

Karnataka High Court Commissioner Of Income-Tax vs Sridev Enterprises on 28 January, 1991 Equivalent citations: 1991 192 ITR 165 KAR, 1991 192 ITR 165 Karn Author: K S Bhat Bench: K S Bhat, R Ramakrishna JUDGMENT K. Shivshankar Bhat, J. 1. The question referred to us, as called for by this court, under section 256(2) of the Income-tax Act, 1961, reads thus : “Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal is right in law in holding that since no additions have been made in earlier years, the opening debit balance cannot be considered during the current year and that the enquiry has to be limited to the increase in the current year only ?” 2. The relevant accounting year of the assessee-firm ended on March 31, 1978. During this accounting year, the assessee had advanced certain sums to Nalanda Enterprises, Bangalore (“Nalanda”, for short); the balance outstanding from Nalanda was Rs. 2,55,750 as on March 31, 1978; no interest was charged against this advance. The assessee had borrowed from third parties and had been paying interest thereon; this interest was claimed as a deduction out of the assessee’s income. Some of the partners of the assessee and Nalanda were common and they had business links interse; in these circumstances, the assessing authority disallowed the deduction claimed by the assessee to the extent of interest-free advances standing in the name of Nalanda on the ground that the amounts borrowed by the assessee were not utilised by the assessee for its own business but were diverted as advance to Nalanda free of interest. However, to the extent of advance shown as existing against Nalanda on the first day of the accounting year, which was the net balance of advances made during the previous accounting year, the same was excluded for the purpose of computing disallowance of deduction. As on April 1, 1977 (the first day of the accounting year ending on March 31, 1978), the advance shown against Nalanda was Rs. 65,478; the advances during this accounting year were found to be Rs. 1,90,272. Therefore, interest at 18% on this sum of Rs. 1,90,272 claimed as a deduction by the assessee was disallowed. The Commissioner of Income-tax (Appeals) dismissed the assessee’s appeal. He held : “When the assessee is paying interest on the amount borrowed, they should not have utilised this loan for advancing money without interest. There was nothing which prevented them from entering into any agreement for charging interest. In any case, the assessee had not been able to show that they were forced by circumstances to make this advance free of interest. There is also no force in the argument that since both the firms are doing the same business, the amount advanced should be considered as a trade advance. Since the two firms are separate entities and assessed to tax also separately, there was nothing to indicate that the interest-free advance was necessitated by business considerations.” 3. The Appellate Tribunal affirmed this order. The Tribunal found that, during the past years, there was no such disallowance when moneys have been advanced to Messrs. Nalanda Enterprises. Therefore, the Appellate Tribunal held : “Since no additions have been made in the earlier years, we hold that the opening balances cannot be considered in this year and the enquiry has to be limited only to the increase in this year. As arguments have been advanced on both the sides by referring to abstract accounts, we find that it will not be a satisfactory

way of deciding the issue. It is no doubt true that the firm may have interest-free loans on partners' accounts, but the question would still remain to be answered as to whether those were the funds which were utilised for making this advance. We cannot deem that these amounts have been utilised on any general proposition. We, therefore, find it necessary to remit the case back to the Commissioner of Income-tax (Appeals) for deciding the issue, viz., whether the advances made in the year of account have come out of borrowed funds or not. If it is shown to be out of funds not borrowed, then no disallowance can be made. If on the other hand, the whole or any part of the advance is out of borrowed funds, then adjustments have to be made only for the advance so made in this year of account as we have already held that the opening balance cannot be the subject-matter of any enquiry in this year." 4. In respect of the advances made during the accounting year in question, the matter was remitted to find out whether the advances made in the year of account have come out of borrowed funds or not and if it is shown to be out of funds not borrowed, "then no disallowance can be made". 5. The Revenue is aggrieved by the limited question remanded; according to the Revenue, the remand should comprise the question pertaining to the opening balance advanced to Nalanda because the said sum was also advanced out of borrowed amounts. 6. We are in agreement with the view expressed by the Appellate Tribunal. The status of the amount outstanding from Nalanda on the first day of the accounting year is the amount that stood outstanding on the last day of the previous accounting year and, therefore, its nature and status cannot be different on the first day of the current accounting year from its nature and status as on the last day of the previous accounting year. Regarding the past years, the assessee's claims for deduction were allowed in respect of the sums advanced during those years; this could be only on the assumption that those advances were not out of borrowed funds of the assessee. This finding during the previous years is the very basis of the deductions permitted during the past years, whether a specific finding was recorded or not. A departure from that finding in respect of the said amounts advanced during the previous year would result in a contradictory finding; it will not be equitable to permit the Revenue to take a different stand now in respect of the amounts which were the subject-matter of previous years' assessments; consistency and definiteness of approach by the Revenue is necessary in the matter of recognising the nature of an account maintained by the assessee so that the basis of a concluded assessment would not be ignored without actually reopening the assessment. The principle is similar to the cases where it has been held that a debt which had been treated by the Revenue as a good debt in a particular year cannot subsequently be held by it have become bad prior to that year. 7. Sri K. R. Prasad, learned counsel for the assessee, referred to a decision of this court in *Bit Tul (P.) Ltd. v. CIT* (ITRC 141 OF 1977 dated 29-7-80) wherein it was held that there should be material to justify the conclusion that any borrowed money by the assessee in a year to which interest had been paid had been diverted for non-business purpose. For the purpose of this reference, it is unnecessary to apply the said principle. 8. Accordingly, we answer the question referred to us in the affirmative and against the Revenue.

9. Answered accordingly.