

IN THE INCOME TAX APPELLATE TRIBUNAL
“A” BENCH : BANGALORE

BEFORE SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER
AND SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER

ITA No.28/Bang/2015
Assessment year : 2009-10

The Deputy Commissioner of Income Tax, Circle 4(1)(1), Bangalore.	Vs.	Kurlon Ltd., No.301-303, North Block, III floor, Manipal Centre, No.47, Dickenson Road, Bengaluru – 560 042. PAN: AABCK 2150K
APPELLANT		RESPONDENT

Appellant by	:	Shri R.B. Krishna, Advocate
Respondent by	:	Dr. P.K. Srihari, Addl. CIT(DR)

Date of hearing	:	12.11.2015
Date of Pronouncement	:	21.01.2016

ORDER

Per Asha Vijayaraghavan, Judicial Member

This appeal by the Revenue is directed against the order of the CIT(Appeals)-I, Bangalore relating to assessment year 2009-10.

2. The assessee is a Public Limited Company engaged in the manufacture and distribution of rubberized mattresses and allied products. The assessee filed its Return of Income for AY 2009-10 on 30.09.2009

declaring total income at Rs. 20,66,45,960/-. Initially, the Return was processed u/s 143(1) and then selected for scrutiny. In the assessment concluded u/s 143(3), the total income has been determined at Rs.22,03,59,532/- due to certain disallowances.

3. One of the disallowances made was an amount of Rs.41,62,382/- on the ground that the assessee had diverted a major portion of the loans taken by it to its subsidiary concern.

4. On appeal, the CIT(Appeals) deleted the disallowance of Rs.41,62,382/-, holding that the advance given by the assessee to its subsidiary was out of commercial expediency. Aggrieved, the Department went in appeal before the Tribunal.

5. The Tribunal in its order ITA No.302/Bang/2013 dated 06.12.2013 remanded the issue back to the file of the CIT(A) for reconsideration. The relevant paragraph of the Tribunal's order is reproduced below:-

“7. We have considered the rival submissions, we find that the CIT(A) has not given any basis on which he has come to the conclusion that the interest free loans were given to the subsidiary company owing to commercial expediency. Merely because, the relationship between the lender company and the borrower company is that of a holding a subsidiary company, commercial expediency is not established. The facts which support the necessity of the assessee in its business interest to give interest free loans to the subsidiary company had to be pleaded and established. Such facts have neither been pleaded nor established by the assessee. In such circumstances, we are of the view that the findings of the CIT(A) is without any basis. We are also .of the view that the availability of surplus funds which

were used to make interest free advances to subsidiary company had not been pleaded by the assessee neither before the CIT(A) nor before the AO. Therefore, this basis on which the CIT(A) deleted the addition made by the AO cannot be sustained.

8. We are however of the view, the question of commercial expediency has to be examined by the CIT(A) and for this purpose, the order of the CIT(A) is set aside and remanded to the CIT(A) for fresh consideration. The learned DR in the course of submissions before us has very strongly urged that the assessee should not be given another opportunity by setting aside for fresh examination of commercial expediency. We, however, find that no details whatsoever were either called for by the AO or CIT(A) in this regard. In these circumstances and in the interest of justice, we deem it appropriate to afford opportunity to the assessee. The assessee will furnish the facts and circumstances which will go to show that the interest free loans to subsidiary company were owing to commercial expediency. The CIT(A) will decide the issue in accordance with law after affording the assessee an opportunity of being heard.”

6. The facts are the assessee had taken loans amount to Rs.44,07,29,994/- on which it had paid interest of Rs.6,51,61,035/- and that it had advanced a sum of Rs.3,63,11,215/- without charging interest to its subsidiary, namely Kurlon Cesare Furniture Pvt. Ltd. (KCF), in which the assessee held 52% of share capital. According to the AO, when the assessee itself had to borrow funds for its requirements, there is no business expediency for it to advance money to its subsidiary without charging interest. The CIT(A) in the first round by his order dated 27.12.2012 observed that the assessee strongly argued that the said subsidiary was financed by them as a holding company out of “commercial expediency”. It was further submitted by the Learned Counsel for the

assessee that the subsidiary utilized the funds for the purpose of business and the subsidiary finally got amalgamated with the assessee as per High Court order dated 7.4.2011. The CIT(A) in his order 27.12.2012 further held as follows:-

“it is seen from the Balance Sheet that loan funds have reduced to Rs.4407.30 lakhs on 31.03.2009 compared to Rs.4668.07 lakhs as on 31.03.2008. It is seen from the Balance Sheet that the share capital and reserves have gone up to Rs.6752.24 lakhs as on 31.03.2009 compared to Rs.5672.90 lakhs as on 31.03.2008. In view of this there was sufficient interest free funds available to the assessee to make advances to the subsidiary company. As the assessee advanced the funds to the subsidiary company as ‘commercial expediency’ the decision of the Hon’ble Supreme Court in the case of S.A.Builders (288 ITR 1) squarely applies to the facts of the case. When the interest free funds are used for the purpose of business, no disallowance can be made. In view of this the submissions of the assessee are acceptable and additions of Rs.41,62,382/- is deleted and AO is directed accordingly”.

7. In the second round, the CIT(A) held that the issue has to be viewed from two angles:

- (i) whether there was commercial expediency for the appellant to give the loan free of interest so that the decision of the Hon’ble Supreme Court in the case of SA Builders (283 ITR 1) would be applicable? and
- (ii) whether the loan had been advanced by the appellant from its own funds to M/s KCF?

8. The CIT(Appeals) observed that the relationship between the assessee and M/S KCF is two-fold. In the first instance, M/s KCF became a subsidiary company following its amalgamation with effect from 1/4/2009 as evidenced by the approval given by the Hon'ble High Court of Karnataka since its original plan of having collaboration with an Italian company fell through due to the latter's decision not to participate in M/s KCF. The relationship between the assessee and M/s KCF is, therefore, one of holding company and subsidiary with 52% share in the capital. The other submission is that the mattresses manufactured by the assessee are used in the furniture items manufactured by the subsidiary, which is supported by sales made by the assessee to the subsidiary company as per the details furnished during the appeal hearing. This, therefore, establishes business relationship between the appellant and its subsidiary i.e. M/s KCF.

9. As regards availability of own funds with the assessee for giving the interest-free loan, the assessee furnished the following data from page 22 of the Annual Report for the year ended 31/3/2008:

Shareholders' funds comprising share capital/reserves, etc.		Rs. 56,72,89,951
Capital grant		Rs. 27,41,274
Total		Rs. 57,00,31,225
Less: Amount utilised for acquisition of fixed assets:		
Net fixed assets including capital WIP	Rs. 54,63,05,597	
Less: Term loans taken for acquisition of fixed assets [Sch.3, p.26 of Annual Report)	Rs. 17,77,44,138	Rs. 36,85,61,459
Own funds available as on 1/4/2009		Rs. 20,14,69,766

10. According to the CIT(Appeals), thus, as declared in the relevant Annual Report, the assessee had substantial funds amounting to Rs.20,14,69,766/- for giving a loan of Rs.3,63,11,215/- free of interest. In this regard, the CIT(A) referred to the observations of his predecessor reproduced above are also relevant. The CIT(A) observed that it is not in dispute that the loan has been given by the assessee to a company which became its subsidiary with the approval of the Hon'ble High Court of Karnataka, after the subsidiary's proposal for collaboration with an Italian company fell through. The CIT(A) held that in view of the availability of its own funds and the nexus between the assessee's business and the business of its subsidiary company, the AO was not justified in disallowing a sum of Rs.41,62,382/- as interest attributable to the loan of Rs.3,63,11,215/- given free of interest to M/s KCF in the light of the decision of the Hon'ble Supreme Court in *SA Builders Ltd. v. CIT (288 ITR 1)*. The CIT(A) therefore deleted the disallowance of Rs.41,62,382/- made by the AO.

11. Aggrieved, the Department is in appeal before us on the following effective grounds of appeal:-

“2. On the facts and circumstances of the case, the Ld. CIT(A) has erred in deleting the addition made by the AO u/s. 36(1)(iii) read with section 37 relying on the decision of the Hon'ble Supreme Court in *SA Builders Ltd. v. CIT (288 ITR 1)*.

3. On the facts and circumstances of the case, the Ld. CIT(A) has failed to appreciate the fact that the amalgamation took effect from 1.4.2009. During the previous year relevant to the

assessment year, M/s. Kurlon Cesare Furniture Pvt. Ltd. was not an amalgamated entity but an independent company. Hence, the claim of commercial expediency is not justifiable and CIT(A) has erred in relying on this argument.

4. On the facts and circumstances of the case, the Ld. CIT(A) has failed to appreciate the fact that when the assessee had taken loan incurring substantial interest payment, its advancing loan to the subsidiary company without charging interest is not tenable.”

12. The Learned Counsel for the assessee before us reiterated the submissions made before the CIT(A) which are as follows:-

“4.1 It is the basic duty and responsibility of the Holding company to ensure that the subsidiary company’s operations are carried on smoothly. In order to fulfil this obligation, the holding company has to fund the subsidiary company whenever required. Such funding amounts to ‘Commercial expediency’, without which the subsidiary company will be rendered helpless and the operations of both the subsidiary company and the holding company may get effected (read ‘affected’) which may ultimately result in adverse situations. Hence to avoid such circumstances, it is necessary to reach out to the subsidiary company and such a gesture. cannot be termed as not arising out of ‘Commercial expediency’.

4.2 It may kindly be noted that the business of the assessee i.e., manufacture of various types of mattresses and related items are lined to the subsidiary company’s business of furniture manufacturing. In the furniture manufacturing, part of the materials used are manufactured by the holding company. In view of this, the business of the holding company and that of the subsidiary company are inextricably linked.”

13. We have heard both the parties. The Id. CIT(Appeals) has followed the decision of the Hon’ble Supreme Court in the decision of *SA Builders (supra)*. However, we find that the assessee has not established the nexus

with evidence with respect to the loan given by the assessee to its subsidiary in order to prove that there has been commercial expediency. Hence we set aside the issue to the file of the Id. CIT(Appeals) to examine and decide this issue afresh in accordance with law.

14. In the result, the Departmental appeal is allowed for statistical purposes.

Pronounced in the open court on this 21st day of January, 2016.

Sd/-

(INTURI RAMA RAO)
Accountant Member

Sd/-

(ASHA VIJAYARAGHAVAN)
Judicial Member

Bangalore,
Dated, the 21st January, 2016.

/D S/

Copy to:

1. Appellant
2. Respondents
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar,
ITAT, Bangalore.