Orissa High Court

Indian Metals And Ferro Alloys ... vs Commissioner Of Income-Tax. on 4 October, 1991

Equivalent citations: 1992 193 ITR 344 Orissa

JUDGMENT A. PASAYAT J. - At the instance of the assessee, the following question has been referred by the Income-tax Appellate Tribunal, Cuttack Bench (in short "the Tribunal") for adjudication under section 256(1) of the Income-tax Act, 1961 (in short"the Act") :

"Whether, on the facts and in the circumstances of the case and on a correct interpretation of section 36(1)(iii) of the Income-tax Act, 1961, the assessee entitled to the deduction of interest of Rs. 1,97,616 while computing its income from business ?"

The factual position as culled from the statement of case submitted by the Tribunal is as follows :

The assessee is a limited company deriving income from business in the manufacture and sale of ferro-silicon. During the assessment year 1975-76, corresponding to the previous year ending on December 31, 1974, the assessee invested a sum of Rs. 14 lakhs in equity shares of a company styled Indian Metals and Carbide Ltd. (hereinafter referred to as "the subsidiary company"). Apart from the above investment, a sum of Rs. 38,41,372 was advanced as loan on interest the rate of which was to be determined later. The assessee received fixed deposits from the public to the tune of Rs. 36,38,050 on which it had to pay interest. Besides, it had also availed of bank loans for various banks for which it had to pay interest. By a resolution of the subsidiary companys board of management dated March 8, 1975, it was acknowledged that interest would be payable on the advances received form the assessee at a rate to be determined later. The average rate of interest paid by the assessee on its borrowings was 10 per cent. Considering the dates of investment and/or advances of the amounts to the subsidiary company, a sum of Rs. 1,97,616 was disallowed from the amount claimed as payment of interest by the Inspecting Assistant Commissioner of Income-tax (Assessment), Bhubaneswar (hereinafter referred to as the "Assessing Officer"). He concluded that the amount of interest attributed to borrowings applied towards investments in and advances made to the subsidiary company was not wholly and exclusively laid out and expended for the purpose of the business of the assessee. In appeal, the disallowance was deleted by the Commissioner of Income-tax (Appeals), Orissa, Cuttack, who held that there was nothing to show that the money advanced to the subsidiary company was out of the borrowed capital and not out of the own funds of the assessee. He noticed that, as against the investment and advances aggregating to Rs. 52 lakhs, the profit generated by the assessee was about Rs. 70 lakhs, the besides its other assets. It was observed that there was no evidence to show that the money lent to its subsidiary company represented loan capital or, for that matter, that it did not, and, in such circumstances, there being no conclusive evidence either way, the issue must be determined in favour of the subject. The Revenue preferred appeal before the Tribunal. On a consideration of the rival stands, the Tribunal was of the view that even if the assessee had its own assets, or generated huge profits during the relevant accounting year, it does not necessarily follow that only those assets or profits were utilised for the purpose of making investment or advances to its subsidiary company. Accounting to it, obviously, the profits generated during the year were not necessarily in cash and the assets already existing before the start of the accounting year would ordinarily be in some other form. It was noticed that the assessee had raised huge loans and accepted deposits on which it paid large amounts of interest and, therefore, it would follow that the money acquired by loans or deposits was utilised directly or indirectly for making investments and advances to the subsidiary company. Consequentially, the Revenues appeal was accepted and the order of disallowance passed by the Assessing Officer was restored. The assessee moved the Tribunal for making a reference to this court under section 256(1) of the Act. The Tribunal has referred the aforesaid question along with the statement of facts.

The main plank of the argument of learned counsel for the assessee is that the approach of the Commissioner of Income-tax (Appeals) was correct and the Tribunal has resorted to generalisations without considering the acceptability of the stand of the assessee. It was submitted that the very fact that the assessee made a profit of more than Rs. 70 lakhs and had other cash inflow for the depreciation of more than Rs. 50 lakhs and the electricity power charges of more than Rs. 39 lakhs, clearly established that the assessee had sufficient funds to make investments and advances out of its own funds and, therefore, the disallowance was improper and the Tribunal has acted on surmises by concluding that the assessees investment in and advances made to the subsidiary company were out of borrowed funds. Learned counsel for the Revenue, however, submits that the burden was on the assessee to establish the source of the money invested in or advanced to the subsidiary company. The Tribunal having inferred from the factual aspects that the borrowed funds carrying interest were utilised, the disallowance is proper.

Section 36(1)(iii) of the Act provides that, in computing the income chargeable under the head "Profits and gains of business or profession", a deduction shall be allowed of the amounts of interest paid in respect of capital borrowed for the purpose of business or profession. What is "borrowed money" has been construed by courts in England and by the Supreme Court in a number of cases. In Part of London Authority v. IRC [1922] 2 KB 599 (CA), Lord Sterndale M. R. observed that, in order that there be borrowed money, there must be a borrower and a lender. A similar view was expressed in CIT v. Bazpur Co-operative Sugar Factory Ltd. [1989] 177 ITR 469 (SC). The essence of interest is that it is a payment which becomes due because the creditor has not had his money at his disposal. It may be regarded either as representing the profit he might have made if he had used his own money, or conversely, the loss he suffered because he had not that use. The general idea is that he is entitled to compensation for the deprivation (see Westminster Bank Ltd. v. Riches [1947] 28 TC 159 (HL)).

The determinative question in a case of this nature is the source from which the assessee makes investments or advances. Where an assessee seeks to deduct certain items from his business profits, the onus of proving the same falls on him. The burden of proving a claim to an allowance or deduction is on an assessee. (See CIT v. Calcutta Agency Ltd. [1951] 19 ITR 191 (SC)). If the assessee makes a claim to deduction in terms of section 36 of the Act for the purpose of computation of income referred to in section 28 of the Act, he has to place materials in support of his claim of entitlement to the deduction. Section 36(1)(iii) relates to the amount of interest paid on capital borrowed for the purposes of the business, profession or vocation. The assessee has to satisfy the assessing authority that he is entitled to obtain deduction in accordance with the taxing statute. The burden is on the assessee to prove that a particular class of income is exempt from taxation. (See H. E. H. Nizams Religious Endowment Trust v. CIT [1966] 59 ITR 582 (SC). It was held in Nizams case

[1966] 59 ITR 582 (SC), that the burden is on the Revenue authorities to show that the income is liable to tax under the statute; but the onus of showing that a particular class of income is exempt from taxation lies on the assessee. To earn the exemption, the assessee has to establish that his case clearly and squarely fails within the ambit of the exempting provisions of the Act. Theprinciples equally apply in cases of deductions claimed. Therefore, the assessee was required to show that the amounts invested in or advanced to the subsidiary company came out of the assessees own funds. The Tribunal, with reference to the factual aspects, came to hold that the money utilised was from the borrowed funds. This essentially is an inference from factual aspects. Reliance was placed on a decision of the Mysore High Court in CIT v. United Breweries [1973] 89 ITR 17, by the assessing authority and the appellate authorities. In that case, the court was primarily concerned with the question whether the subsidiary company was an agent of the parent company and whether there was in addition to capitalist control, functional control by the parent company over its subsidiary company. It was held that the parent company exercised functional control over the subsidiary and the existence of such subsidiary company as a separate legal entity did not prevent the business of the subsidiary being treated as that of the parent company. Ultimately, the conclusion was that if the parent company had both functional and capitalist control over the subsidiary company, the business of the subsidiary was to be treated as that of the parent company. In the said case, a plea was raised stating that the subsidiary company was a part and parcel of the parent company and, therefore, the principles of agency applied and the interest as claimed was entitled to deduction under section 36(1)(iii) in the instant case, the subsidiary company had agreed to pay interest and, therefore, the functional and capitalist control aspect is not very relevant.

Strong reliance is placed on the accepted position that the assessee earned a profit of more than Rs. 70 lakhs during the year which was much more than the investment and advance. The substance of this argument could have been countenanced had the assessee placed materials to show that it had generated surplus in excess of the investment and advance, prior to such investment and advance. No material was placed in this regard by the assessee.

Illustratively, it may be pointed out that, in a hypothetical case, an assessee can earn profit only after the date of investment and advance. It cannot be said that because, in the concerned assessment year, the profit was more than the investment and advance, those came only out of the profit. The actual financial liquidity position on the relevant date has to be established by the assessee.

In that view of the matter, the Tribunal was justified in holding that the assessee was not entitled to deduction of interest in respect of investments in, and advances made to, the subsidiary company.

The reference is, accordingly, answered in favour ofthe Revenue and against the assessee. No costs.

S. K. MOHANTY J., - I agree.