also consistently paying tax at the maximum rate of tax i.e. 30%, which leaves no room for the revenue to allege that the assessee has used a colourable device to evade taxes.

26. We, therefore, in the facts and circumstances of the case and respectfully following the judgment of the Hon'ble Apex Court as well as the finding of the Tribunal in the case of the assessee for the preceding year and also looking to the fact that the type of business and facts for each year are consistent as in the past and the revenue has also failed to bring any distinguishing fact, are, therefore, are of the considered view that the assessee has duly acted within the four corners of law and loans taken by the assessee from the directors and shareholders were for the business purpose which a prudent businessman should have taken and we are further of the view that the alleged interest paid to directors and shareholders for AY 2007-08, AY 2009-10, AY 2010-11 and AY 2011-12 at Rs.9,23,22,357/-, Rs.9,66,79,822/-, Rs. 10,71,19,265/- and Rs. 11,87,94,449/- respectively are purely business expenditure only and by no canon it can be termed as nonbusiness expenditure. We, therefore, set aside the findings of both the lower authorities and delete the disallowance of alleged interest expenditure paid to directors and shareholders for AY 2007-08, AY 2009-10, AY 2010-11 and AY 2011-12 at Rs.9,23,22,357/-, Rs.9,66,79,822/- Rs.10,71,19,265/- and Rs.11,87,94,449/- respectively and allow this common issue raised by the assessee in all the four years."

6. Respectfully following the finding of Tribunal (supra), we uphold the disallowance of interest deleted by Ld.CIT(A). Thus, grounds raised by the Revenue in both appeals are dismissed.

7. In the result, both the appeals of the Revenue are dismissed.

5. Hence, in the absence of any material change on the facts of the issue and the legal preposition, the addition made by the Assessing Officer is hereby deleted.

6. In the result, the appeals of the assessee are allowed.

Order Pronounced in the Open Court on 21/11/2023.

Sd/-	Sd/-
(DR. B.R.R. KUMAR)	**(YOGESH KUMAR U.S.)**
Accountant Member	**Judicial Member**

Dated: 21/11/2023
*Singh/NV

Copy of the order forwarded to :

1. The Appellant
2. The Respondent.
3. Concerned CIT
4. The CIT(A)
5. D.R.,

Asstt. Registrar