

आयकर अपीलीय अधिकरण, 'ए' न्यायपीठ, चेन्नई।
IN THE INCOME TAX APPELLATE TRIBUNAL
'A' BENCH: CHENNAI

श्री महावीर सिंह, उपाध्यक्ष एवं श्री मंजुनाथ. जी, लेखा सदस्य के समक्ष
BEFORE SHRI MAHAVIR SINGH, VICE PRESIDENT AND
SHRI MANJUNATHA. G, ACCOUNTANT MEMBER

आयकर अपील सं./ITA No.3506/Chny/2019
निर्धारण वर्ष /Assessment Year: 2016-17

**The Asst. Commissioner of
Income Tax,**
Circle-2,
Erode.

**M/s. K3 Management and
Education Service Pvt. Ltd.,**
Old No.33/New No.81, Car Street,
Anthiyur, Erode – 638 001.
[PAN: AAFCK-7114-D]

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/ Appellant by
प्रत्यर्थी की ओर से /Respondent by

: Shri Nilay Baran Som, CIT
: Shri S. Sridhar, Advocate

सुनवाई की तारीख/Date of Hearing

: 18.12.2023

घोषणा की तारीख /Date of Pronouncement

: 29.12.2023

आदेश / ORDER

Per Mahavir Singh, Vice President :

This appeal by the Revenue is arising out of the order of the Commissioner of Income Tax (Appeals)-3, Coimbatore [hereinafter "CIT(A)] in Appeal No.212/18-19 dated 31.10.2019. The assessment was framed by the Asst. Commissioner of Income Tax, Circle-2, Erode [hereinafter "(A.O)] for the Assessment Year (A.Y) 2016-17 u/s.143(3) of the Income Tax Act, 1961 (hereinafter the 'Act'), vide order dated 22.12.2018.

2. The only issue in this appeal of Revenue is as regards to the order of CIT(A) deleting the disallowance made by A.O on the interest expenditure u/s. 36(1)(iii) of the Act for the reason that borrowing funds has been directed for non business purposes. For this, the Revenue has raised following five grounds:

(i) Whether on the facts and circumstances of the case, Id. CIT(A) was correct in holding that interest payment was expenditure allowed u/s 36(1)(iii) when it is a fact that the assessee became owner of the said asset two years after availing loan from bank and Proviso to Section 36(1)(iii) is clearly applicable on the facts of the case?

(ii) Whether on the facts and circumstances of the case, Id. CIT(A) had not appreciated the fact that as per Balance Sheet as on 31.03.2015, it was shown that assessee had advanced loan to Others to the tune of Rs. 1,31,16,387/-, which further establishes that loans from bank was not utilized for the purpose of business?

(iii) Whether on the facts and circumstances of the case, Id. CIT(A) had failed to appreciate the fact that during the relevant assessment year, the assessee had not become the owner of the property, rather it was through a protracted and cumbersome process of investing in firm, renaming the firm, converting the firm into company and then merging the company with assessee-company that after two years the property came into its possession?

(iv) Whether on the facts and circumstances of the case, Id. CIT(A) was correct in holding that the assessee borrowed funds in order to acquire control over the new company and for subsequent merger with appellant company when it is a fact that the said company was formed after conversion from firm, i.e. after one year of availing loan, and there was no agreement with the said company or any other evidence to show that the assessee proposed to follow this strange method of acquiring land and building?

(v) Whether on the facts and circumstances of the case, Id. CIT(A) was correct in holding that Assessing Officer had gone wrong in concluding that the borrowed funds have been diverted for non-business purposes when it is a fact that the assessee had utilized the loans for investing as share capital in a firm?

3. The brief facts of the case are that the assessee-company was incorporated on 26.09.2014 with the following three Directors 1) Shri K. Kavin Kumar 2) Shri C.K. Kandasamy & 3) Shri R. Thangavel. The assessee-company started and engaged in the business of infrastructure development of training and education. Subsequently, the assessee along with Shri K. Kavin Kumar, Shri C.K. Kandasamy, Shri R. Thangavel, Shri Suresh Belliraj and 9 members of family of Shri Suresh Belliraj formed a partnership firm namely Mangalam Infrastructure Services on 23.10.2014. Subsequently, this name of firm was changed to KKK Management and Education Services on 11.03.2015. Subsequently, the firm was converted into a limited company on 23.12.2015. This KKK Management and Edu Services, a company got merged with K3 Management and Education Services Pvt. Ltd. by order of NCLT dated 01.01.2016

4. The A.O noted during the course of assessment proceedings that the assessee in its balance sheet as on 31.03.2016 shown a long term borrowing being loan from bank amounting to Rs. 23,98,73,935/- under non-current liabilities and claimed interest expenditure in the P & L account to the tune of Rs. 3,57,37,643/-. The details of loan are as under:

Sl. No.	Particulars	Limit	Interest Rate	Purpose
1.	Karur Vysya Bank – term Loan – 162716000000010- Others	1 Crore	@13% rate of interest per annum	For purchase/installation of furniture, IT networking, laboratory equipment, security surveillance, PA systems, power, etc. supply, sound systems, console unit, connectors, lighting etc.
2.	Karur Vysya Bank – Term Loan – 1624716000000017 – Building	27 Crore	@ 13% rate of interest per annum	For purchasing Land and Building of Riverside Public School, Kotagiri
3.	Karur Vysya Bank – SOD-RE	0.50 Crore	11% to 13%	To meet working capital requirements

5. The A.O noted the complete details of loan investment in Para 8 as under:

“8. As per the details, M/s.K3 Management and Edu services Pvt Ltd availed a crore from Karur Vyasa bank for the purchase of Land and Building of Riverside as per loan proposal and post sanction letter produced]. The company loan of Rs 1 crore from Karur Vyasa bank for the installation or purchase equipments, furniture etc. Also an SOD of Rs 50 lakhs was sanctioned from same of the loan amount, the assessee made payments to various parties Rs.26,50,01,000/- and have shown an amount of Rs.26,50,01,000/- as investment partnership firm Mangalam Infrastructure Services which was subsequently renamed as KKK Management and Edu Services as explained in Para No.4. As per the Trial Balance of the assessee as on 1/4/2015, the amount of Rs.26,50,01,000/- was shown as investment in KKK Management and Edu Services in which assessee is a partner. Further, the assessee had advanced Rs.9,00,000/- to M/s. Mangalam Silks. As per the Trial Balance of KKK Management and Edu Services as on 1/4/2015, assessee's capital in that Rs.26,50,01,000/- and assessee was a loan creditor for Rs.66,86,400/-. M/s. KKK Management and Edu Services was converted a limited company on 23/12/2015 by name M/s. KKK Management and Edu Services Pvt. Ltd. As per the Balance 31/3/2016 in the ITR, assessee's investment in unlisted equities was Rs.27,24,26,000/- (As per Balance sheet as on 31/3/2015, investment in Partnership firm Rs.26,50,01,000/-) and had advanced loan to Others to the tune of Rs.1,31,,16,387/ (As per

Balance 31/3/2015, Loans & advances to related parties Rs.75,86,400/- and to Others Rs.23,00,000/-). As per the P & L account, the assessee has not credited any interest income for the AY 16-17.”

6. In the light of the above, the A.O was of the view that the assessee has diverted the interest bearing funds taken on loan from Karur Vysya Bank and therefore, not eligible for claim of interest at Rs.3,57,37,643/-. Therefore, he disallowed the interest by observing that the assessee has not utilized the loan funds for which purpose it was availed for its own business and converted to a limited partnership firm as capital contribution. Therefore, he disallowed the interest. Aggrieved, the assessee preferred an appeal before CIT(A).

7. The CIT(A) after considering the submissions of the assessee and going through the details, deleted the disallowance by observing in para 4.3 and 4.4 as under:

“4.3 I have gone through the facts of the case, written submissions of the appellant, and the assessment order, and I find that the AO has gone wrong in concluding that the borrowed funds have been diverted for non business purposes for the following reasons.

1. The appellant has diverted the loan obtained as a capital contribution to a related partnership firm which the appellant acquired controlling interest subsequently.

2. The appellant company is already into the business of developing infrastructure and providing educational services for which they are in receipt of income. Prior to this transaction, the company is providing services to Mangalam Matriculation School, and Mangalam Higher Secondary School.

3. It is incorrect to say that the appellant has invested in the firm

to earn share income, which is an exempted income. The investment can fetch, interest on capital, rental income, and remuneration to partners which are taxable revenues.

4. The amount borrowed is utilized to acquire the asset in its name. The appellant has utilized the money borrowed by paying to the contributor of the assets of the firm. This has resulted in the assets being reflected in the books of the company. The immovable property which is in the books of the firm KKK Management and Edu Services got converted to a private limited company by way of part IX conversion. This company KKK Management and Edu Services Private Limited got merged with the petitioner company vide NCLT order w.e.from 01.01.2016. This implies that the money borrowed was only for the purpose of acquisition of the assets by the appellant.

5. From the accounts it is seen that K3 Management and Edu Services Private Limited has provided various educational services to Riverside Public School, Kotagiri and has earned an income of Rs.51.52 lakhs from the same, during the FY 2015-16. This indicates that the investment was not diversion but a strategic investment decision.

6. In the instant case, the primary security/collateral security provided to the bank was nothing but the assets of the company K3 Management and Edu Services (P.) Ltd. based on which loan was sanctioned to the appellant. It is manifest that the advance to K3 Management and Edu Services (P) Ltd. became imperative as a business expediency, in view of the undertaking given to the financial institution by the appellant.

7. The Supreme Court of India in the case of Hero Cycles (P) Ltd Vs CIT (Central Ludhiana, [2015] 63 taxmann.com 308 (SC) has held that once it is established that there is nexus between expenditure and purpose of business (which need not necessarily be business of assessee itself, it is not in the realm of revenue to decide the reasonableness of expenditure. In the instant case, the appellant borrowed funds in order to acquire control over the new company and for subsequent merger with the appellant company. It was a strategic business decision to expand and grow.

4.4 For the reasons noted above, I am convinced that the borrowed funds were utilized majority stake in the company M/s. KKK Management and Edu Services (P) Ltd. was paid on borrowings for the purpose of acquisition of the immovable property scheme of merger effected through the NCLT. Hence I hold that the interest amounting to Rs.3.57,37,643/- is an allowable expenditure u/s 36(1)(iii) the appellant or in the alternative is an allowable expenditure u/s 37(1) being coming in the scope of commercial expediency.”

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

8. We have heard the rival contentions, and gone through the facts and circumstances of the case. We noted that the assessee i.e., K3 Management and Education Services Pvt. Ltd. is a private limited company incorporated on 26.09.2014. Admittedly, the assessee-company is engaged in the business of infrastructure development promoted by Shri C.K. Kandasamy and Shri K. Kavin Kumar Kandasamy. There was another partnership firm i.e., namely Mangalam Infrastructure Services formed on 23.10.2014 with Shri C.K. Kandasamy family and Shri Suresh Belliraj family as partners. This firm was re-named as KKK Management and Education Services vide supplementary partnership deed dated 11.03.2015. Subsequently, KKK Management and Education Services, a partnership firm was converted into a private limited company as on 23.12.2015. Subsequently, by order of NCLT dated 01.01.2016, KKK Management and Education Services Pvt. Ltd. got merged with K3 Management and Education Services Pvt. Ltd. and the partners of erstwhile KKK Management and Education Services Pvt. Ltd., a partnership firm, which held immovable properties brought in assets of the firm as contribution towards share capital. We have also gone through the loan acquired by the assessee-company and noted that the primary

security and collateral security provided to the bank was nothing, but the assets of the assessee-company K3 Management and Education Services Pvt. Ltd., based on which loan was sanctioned to the assessee-company. From the above facts, it is clear that the amount borrowed is utilized by assessee-company to acquire the assets in its name and assessee has also utilized the money borrowed by paying to the contributor of the assets of the firm. From the above, it is manifest that advances to K3 Management and Education Services Pvt. Ltd. becomes imperative as business expediency. In our view, it is established that there is a nexus between the expenditure of interest incurred by the assessee on availing of loan, which are used for the purpose of business. Hence, in our view, the CIT(A) has rightly deleted the disallowance and allow the claim of the assessee. We uphold the order of CIT(A) and dismiss this issue of Revenue's appeal.

9. In the result, the appeal of Revenue is dismissed.

Order pronounced on 29th December, 2023.

Sd/-
(मंजुनाथ. जी)
(Manjunatha. G)

लेखा सदस्य /Accountant Member

Sd/-
(महावीर सिंह)
(Mahavir Singh)
उपाध्यक्ष / Vice President

चेन्नई/Chennai, दिनांक/Dated: 29th December, 2023.

EDN/-

आदेश की प्रतिलिपि अग्रेषित/**Copy to:**

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|-------------------------|--------------------------|--------------------|
| 1. अपीलार्थी/Appellant | 2. प्रत्यर्थी/Respondent | 3. आयकर आयुक्त/CIT |
| 4. विभागीय प्रतिनिधि/DR | 5. गार्ड फाईल/GF | |