

**आयकर अपीलीय अधिकरण, कोलकाता पीठ “बी”, कोलकाता**  
**IN THE INCOME TAX APPELLATE TRIBUNAL “B” BENCH: KOLKATA**  
श्री राजेश कुमार, लेखा सटस्य एवं श्री प्रदीप कुमार चौबे, न्यायिक सदस्य के समक्ष  
[Before Shri Rajesh Kumar, Accountant Member & Shri Pradip Kumar Choubey, Judicial Member]

**I.T.A. No. 1096/Kol/2023**  
**Assessment Year: 2020-21**

DCIT, Circle-11(1), Kolkata	Vs.	South City Projects (Kolkata) Limited  (PAN: AAACD 8933 A)
Appellant / (अपीलार्थी)		Respondent / प्रत्यर्थी

Date of Hearing / सुनवाई की तिथि	31.07.2024
Date of Pronouncement/ आदेश उद्घोषणा की तिथि	24.10.2024
For the Appellant/ निर्धारिती की ओर से	Shri Akkal Dudhwewala, A.R Smt. Vidhi Ladia, A.R
For the Respondent/ राजस्व की ओर से	Shri A. Kundu, CITDR

**ORDER / आदेश**

**Per Rajesh Kumar, AM:**

This is an appeal preferred by the revenue against the order of the Ld. Commissioner of Income Tax (Appeals)-NFAC, Delhi (hereinafter referred to as the “Ld. CIT(A)”) dated 28.02.2023 for the AY 2020-21.

2. In the several grounds raised in this appeal, the revenue has assailed the order passed by the Ld. CIT(A) deleting the disallowance of Rs. 46,27,18,547/- made by the

AO on account of proportionate interest paid on loans which were advanced to M/s AA Infra properties Pvt. Ltd. [“AAIPL”].

3. Facts in brief are that, the assessee is a company engaged in the business of Real Estate Development and maintenance service of commercial area let out to various tenants. The assessee had filed return of income during the year declaring total income of Rs. 46,89,36,410/-. The case of the assessee was selected for complete scrutiny through CASS and statutory notices were duly issued and served upon the assessee. The AO observed from the details furnished by the assessee that the assessee was paying interest on money borrowed whereas it had advanced interest free loans to AAIPL and accordingly called upon the assessee to explain as to why proportionate interest paid on such loans advanced to AAIPL should not be disallowed. In response, the assessee had submitted that, in the course of its real estate business, it had formed a special purpose vehicle by way of subsidiary M/s AAIPL through which it was conducting real estate projects overseas. The said subsidiary AAIPL had undertaken real estate projects in Sri Lanka & Dubai through step-down subsidiaries, M/s Indocean Developers Pvt. Ltd. [“IDPL”] and M/s AA Infra (Middle East) Ltd [“AAIML”]. These subsidiaries had raised external finances from Banks/FIs, who had required the promoters to also infuse their capital into these projects. The assessee being the principal promoter had accordingly advanced loans aggregating to Rs.492.72 crores to AAIPL, which in turn, had advanced loans to these foreign entities viz., Rs.376.94 crores to IDPL and Rs.113.58 crores to AAIML. The funds were advanced after making due compliance with RBI/FEMA guidelines. The loan were advanced by the assessee mainly over a period coming from F.Y. 2014-15 to F.Y. 2018-19 and the assessee had charged interest on these loans ranging between 11% - 13.5%, which had been serviced by AAIPL until FY 2018-19. During the impugned financial year, the financial position of IDPL had significantly deteriorated due to (a) significant increase in the cost of the project, (b) increase in timing for completion of the project, (c) revenues of IDPL declining on account of slump in the real estate prices in Sri Lanka, (d) global economic downturn on account of COVID situation through multiple factors (e) adverse impact to the brand

due to litigation between the directors of IDPL and AA IPL and (f) significant increase in the financial liabilities of IDPL on account of interest levied on other loans obtained from third parties / bankers. Likewise, even the real estate project at Dubai was stalled and the subsidiary was not in a position to service the interest cost. Due to this extraordinary financial crisis and taking into account the litigations which the foreign subsidiaries were entangled in, the Board of Directors of the assessee decided and resolved not to charge any interest on the loans advanced to AA IPL for this AY 2019-20 unless situation improves, in order to ensure the sustainability of the project and protect the principal investment. According to assessee therefore, the loans were granted to subsidiary in the course of business, and the decision to not charge interest was a commercial and a prudent decision, and thus the corresponding interest paid on loans which were advanced to AA IPL was claimed to be allowable u/s 36(1)(iii) of the Act.

4. The AO however was not agreeable to above explanation offered by the assessee. According to the AO, although the assessee had not charged interest from AA IPL, but from the income tax return of AA IPL, he observed that, AA IPL had been earning interest from foreign subsidiaries and therefore the assessee cannot contend that AA IPL did not have the financial ability to pay interest and that the argument of commercial expediency does not hold good. Later on, in the course of video hearing granted by the AO, the assessee explained that AA IPL had only shown interest income in books by way of an entry and it had created equivalent amount of provision for its non-recovery in the books of accounts since the interest was un-serviceable by the subsidiaries due to their financial distress. The AO is noted to have taken due cognizance of this factual position, but observed that, like AA IPL, the assessee could have also provided for the interest income from AA IPL and correspondingly debited provision for loss but rather it chose to waive interest forever. This according to AO was done so that the assessee is not required to pay taxes on the interest income. With these observations, the AO quantified the proportionate interest being paid on loans given to AA IPL at 11% and accordingly disallowed proportionate interest expenditure of Rs.46,27,18,547/- out of

the total interest expense of Rs.82,47,18,547/-. Besides, the AO also made other disallowances / additions in the assessment framed u/s 143(3) read with Section 144B of the Act dated 26.09.2022.

5. The assessee challenged the said order before the Ld. CIT(A) who allowed the appeal of the assessee and inter alia directed the AO to delete the disallowance of interest of Rs. 46,27,18,547/-. The relevant portion read as under:

*“6.3.4. I have considered the facts of the case and the submissions placed on record. It is noted that the assessee is engaged in the business of development of real estate. The facts show that in order to expand its footprint in the real estate business overseas, the appellant had formed a Special Purpose Vehicle (SPV) by way of a subsidiary, AA IPL. In turn, AA IPL had undertaken real estate project in Sri Lanka, under the aegis of its subsidiary, IDPL. The facts on record show that IDPL was undertaking a substantially large real estate project in Sri Lanka. Being a foreign investment project, the Banks/financial Institutions had required the Indian Promoters of IDPL to also infuse funds in order to finance this real estate project. The appellant being the parent company had therefore sourced monies from both own surplus funds and borrowed funds to advance loan to AA IPL which was specifically meant for the project being undertaken in Sri Lanka. AA IPL, had in turn advanced loans to IDPL, in compliance with the RBIIFEMA guidelines. The facts on record show that the loan advanced by the assessee was interest bearing and in FYs 2014-15 to 2018-19, the assessee had charged interest from AA IPL in the range of 11% - 13.5%. It is therefore not the case that the loan advanced to AA IPL was interest free. Rather, it carried commercial rate of interest. During the relevant FY 2019-20, several disputes/ litigation arose in the management of AA IPL and IDPL, copies of which were also uploaded along with the written submissions. Perusal of the same shows that certain mis-deeds were committed by one of the directors of AA IPL, both in the management of AA IPL as well as IDPL, due to which several legal cases/ suits were filed in India as well as in Sri Lanka. It is noted that these disputes took substantial time to resolve in as much as the matter had travelled upto the Supreme Court and later on the disputes were resolved pursuant to arbitration in the year 2021-22. Consequent thereto, the real estate project being Undertaken at Sri Lanka got embroiled in controversy and litigation leading to delayed completion of the project. Moreover, due to the onset of COVID 19 in the month of January 2020, the global economy was faced with a significant downturn and the one of the worst affected sectors was the real estate sector leading to a slump in the prices as well as in the sales. To add to the woes, IDPL was also saddled with financial liabilities related to the loans availed from banks which had also become unserviceable. In view of the aforesaid financial crisis and having regard to the extra ordinary COVID situation, and taking note of the fact that IDPL did not have revenues to service the loan availed from AA IPL, the management of the appellant considered it prudent to not charge interest from AA IPL until the financial health and situation of IDPL improved. I, therefore, note that the appellant had indeed substantiated the financial hardship and disputes being faced by AA IPL & IDPL which lead the appellant, being the parent company, to offer financial support in the form of waiver of interest payable on the loan so advanced. 6.15 With regard to the observation of the AO that, since AA IPL had received interest income from IDPL, there was no commercial rationale for the appellant to have waived the interest, it is noted from the facts that this observation was factually erroneous. From the financials of AA IPL placed on record, it is noted that AA IPL had simply —credited interest income on the loan advanced to AA IPL by way of book entry against which an equivalent amount of provision for bad and doubtful debt was also created in the books of accounts. AA IPL is noted to have not actually received any*

*interest from IDPL and, therefore, the observation of the AO that AA IPL was in receipt of interest income on the loan it had advanced to IDPL is found to be untenable. As far as the tax treatment meted out to these entries in the books of AA IPL is concerned. I am in agreement with the appellant that the same is independent of the appellant and whether or not the same is brought to tax or not in the hands of AA IPL, is irrelevant to decide the issue impugned before me.*

*6.3.6 In order to claim deduction u/s 36(1)(iii) of the Act, it is well settled in law that it is not necessary for an assessee to prove that the deployment of borrowed capital has produced matching or corresponding income. The interest paid is to be allowed, irrespective of whether the assessee has been able to generate or produce any income or not, by utilizing borrowed capital. It is now a settled judicial position that the expression 'used for the purposes of business' is much wider in its scope and connotation. From the facts as discussed above, it is clear that under the aegis of AA IPL, the appellant was conducting a real estate project in Sri Lanka, in furtherance of its real estate business. The loan advanced by the appellant to its subsidiary engaged in the same line of business was prompted on the principle of commercial expediency because the appellant had both strategic and economic interest in the financial well-being of the same. I, therefore, find merit in the submission of the appellant that the loan was advanced to AA IPL for business purposes". The issue for consideration is whether the fact that the appellant did not charge interest on the loan advanced to subsidiary in the course of business could be reason enough to disallow the interest expense incurred in relation thereto.*

*6.3.7 It is noted that similar issue had come up for consideration before the Hon'ble Supreme Court in the case of S A Builders Ltd vs. CIT (288 ITR 1). In the instant case, the assessee had borrowed capital on which interest was paid. The assessee had granted interest free loans to its subsidiaries and associate concerns. The Tribunal as well as the High Court held that part of the interest paid was liable for disallowance since the assessee had diverted its borrowed capital to the subsidiary and associate concerns from which no income was realized. On appeal by way of Special Leave Petition, the Supreme Court however held that the authorities below had approached the matter from an erroneous angle. According to the Apex Court, both for the purposes of section 37 as well as 36(1)(ii) of the Act, the expression "for the purposes of business" had to be considered and interpreted from the view point of "commercial expediency" and for that purpose it was wholly immaterial if a third party also benefitted. The relevant findings of the Supreme Court are reproduced below:*

*"That the borrowed money is not utilized by the assessee in its own business but had been advanced as interest free loan to its sister concern is not relevant. What is relevant is whether the amount was advanced as a measure of commercial expediency and not from the point of view whether the amount was advanced for earning profits.*

*Once it is established that there was nexus between the expenditure and 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 his profits."*

*6.3.8 Similar issue is noted to have been examined again by the Hon'ble Apex Court in the case of Hero Cycles (P) Ltd Vs CIT (236 Taxman 447). In the instant case, the assessee had advanced a sum of Rs. 116 lacs to its subsidiary company known as M/s. Hero Fibers Limited and this advance did not carry any interest. According to the AO, the assessee had borrowed the money from banks and paid interest thereupon which was utilized to advance interest free monies to subsidiary, and therefore the AO disallowed the interest holding that it was not for business purposes. On appeal, the Hon'ble Supreme Court taking note of its above judgment (supra)*

*held that the advance to M/s. Hero Fibres Limited became imperative as a business expediency in view of the undertaking given to the financial institutions by the assessee to the effect that it would provide additional margin to M/s. Hero Fibres Limited to meet the working capital requirements for meeting any cash losses and accordingly, allowed the deduction so claimed u/s 36(1)(iii) of the Act. The relevant findings of the Hon'ble Apex Court are as follows:*

*"13. In the process, the Court also agreed that the view taken by the Delhi High Court in CIT v. Dalmia Cement (P.) Ltd. /20021 121 Taxman 706 wherein the High Court had held that once it is established that there is nexus between the expenditure and the purpose of 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. It further held that no businessman can be compelled to maximize his profit and that 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.*

*14. Applying the aforesaid ratio to the facts of this case as already noted above, it is manifest that the advance to M/s. Hero Fibres Limited became imperative as a business expediency in view of the undertaking given to the financial institutions by the assessee to the effect that it would provide additional margin to M/s. Hero Fibres Limited to meet the working capital for meeting any cash losses.*

*15. It would also be significant to mention at this stage that, subsequently, the assessee company had off-loaded its shareholding in the said M/s. Hero Fibres Limited to various companies of Oswal Group and at that time, the assessee company not only refunded back the entire loan given to M/s. Hero Fibres Limited by the assessee but this was refunded with interest. In the year in which the aforesaid interest was received, same was shown as income and offered for tax.*

*16. Insofar as the loans to Directors are concerned, it could not be disputed by the Revenue that the assessee had a credit balance in the Bank account when the said advance of Rs. 34 lakhs was given. Remarkably, as observed by the CIT (Appeal) in his order, the company had reserve/surplus to the tune of almost 15 crores and, therefore, the assessee company could in any case, utilise those funds for giving advance to its Directors.*

*17. On the basis of aforesaid discussion, the present appeal is allowed, thereby setting aside the order of the High Court and restoring that of the Income Tax Appellate Tribunal."*

*6.3.9 Following the judgment of the Hon'ble Apex Court in the case of S.A. Builders Ltd (supra), it is noted that similar view has been expressed by the Hon'ble Madras High Court in the case of CIT Vs RPG Transmissions Ltd (359 ITR 673). In the decided case also the assessee had raised borrowings to acquire stake in electricity business by purchase of shares of CESC Limited. The AO, had disallowed the expenditure on account of interest relating to the borrowings holding that it was in the capital field as it was invested for purchase of shares of CESC Ltd. On appeal the Hon'ble High Court upheld the orders of the lower appellate authorities wherein it was held that there was a nexus between the nature of business carried out, i.e., generation and distribution of electricity, power transmission, etc., and, therefore, it was held that the investments were made for the purpose of the business and, accordingly, irrespective of whether it resulted in matching income or not, no part of the interest expenditure could be disallowed. The relevant findings of the Hon'ble Madras High Court is as follows:*

*"Section 36(1)(iii) contemplates that, firstly, the money should have been borrowed by the assessee, secondly, it must have been borrowed for the purpose of business and, thirdly, the assessee must have paid interest on the said amount. Furthermore, section 36(1)(iii) does not contemplate any test that the amounts so invested should be wholly and exclusively for making or earning such income. On a plain reading of section 36(1)(iii), there is no such requirement mandated in the section to confine such expense. Furthermore, the section also does not place any embargo on investments to be made in group concerns and subsidiary concerns. The investment made in shares by the assessee by utilizing borrowed capital was for strategic business purposes because the companies were promoted as special purpose companies to strengthen and promote its existing business by combining different business segments."*

*6.3.10 Similar issue came up for consideration before the Hon'ble Gujarat High Court in the case of B Nanji & Co. Vs DCIT (124 taxmann.com 357). In the decided case also the assessee which was engaged in the business of real estate had acquired a housing finance company viz., IFHC, by way of acquisition of equity stake. The said acquisition was funded by interest bearing borrowings. The AO disallowed the interest paid thereon holding it to be in the capital field. On appeal, the Hon'ble High Court noted that the assessee had acquired the said finance company so as to make funds readily available when required for development of a housing project or to fund any acquisition of real estate, and therefore it held that the investments were for expansion of the assessee's existing real estate business. The Hon'ble Gujarat High Court thus upheld the orders of the lower authorities, allowing the deduction for interest u/s 36(1)(iii) of the Act.*

*6.3.11 It is noted that similar facts and circumstances were also involved in the decision rendered by the Hon'ble ITAT, Kolkata in the case of S.P. Jaiswal Estates (P.) Ltd. (140 ITD 19). In the instant case also, the assessee had advanced interest free loans to its subsidiary company which was to undertake real estate project in Goa. According to the assessee, the loan was advanced in furtherance of existing business of real estate and therefore, on the principles of commercial expediency, the interest paid on the loans borrowed to fund the subsidiary was allowable u/s 36(1)(ii) of the Act. The AO, however, rejected the contention on the premise that the subsidiary was only holding the plot of land at Goa but then, since no construction on this plot was possible, it could not be said that advance given to the said subsidiary was commercially expedient. On appeal, however, the Hon'ble Tribunal following the decision of the Hon'ble Apex Court in the case of S.A.Builders (supra) deleted the disallowance. The relevant findings of the Tribunal are noted to be as follows:*

*"The approach adopted by the Assessing Officer, however, overlooks the factual aspect that the restrictions on constructions were placed by the directions of Goa Coastal Zone Management Authority which were under legal challenge by the assessee, and thus these restrictions had not achieved finality. What is material is that the assessee being one hundred per cent holding company of 'H' Ltd., had a deep interest in the subsidiary and that the advances given to the subsidiary company were for the purposes of business. When an assessee gives an interest free advance to a one hundred per cent owned subsidiary for its business purposes, it cannot but ordinarily be said to be commercially expedient. Of course, there has to be some material to show that the funds advanced to the subsidiary company were used for some business purposes, but then the Assessing Officer did not probe this aspect of the matter but simply rejected the commercial expediency of the interest free advance on the ground that construction was not possible on the plot owned by the subsidiary company. The objection taken by the Assessing Officer was devoid of any legally sustainable merits, but then the Commissioner (Appeals) did not even deal with this issue at all. When there are no findings by the Commissioner (Appeals) on this aspect, the point of difference, to this extent, cannot be adjudicated upon."*

*6.3.12 Similar view is noted to have been expressed by another coordinate Bench of Hon'ble ITAT, Kolkata in the case of Divakar Solar System Ltd. (88 taxmann.com 770) wherein also the assessee had borrowed which was forwarded to its subsidiary interest-free, keeping in view the strategic business purposes to strengthen and promote its existing business. The interest paid on such loan was disallowed by the AO u/s 36(1)(iii) of the Act. On appeal, the Hon'ble Tribunal, while relying on the Supreme Court decisions in the case of S.A. Builders Ltd vs CIT(A) (supra) and Hero Cycles (P.) Ltd vs CIT (supra), and the decision of the Hon'ble Madras High Court in the case of RPG Transmissions Ltd (supra), held that the test of commercial expediency was proven in the instant case beyond doubt and, hence, the interest paid on borrowed capital was to be allowed.*

*6.3.13 In the given facts of the present case also, it is observed that the appellant had advanced loans to AA IPL in the course of and for the purposes of business and it has demonstrated that the loans so advanced and the interest waiver given were based on commercial prudence. Hence, following the judicial precedents (supra), it is held that the interest expense incurred on the borrowings which were used in relation to the advancement of loans to the subsidiary was for the purposes of business and therefore allowable as deduction u/s 36(1)(iii) of the Act. The disallowance of Rs.46,27,18,547/- made by the AO is, therefore, held to be unsustainable, both on facts and in law, and is thus deleted. Ground Nos. 2 to 7 are therefore allowed."*

Aggrieved by the above order of the Ld. CIT(A), the Revenue is now in appeal before us.

6. The Ld. D.R while defending the order of AO submitted that, the assessee had not charged interest on the loans advanced to AA IPL without any justification. The Ld. DR submitted that, the assessee ought to have accrued the interest on the loans and that the AO ought to be directed to tax notional interest income on such loans given to AA IPL. He reiterated the AO's findings that, AA IPL had earned interest income from the loans to foreign subsidiaries and therefore there was no valid reason for the assessee to not charge interest from AA IPL. He further submitted that, the assessee had borrowed monies from banks to advance loans to AA IPL and had been charging interest until AY 2019-20 and therefore, there was no justification not to charge interest in the impugned financial year. According to the DR, the inability of IDPL to service interest to AA IPL, due to financial distress, to meet its financial commitment to their external banks could not justify the non-charging of interest by the assessee on the money lent by it to AA IPL. The Ld. DR also submitted that even if the delay and cost overruns in the project had rendered the foreign subsidiaries in precarious position, but the fact remains that AA IPL was a solvent company having ability to pay the interest. He accordingly urged that the

order of the Ld. CIT(A) be reversed and that the impugned addition ought to be upheld by way of notional interest income receivable from AA IPL.

7. The Ld. A.R on the other hand strongly relied on the order of Ld. CIT(A) by submitting that the First Appellate Authority has taken into consideration the factual position of the foreign subsidiary after considering the financial hardships, stringencies due to time and cost overrun, COVID pandemic as well as the litigation between the project partners, recorded a finding after following several judicial decisions that the non-charging of interest by the assessee from AA IPL was based on commercial considerations and therefore interest paid on loans advanced to AA IPL were deployed for business purpose and hence allowable u/s 36(1)(iii) of the Act. The Ld. A.R strongly opposed the contentions put forth by Ld. DR and made multi-fold arguments. The first plea put forward was that, the issue in appeal was disallowance of interest paid on borrowings in relation to loans advanced to AA IPL and that it was never the case of the AO that notional interest income ought to be taxed on the non-interest bearing loans given to AA IPL. He thus submitted that, the Ld. DR cannot make out an altogether new case now before us, which does not emanate from the assessment order. To buttress his contention, he pointed out that, the AO had also made an addition on account of notional guarantee commission income as well in relation to the guarantees extended to foreign subsidiaries from AA IPL. It was shown that, earlier the assessee was actually charging guarantee commission but due to the financial distress faced by foreign subsidiary, it had stopped charging it from AA IPL from this AY 2020-21. This addition was deleted by Ld. CIT(A) and the Revenue did not prefer an appeal on this issue before us. According to Ld. AR therefore, once the Revenue had accepted in principle that, notional income cannot be brought to tax which was never ever es earned by the assessee, then the Ld. DR cannot urge that notional interest income on loans to AA IPL be taxed.

8. The Ld. AR thereafter opposed the contention of the Ld. DR that, AA IPL was solvent and that it had derived interest from the foreign subsidiaries. Taking us through the documents which were placed before the lower authorities, he showed us that,

AAIPL had only passed a book entry for interest income against which provision for credit loss and that no interest was serviced by the foreign subsidiaries to AAIPL. The Ld. AR thus submitted that the argument of Ld. DR that, AAIPL was in receipt of interest income on the loan was factually incorrect.

9. The Ld. AR presented before the bench at length the background of the loans advanced to AAIPL and the non-charging of interest on the same. The ld. AR submitted that the assessee was the flagship company which had promoted AAIPL as its subsidiary to undertake foreign real estate ventures in collaboration with one Mr. JH who had 12.5% stake in AAIPL. From FYs 2014-15 to F.Y. 2018-19, loans were extended to AAIPL on which interest was charged and duly served by AAIPL. During AY 2020-21, serious litigations had cropped between the assessee and Mr. JH in its subsidiaries in Sri Lanka and Dubai due to the actions of Mr. JH trying to vest control over both these subsidiaries due to which the recoverability of the loan & interest had come into doubt. He further submitted that, majority of the loan was advanced to IDPL which was undertaking one of the prestigious project involving investment of more than Rs.2000 crores, which had been funded by the assessee through SPV, AAIPL after obtaining series of approvals from RBI along with local banks/FIs of Sri Lanka. Taking us through the financials of IDPL and also news reports, the Ld. AR showed that even the financial position of IDPL deteriorated substantially due to significant increase in the cost of the project, increase in timing for completion of the project, revenues of IDPL declining on account of slump in the real estate prices in Sri Lanka, global economic downturn on account of COVID situation and adverse impact to the brand due to litigation between the shareholders and significant increase in other financial liabilities of IDPL. The ld AR submitted that for these reasons, the assessee did not charge interest on the loans advanced to AAIPL in the course of its business as a measure of commercial expediency to protect the interests in the subsidiaries as well as its principal investment by way of loans. The ld AR, while referring to the appellate order of Ld. CIT(A) at Para 6.3.6, submitted that ld CIT(A) also held that, the money advanced by the assessee to its subsidiary, AAIPL engaged in the same line of business

was prompted on the principle of commercial expediency because the assessee had both strategic and economic interest in relation to the same in Sri Lanka & Dubai and thus held that the loan was advanced to AA IPL for business purposes. Accordingly the interest incurred on loans borrowed for the purpose of advancing such loan to AA IPL was allowable as business expenditure u/s 36(1)(iii) of the Act.

10. The Ld. A.R while referring to para 6.3.6 submitted that the Ld. CIT(A) has recorded a clear-cut finding that the money advanced by the assessee to subsidiary engaged in the same line of business was based on the principle of commercial expediency because the assessee had both strategic and economic interest in relation to the same in Sri Lanka and thus held that the loan advanced to AA IPL for business purposes. The Ld. A.R in defense of his arguments relied on the following decisions:

- i) Madhav prasad Jatia vs. CIT (1 Taxman 477)(SC)*
- ii) S A Builders Ltd. vs. CIT (158 Taxman 74)(SC)*
- iii) Hero Cycles Pvt. Ltd. vs. CIT (63 taxmann.com 308)(SC)*
- iv) CIT vs. RPG Transmissions Ltd. (48 taxmann.com 57)(Mad HC)*
- v) B. Nanji & Co vs. DCIT (124 taxmann.com 357) (Guj HC)*
- vi) S. P. Jaiswal Estates Pvt. Ltd. vs. ACIT (29 taxmann.com 221)(ITAT Kol)*
- vii) Vaman Prestressing Co. Pvt. Ltd. vs. Addl. CIT (154 taxmann.com 325)(Bom HC)*
- viii) CIT vs. Golf View Homes Ltd. (88 taxmann.com 497)(Kar HC)*
- ix) PCIT vs. Reebok India Company (98 taxmann.com 413)(Del HC)*
- x) PCIT vs. Gaursons Realty Pvt. Ltd. (120 taxmann.com 259) (Del HC)*

11. While arguing the alternate, the Ld. AR further submitted that, the assessee's own funds available was in excess of the monies advanced to AA IPL and therefore, it was to be presumed that the loans were given out of the own interest free funds available with the assessee and hence, even otherwise, no disallowance can be made on account of interest. For this, the Ld. A.R relied on the following decisions:

- i) South Indian Bank Ltd. vs. CIT [130 taxmann.com 178] (SC)*

- ii) *CIT vs. R L. Kathia Engineering & Automobiles Pvt. Ltd. [33 taxmann.com 14] (Guj. HC)*
- iii) *CIT vs. Prem Heavy Engg Works Pvt. Ltd. [150 taxman 90] (Allahabad HC)*

12. The Ld. A.R, therefore, submitted that in view of the facts of the instant case and the various judicial decisions and ratio laid down by the Hon'ble Supreme Court and also by various High Courts, order passed by the first appellate authority may be upheld and the appeal of the revenue may be dismissed.

13. After hearing the rival contentions and perusing the material on record, we note that, the issue before us for adjudication is whether the decision of the assessee to not charge interest from its subsidiary, AA IPL on the loan advanced out of borrowed capital is out of business consideration and commercial expediency and whether the Ld. CIT(A) was justified in deleting the disallowance of proportionate interest on borrowings utilized for advancing such loans to AA IPL, which according to AO, were for non-business purposes. From the facts on record, we observe that, the assessee is engaged in the business of real estate development and in furtherance of its business, it had set-up an Indian subsidiary in the name of AA IPL in which it held 87.5% along with one Mr. JH who held 12.5% for undertaking real estate projects abroad. It is further observed that AA IPL had accordingly set-up subsidiaries in Sri Lanka & Dubai which were undertaking real estate projects in the respective countries. We further note that the monies advanced by the assessee to AA IPL to further fund the step-down subsidiaries abroad was in the course and for the purposes of its business.

13.1. We note that, IDPL in Sri Lanka had undertaken a project worth Rs.2000 crores for which the assessee and AA IPL had obtained approvals from RBI & President of Sri Lanka. In order to undertake the project, IDPL had obtained loans from Banks/FIs, which were guaranteed by the assessee. Further, as a part of assessee's agreed commitment to the Banks/FIs to bring in promoter's contribution, the assessee had infused funds in IDPL through AA IPL by way of loan. The assessee accordingly advanced loans of Rs.472.92 crores carrying interest to AA IPL, which in turn, advanced

loan to IDPL from AYs 2014-15 to 2018-19. These loans were being regularly serviced by the foreign subsidiaries and correspondingly AA IPL was servicing the interest to the assessee until AY 2018-19. However, during the relevant AY 2019-20 the assessee did not charge any interest on loans advanced to AA IPL due to which the AO disallowed corresponding proportionate interest paid on borrowings in relation to such loans. We observe from the facts and material placed before us that the principal reason for not charging interest from AA IPL was cropping up of serious litigation between the assessee which held 87.5% in AA IPL with the other shareholder Mr. JH who held 12.5%. The assessee is noted to have taken legal steps to protect its interest in its subsidiaries and the details of litigation are available at Pages 187 to 271 of the paper book. Having gone through the same, it is noted that, during the financial year 2019-20, the litigations had not been resolved which continued till financial year 2021-22 and during the intervening period Mr. JH was in control of both the foreign subsidiaries as on 31.03.2020 due to which neither the assessee nor AA IPL had access to their books of accounts or control over them. We also note that appropriate disclosures in this regard were also made by the assessee in its Note Nos. 38 to 41 of the audited financial statements a copy of which is available at Page 67 of Paper Book. Having considered these facts and circumstances, we find merit in the Ld. CIT(A)'s findings that, on the given facts, it was commercial prudence that, the AA IPL would not be able to realize interest from the foreign subsidiaries and thus the assessee will also not be able to realize interest due on the loans advanced to AA IPL.

14. We note from the financials of IDPL that, its financial position had also considerably deteriorated. IDPL has accumulated losses in excess of Rs.341 crores, negative cash flow from operating activities of Rs.438.93 crores with a meagre revenue of Rs.91 lacs during the year corroborating the fact that the revenues of IDPL was declining due to slump in real estate market of Sri Lanka. The initial estimated project completion date was July 2017 which due to several reasons stood extended to March 2022. The Ld. AR also took us through the news articles available in public domain, copies of which are available at Pages 274 to 284 of paper book, from which we note

that, the project was stalled due to cost overruns and that the President of Sri Lanka had to intervene to restart the project. It is also undisputed that there was a global economic downturn on account of Covid situation at the fag-end of FY 2019-20 which further aggravated the stringent financial situation of IDPL. The Ld. AR also showed us that, the monies which were being advanced by the assessee to IDPL during the later years was to meet its financial repayment obligations to Banks/FIs and prevent the account from being NPA. It is only due to these factors, the board of directors of the assessee have passed a board resolution deciding not to charge any interest from AA IPL in financial year 2019-20 until the situation becomes better. Having regard to these facts, we find that the Ld. CIT(A) had rightly observed that, the assessee's decision not to charge the interest from AA IPL on the loans advanced was out of business consideration and commercial expediency.

15. Coming to the argument of Ld. DR that AA IPL was solvent and since the AA IPL had received interest income from IDPL there was no commercial rationale for the assessee to waive off the interest. We find that, this has been controverted by the Ld. CIT(A) at Para 6.3.5 of the order, wherein after examining the records and financials of AA IPL, he has recorded a finding of fact that, AA IPL did not actually received any interest from subsidiaries and that it had accounted for and credited interest income by way of book entry against which the equivalent amount of provision for bad and doubtful debts was also created in the books of accounts.

16. On the next argument of Ld. DR proposing to tax interest income receivable from AA IPL, if the deletion of interest disallowance is upheld, we agree with the Ld. AR that, this was not the case of the AO himself. The undisputed facts, as discussed above, are that, the assessee did not charge interest from AA IPL. The AO had accordingly disallowed proportionate interest corresponding to such non-interest bearing loans given to AA IPL and no addition was made on account of interest income. Hence, we do not find any merit in the Ld. DR's contention in trying to make out a completely new case which is not the issue before us. For the above reasons, we thus uphold the Ld. CIT(A)'s finding that, the loan was advanced by assessee to AA IPL for business

purpose and that the action of not charging interest during the relevant year was driven by commercial and business considerations. In light of these findings, the next issue to be answered is whether since the assessee did not charge interest on loans given to subsidiary for business purposes, the corresponding proportionate interest paid on borrowings is to be disallowed. In this regard, it is noted that the provisions of Section 36(1)(iii) of the Act allows deduction of the interest paid in respect of the capital borrowed for the purpose of business or profession. The Hon'ble Supreme Court in the case of **Madhav Prasad Jatia vs CIT (supra)** has noted that the expression "*for the purpose of his business*" is wider in scope than the expression "*for the purpose of earning income, profits or gains*". In the case of **Indian Bank Limited vs CIT (56 ITR 77)**, the Hon'ble Supreme Court held that, what is to be examined is if the interest expenditure had been incurred for business purpose, and that it is not necessary to show as to whether it resulted into any income or not. We also refer to the case of **SA Builders Ltd. Vs CIT (supra)** wherein the AO had disallowed portion of the interest paid on the premise that the assessee had diverted to its borrowed capital to the subsidiary and associate concerns from which no income was realized, which was confirmed by the High Court. On appeal by way of Special Leave Petition, the Hon'ble Apex Court however held that, the authorities below had approached the matter from an erroneous angle. The Hon'ble Apex Court held that, for both the purposes for Section 37 as well as Section 36(1)(iii) of the Act the expression '*for the purpose of business*' had to be considered and interpreted from the view point of commercial expediency and for that purpose it was wholly immaterial if a third party also benefitted from the same. The Hon'ble Apex Court held that, what is relevant is whether the amount was advanced as a measure of commercial expediency and not from the point of view whether the amount was advanced for earning profits. The Hon'ble Apex Court held that once it is established that there was nexus between the expenditure and 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.

17. We also refer to the case of **Hero Cycles (P.) Ltd vs CIT (supra)** relied upon by the Ld. CIT(A) for deleting the interest disallowance impugned before us. In this case also, the assessee had borrowed money from the banks out of which loans were advanced by the assessee to its subsidiary company on which no interest was charged. The AO had disallowed the corresponding interest expenditure u/s 36(1)(iii) of the Act. On appeal, the Hon'ble Apex Court observed that, the advance to subsidiary company had become imperative as a business expediency in view of the undertaking given to the financial institutions by the assessee to the effect that it would provide additional margin to subsidiary company to meet the working capital for meeting any cash losses. The Hon'ble Apex Court accordingly held that, once it is established that there is nexus between the expenditure incurred and the purpose of business (which need not necessarily be the business of the assessee itself), the tax authorities 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. The Hon'ble Court further held that no businessman can be compelled to maximize his profit and that the revenue authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. The Hon'ble Apex Court accordingly held that, the deduction of interest expenditure is allowable u/s 36(1)(iii) of the Act, even if the loan was ultimately advanced to its subsidiary company without charging any interest on the same.

18. We have also perused all other decisions relied by the Counsel for the assessee inter alia including the cases of CIT vs. RPG Transmissions Ltd. (supra) (Mad HC), B. Nanji & Co vs. DCIT (supra) (Guj HC), S. P. Jaiswal Estates Pvt. Ltd. vs. ACIT (140 ITD 19) and we find that the view which percolates in all these decisions is that, once it is proved that the money advanced out of borrowed capital is for the purpose of business, then no disallowance can be made u/s 36(1)(iii) of the Act, irrespective whether such business purposes yielded income or gain to the assessee or not.

19. In the instant case before us, the assessee is in the real estate business and so was its subsidiary AAIPL and step down foreign subsidiaries. The loans were infused

into the step down foreign subsidiaries through the aegis of AAIPL for the reason that the Banks required the promoter to infuse funds as their commitment to the real estate project, which sufficiently proved that the funds were advanced for the business purposes. These loans originally carried interest which were serviced as well. However, for the reasons discussed above viz., serious litigation between partners and financial distress in foreign subsidiary, the assessee decided not to charge interest from this year in order to protect its overall business interests as well as principal loan amount. As has been discussed above, it is not necessary to show that the said deployment of borrowing always results in income to the assessee. The assessee have sufficiently established that the loans were advanced to AAIPL for the business purposes and therefore, even if the loans did not yield interest income during the year, yet the interest paid on borrowings has to be considered to be admissible for the purpose of Section 36(1)(iii) of the Act. Considering the facts of the case and ratio laid down in the above decisions, we do not find any infirmity in the order of Ld. CIT(A). Therefore, we are inclined to uphold the same by dismissing the appeal of the Revenue.

20. In the result, the appeal of the revenue is dismissed.

Order is pronounced in the open court on 24<sup>th</sup> October, 2024

Sd/-

Sd/-

(Pradip Kumar Choubey /प्रदीप कुमार चौबे)  
Judicial Member/न्यायिक सदस्य

(Rajesh Kumar/राजेश कुमार)  
Accountant Member/लेखा सदस्य

Dated: 24<sup>th</sup> October, 2024

SM, Sr. PS

Copy of the order forwarded to:

1. Appellant- DCIT, Circle-11(1), Kolkata
2. Respondent – South City Projects (Kolkata) Ltd., South City Business Park,  
Unit-711, East Kolkata Township, Kolkata-700107.
3. Ld. CIT(A)- NFAC, Delhi
4. Ld. Pr. CIT- , Kolkata
5. DR, Kolkata Benches, Kolkata (sent through e-mail)

True Copy

By Order

Assistant Registrar  
ITAT, Kolkata Benches, Kolkata