

IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

ITA No. 388 of 2014 (O&M)
RESERVED on: 08.07.2015
DATE OF DECISION: 31.07.2015

Commissioner of Income Tax-I

.... Appellant

versus

M/s Kudu Industries

..... Respondents

**CORAM: - HON'BLE MR. JUSTICE S. J. VAZIFDAR, ACTING CHIEF JUSTICE
HON'BLE MR. JUSTICE G. S. SANDHAWALIA**

Present: Mr. Rajesh Katoch, Advocate for the appellant

Ms. Radhika Suri, Senior Advocate with
Ms. Rajni Paul, Advocate for the respondent

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S. J. VAZIFDAR, ACTING CHIEF JUSTICE:

This is an appeal against the order of the Income Tax Appellate Tribunal which pertains to the assessment year 2009-10.

2. By an order dated 25.03.2015, notice of motion was issued in respect of the question of law raised in paragraph 5(i). The order noted that the other questions raised have been answered against the appellant by our order and judgment dated 03.03.2015 in *Commissioner of Income Tax-I, Ludhiana vs. M/s Kudu Industries, Ludhiana, ITA No. 382 of 2014.*

3. The appeal is admitted on the following substantial question of law: -

"i) Whether on the facts and in the circumstances of the case, the Hon'ble ITAT was right in law in directing the AO to recompute the disallowance under section 36(1)(iii) of the

Act by adopting the average cost of debt for the year."

4. The assessee was engaged in the manufacturing, trading and job work of yarn and fabrics. The assessee had made interest free advances to various parties including by way of advances to suppliers and employees. These were in the normal course of business. However, advances were made to two parties, namely, Smt. Ritu Saluja and Shiv Narain Investments Private Limited due to their temporary financial requirements.

5. The Assessing Officer following the judgment of this Court in *Commissioner of Income Tax-I, Ludhiana vs. M/s Abhishek Industries, Ludhiana*, [2006] 286 ITR 1 (P&H) disallowed on a proportionate basis the interest pertaining to the said two advances on the ground that they were not made on account of commercial expediency. In *Commissioner of Income Tax-I, Ludhiana vs. M/s Abhishek Industries, Ludhiana (supra)*, it was held:

"15. Entire money in a business entity comes in a common kitty. The monies received as share capital, as term loan, as working capital loan, as sale proceeds etc. do not have any different colour. Whatever are the receipts in the business, that have the colour of business receipts and have no separate identification. Sources have no concern whatsoever. The only thing sufficient to disallow the interest paid on the borrowing to the extent the amount is lent to sister concern without carrying any interest for non-business purposes would be that the assessee has some loans or other interest bearing debts to be repaid. In case the assessee had some surplus amount which, according to it, could not be repaid prematurely to any financial institution, still the same is either required to be circulated and utilised for the purpose of business or to be invested in a manner in which it generates income and not that it is diverted towards sister concern free of interest. This would result in not presenting true and correct picture of the accounts of the assessee as at the cost being incurred by the assessee, the sister concern would be enjoying the benefits thereof. It cannot possibly be held that the funds to the extent diverted to sister concerns or other persons free of interest were required by the assessee for the purpose of its business and loans to

that extent were required to be raised. We do not subscribe to the theory of direct nexus of the funds between borrowings of the funds and diversion thereof for non-business purposes. Rather, there should be nexus of use of borrowed funds for the purpose of business to claim deduction under Section 36(1)(iii) of the Act. That being the position, there is no escape from the finding that interest being paid by the assessee to the extent the amounts are diverted to sister concern on interest free basis are to be disallowed."

6. The Assessing Officer held that in respect of the advances given for non-business purposes, interest is to be disallowed on a proportionate basis since all the funds of the assessee are placed in a common kitty and it is not possible to separate the borrowed funds from the assessee's own funds. The Assessing Officer accordingly computed the interest at 11.5% in respect of the advances to the two parties and added the same back to the income of the respondent/assessee. Penalty proceedings under Section 271(1)(c) were also initiated separately. The CIT (Appeals) upheld this order.

7. The Tribunal set aside the order of the CIT (Appeals) in this regard. As rightly held by the Tribunal, the judgment of this Court in *Commissioner of Income Tax-I, Ludhiana vs. M/s Abhishek Industries, Ludhiana (supra)* does not deal with the question of the rate of interest to be applied in cases where the assessee has mixed funds available with it. We also agree with the Tribunal's view that where mixed funds are diverted towards interest free advances the disallowance should be made up to the level of the average cost of debt to the assessee. There is no justification in taking into consideration the rate of interest in respect of any particular transaction whereunder an assessee avails advances on interest. An assessee may avail several advances from the same lender or from different lenders and at varying rates of interest. In the absence of anything to indicate that the interest free advance was made only

from a particular corresponding advance received by the assessee, the advance made by the assessee would obviously be from the common pool of money. Money lying in a common pool has no identity. The various amounts advanced to the assessee get merged into a common pool. There is no justification then either for the assessee or for the department to take into consideration the rate of interest in respect of a particular advance or advances to the assessee. The only logical approach is to take into consideration the average interest rate at which the assessee has availed of the advances.

8. In the circumstances, the question of law is answered against the appellant. The order of the Tribunal is upheld. The appeal is dismissed.

(S. J. VAZIFDAR)
ACTING CHIEF JUSTICE

31.07.2015
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(G. S. SANDHAWALIA)
JUDGE

Note: Whether reportable: YES