2025:MHC:1272

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 03.06.2025

CORAM

THE HON'BLE MR.K.R.SHRIRAM, CHIEF JUSTICE

AND

THE HON'BLE MR.JUSTICE SUNDER MOHAN

Tax Case Appeal No.22 of 2016

Commissioner of Income Tax,
Chennai : Appellant

versus

M/s.Star Investments Pvt. Ltd
No.9, Bazullah Road,
T.Nagar,
Chennai 600 017 : Respondent

Prayer: Appeal filed against the Judgment passed by the Income Tax Appellate Tribunal, Madras, 'A' Bench dated 22.05.2015 in ITA No.50/Mds/2013.

For Appellant : Mr.J.Narayanasamy

For Respondent : Mr.I.Dinesh

JUDGMENT

(Judgment of the Court was delivered by the Hon'ble Chief Justice)

This appeal, filed under Section 260A of the Income Tax Act, 1961, (for short, 'the Act') came to be admitted on 27.01.2016, and the following two substantial questions of law were framed:

> *"1. Whether on the facts and circumstances of the case the Tribunal was right in holding that the assessee is eligible for deduction of bad debts of Rs.8,46,97,280/- when the transaction is not in the nature of loan between the parties.*
>
> *2. Whether on the facts and circumstances of the case the Tribunal was right in holding that the assessee's action of standing as guarantor for the loan availed by its sister concern and consequential invocation of the guarantee clause by the bank and appropriation of the amounts by the sale of the share held by the assessee to satisfy the dues of the defaulting sister company is for the purpose of the assessee's business and the assessee is entitled for deduction of business loss?"*

2. Assessee is an investment company engaged in the trading of shares. Assessee was promoted by Balaji Group of Companies. Assessee also held shares in Balaji Distilleries Ltd (BDL) as promoter. Assessee held these shares as stock-in-trade. One of the companies which was promoted by Assessee was Balaji Industrial Corporation Ltd (BICL).

3. BICL availed a loan of Rs.10 Crore from the Industrial Credit and Investment Corporation of India Ltd (ICICI Ltd). As one of the conditions required for disbursing the loan, understandably to secure the repayment of the loan, assessee, being the promoter of BICL, had to pledge the shares that it held in BDL, to ensure asset coverage of 1.5 times of loan sanctioned by ICICI and guarantee assistance on market value basis. Accordingly, assessee pledged 28,69,200 equity shares of BDL.

4. Over a period, BCIL was unable to repay its loan to ICICI. ICICI, to recover the amount that was payable to it by BICL, under the terms and conditions of loan and guarantee given by assessee, sold on 1.4.2008, out of 28,69,200 shares pledged, 25,15,200 equity shares at Rs.37.65 per share, which was the prevailing market value on 01.04.2008. Accordingly, assessee accounted for Rs.9,46,97,280/- of the dues from BICL to ICICI.

5. Assessee having guaranteed repayment on behalf of BICL, to ICICI, naturally, BICL had to pay any amount that assessee paid on its behalf to ICICI. Consequently, BICL became liable to pay to assessee a sum of

Rs.9,46,97,280/- on 01.04.2008 (AY 2009-10). Indisputably, BICL paid only Rs.One crore to assessee and assessee accepted the same in full and final settlement of the outstanding amount of Rs.9,46,97,280/-. The unpaid amount of Rs.8,46,97,280/-, assessee decided to write it off as bad debts in the books of accounts for the year ending 31.03.2009 (AY 2009-10). As noted above, liability of BICL to assessee also arose only in AY 2009-10.

6. This write-off as bad debts was not accepted by the Assessing Officer. The assessee filed an appeal before the Commissioner of Income Tax (A), who also confirmed the order of the Assessing Officer. Aggrieved, assessee preferred an appeal before the Income Tax Appellate Tribunal. The Appellate Tribunal, by the impugned order pronounced on 22.05.2015, reversed the findings of the AO as well as CIT (A) and accepted assessee's stand that the amount of Rs.8,46,97,280/- can be written-off. It is against this order, the present appeal is preferred.

7. The question in short to be answered by us, is whether assessee could have written-off this amount as bad debts.

8. Shri Narayanasamy appearing for the Revenue submitted that the assessee was an investment company engaged, among other things, in trading of shares. The sale proceeds of the shares pledged by the assessee was appropriated by ICICI towards outstanding loan of BICL. The loan availed by BICL and the sale consideration received by ICICI on sale of pledged shares has nothing to do with the assessee company. The write-off claimed was not wholly and exclusively for the business purpose of assessee because what was sold was only because of the mortgage of shares by assessee for the loan availed by BICL.

9. It was also submitted that the voluntary act of pledging the shares for the loan taken by BICL cannot be considered to be an act of business transaction and hence, assessee cannot claim the amount as deduction under Section 36(1)(vii) of the Act. It was also submitted that the condition prescribed under Section 36(2) of the Act has not been satisfied inasmuch as assessee has not shown in any year that this amount was recoverable by BICL.

10. In our view, the issue in this case is squarely covered by a judgment of a Division Bench of the Bombay High Court in ***Mahindra and Mahindra Ltd. vs. Commissioner of Income Tax***[1], which was authored by one of us (Chief Justice).

11. In that case, Mahindra was a promoter holding more than 27% of the equity shares of its group company called Machinery Manufacturers Corporation Ltd ("MMC"). It had to incur certain miscellaneous expenses amounting to Rs.42,89,185/- on behalf of MMC. It also had to recover a sum of Rs.6,22,01,000/- which was not allowed to be written-off. Mahindra had also provided guarantee of Rs.200 lakhs to IDBI for the rehabilitation assistance disbursed by IDBI to MMC. Mahindra, to preserve and protect the value of good-will attached to it, decided to bear the unavoidable expenditure of Rs.42.89 lakh of MMC and included the same in miscellaneous expenses. The Assessing Officer disallowed the same as also the amount of Rs.6,22,01,000/- that it had written-off. The Court held that since the expenditure was wholly incurred for the purpose of commercial

1*[2023] 151 taxmann.com332 (Bombay)*

expediency because MMC was a group company of Mahindra and the nexus between Mahindra and MMC was not disputed, the AO failed to appreciate the claim in its proper perspective. The expenditure/debts should be treated as having been incurred for the purpose of business and directly relatable to the business of the assessee and thus eligible for deduction as business expenditure/loss in Mahindra's return of business income.

12. It will be apposite to reproduce paragraphs 25 to 27 of *Mahindra and Mahindra* (supra).

> *"25. One can understand the Assessing Officer had disallowed these amounts after arriving at a conclusion that the decision to incur the expenses mentioned above or the debts mentioned above was not bonafide. That is not the case. Whether to treat the debt as bad debt or as business loss/deduction under Section 28 of the Act is a commercial or business decision of the assessee based on the relevant material in possession of the assessee. Once the assessee records the amounts as business loss/ deductions in his books of account that would prima facie establish that it was not recoverable loss unless the Assessing Officer for good reasons holds otherwise. The burden would be on the Assessing Officer to make out cogent reasons, which is not so in the case here. It is also not in dispute that the amounts spent were against/recoverable from group company MMC. It is quite obvious for reasons mentioned above that the amounts in question were incurred by appellant for the business expediency of the group company. It is not disputed that there existed a nexus between appellant and MMC. Such expenditure/debt should be treated as having been incurred for the purpose of business and directly relatable to the business of appellant and thus eligible for deduction as business expenditure in their return of business income. Otherwise it would not reflect the true profit and gain of appellant. A sum of money expended, not of necessity and with a view to a direct and*

immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency, and in order indirectly to facilitate the carrying on the business, may yet be expended wholly and exclusively for the purposes of the trade as held in British Insulated and Helsby Cables Ltd. V/s. Atherton [1926] AC 205.

26 In Commissioner of Income Tax, Delhi V/s. Delhi Safe Deposit Co. Ltd.8 the Apex Court was examining whether the amount in question can be treated as an expenditure laid out or expended wholly and exclusively for the purposes of the business of the assessee which is admissible as a deduction under Section 37 of the Act when the assessee was claiming deductions on the ground that the expenditure was incurred due to commercial expediency. In that case also the assessee had incurred the expenditure in question to avoid any adverse effect on its reputation like the case at hand. The Apex Court held that the expenditure incurred was a deductible expenditure. In fact that was the case where three persons A, B and the assessing company, which had also other businesses, were partners in a managing agency firm with 50%, 25% and 25% shares, respectively. At the instance of A, a large sum of money was advanced by the managed company to another firm at Calcutta. When the demand for repayment was made, the Calculta firm repudiated the claim and, out of the loss of Rs.1,90,092/- to the managed company, the sum of Rs.95,092/- was agreed to be borne by B, the assessee company and D, who was the brother of A, who was inducted into the managing agency firm as partner in place of A. The assessee's claim to have the sum of Rs.9,500/- which was paid by it to the managed company during the previous year relevant to the assessment year 1962-1963 in partial discharge of its liability of Rs.47,500/- deducted as business expenditure, was disallowed by the Income Tax Officer and the AAC confirmed the order of the Income Tax Officer on the ground that the amount was actually the loss of a firm which was no longer in existence, that the loss had been borne by the assessee on personal considerations and that the managing agency firm had not claimed the loss in its return. The Appellate Tribunal reversed the order of the AAC and allowed the assessee's claim on the ground that though there was a change in the constitution of the firm, the assessee's liability had not ceased, that since the assessee was a company there was no question of any personal consideration and that the assessee had made the payment purely on business considerations with the sole object of maintaining its business connection which was yielding profit. On a reference, the High Court held that the assessee was entitled to the deduction claimed. On appeal, the Apex Court held

that the assessee incurred the expenditure in question to avoid any adverse effect on its reputation, to protect the managing agency, which was an income earning apparatus, and for retaining it with the reconstituted firm in which the interest of the assessee was the same as before. The Apex Court, therefore, held that the expenditure was laid out on purely business considerations and wholly for the purpose of the assessee's business. The Apex Court also held that the true test of an expenditure laid out wholly and exclusively for the purposes of trade or business is that it is incurred by the assessee as incidental to his trade for the purpose of keeping the trade going and of making it pay and not in any other capacity than that of a trader and the expenditure incurred on the preservation of a profit earning asset of a business is always a deductible expenditure. It will be useful to reproduce the relevant portion, which reads as under :

> *The first question which needs to be examined is whether the amount in question can be treated as an expenditure laid out or expended wholly and exclusively for the purposes of the business of the assessee which is admissible as a deduction under s. 37 of the Act. It is no doubt true that the solution to a question of this nature sometimes is difficult to arrive at. But, however difficult the task may be, a decision on that question should be given having regard to the decisions bearing on the question and ordinary principles of commercial trading and of commercial expediency. The facts found in the present case are that the assessee was carrying on business as a partner of the managing agency firm and it also had other businesses, the managing agency agreement with the managed company was a profitable source of income and that the assessee had continuously earned income from that source. But on account of the negligence on the part of one of its partners, there arose a serious dispute which could have ordinarily resulted in a long drawn out litigation between the managing agency firm and the managed company affecting seriously the reputation of the assessee in addition to any pecuniary loss which the assessee as a partner was liable to bear on account of the joint and several liability arising under the law of partnership. The settlement arrived at between the parties prevented effectively the hazards involved in any litigation and also helped the assessee in continuing to enjoy the benefit of the managing agency which was a sound business proposition. It also assisted the*

assessee in retaining the business, reputation unsullied which it had built up over a number of years. It is also material to notice here that it was not shown that the settlement was a gratuitous arrangement entered. into by the assessee to benefit the defaulting partner, exclusively even though he might have been benefited to some extent. It is no doubt true that it was voluntary in character but on the facts and in the circumstances of the case, whether it would make any difference at all is the point for consideration.

Dealing with the question whether an expenditure incurred by a brewery in aid of their tenants of tied houses as a necessary incident of the profitable working of the brewery business was an admissible expenditure in the computation of the income-tax liability of the brewery, Lord Sumner upholding the above claim observed in Usher's Wiltshire Brewery L'd. v. Bruce [1915] AC 433, 469 (HL), thus:

> *Where the whole and exclusive purpose of the expenditure is the purpose of the expender's trade, and the object which the expenditure serves is the same, the mere fact that to some extent the expenditure enures to a third party's benefit, say that of the publican, or that the brewer incidentally obtains some advantage, say in his character of land- lord, cannot in law defeat the effect of the finding as to the whole and exclusive purpose.*

In British Insulated and Helsby Cables Ltd. v. Atherton [1926] AC 205; [1925] 10 TC 155, 193 (HL), Lord Cave observed:

> *It was made clear in the above cited cases of Usher's Wiltshire Brewery v. Bruce [1915] AC 433 (HL) and Smith v. Incorporated Council of Law Reporting for England and Wales [1914] 3 KB 674 (KB), that a sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency, and in order indirectly to facilitate the carrying on of the business, may yet be expended wholly and exclusively for the purposes*

of the trade.....

Rowlatt J. in Mitchell v. B. W. Noble Ltd. (1927) 1 KB 719; 11 TC 372, held that the money spent on getting rid of a director and saving the company from scandal was deductible. Affirming the above view, the Court of Appeal (whose judgment appears at p. 731) held that as the payment was not made to secure an actual asset so as effectually to increase the capital of the company but was made in order to enable the directors to carry on the business of the company as they had done in the past unfettered by the presence of the retiring director, which might have had a bad effect on the credit of the company, it must be treated as revenue and not as capital expenditure and was deductible as such for income-tax purposes.

The true test of an expenditure laid out wholly and exclusively for the purposes of trade or business is that it is incurred by the assessee as incidental to his trade for the purpose of keeping the trade going and of making it pay and not in any other capacity than that of a trader. In CIT v. Malayalam Plantations Ltd. [1964] 7 SCR 693; 53 ITR 140, 180, Subba Rao J. (as he then was) summarised the legal position, at p. 705, thus:

The aforesaid discussion leads to the following result: The expression for the purpose of the business' is wider in scope than the expression for the purpose of earning profits. Its range is wide: it may take in not only the day to day running of a business but also the rationalization of its administration and modernization of its machinery; it may include measures for the preservation of the business and for the protection of its assets and property from expropriation, coercive process or assertion of hostile title; it may also comprehend payment of statutory dues and taxes imposed as a pre-condition to commence or for carrying on of a business; it may comprehend many other acts incidental to the carrying on of a business. However wide the meaning of the expression may be, its limits are implicit in it. The purpose shall be for the purpose of the business, that is to say, the expenditure incurred shall be for the carrying on of the business and the assessee shall incur it in his capacity as a per- son carrying on the

business.

In the instant case, the assessee incurred the expenditure in question to avoid any adverse effect on its reputation, to protect the managing agency which was an income earning apparatus and for retaining it with the reconstituted firm in which the interest of the assessee was the same as before. It was likely that but for the expenditure, the fair name of the assessee would have been tarnished or rendered suspicious and the managing agency would have been terminated. The expenditure incurred on the preservation of a profit earning asset of a business has always been held to be a deductible expenditure by courts. In the circumstances, it is difficult to hold that the expenditure incurred by the assessee was either gratuitous or one incurred outside the trading activities of the assessed, The expenditure was, therefore, rightly held to be deductible under s. 37.

27. In the case at hand also the expenditure incurred were wholly incurred for the purpose of commercial expediency because MMC was a group company of appellant and appellant was, as could be seen from the orders passed by BIFR, keen in the preservation of MMC and to keep it as a going concern. The nexus between appellant and MMC is also not disputed. The Assessing Officer failed to appreciate the claim in the proper perspective. Appellant participated in the rehabilitation scheme of MMC and lent rehabilitation assistance by paying amounts to MMC as well as by converting its existing ICDs with MMC into rehabilitation assistance. Appellant also provided a guarantee of Rs.200 lakhs to IDBI for the rehabilitation assistance disbursed by IDBI to MMC. If there was no commercial expediency, there was no reason for appellant to incur these amounts or participate in the rehabilitation scheme of MMC. Appellant was also the managing agents of MMC and MMC was also a Mahindra Group Company. It is certainly not necessary for the name of Mahindra and Mahindra to be used in the name of MMC to prove it was a group company. These expenditure/debts should be treated as having been incurred for the purpose of business and directly relatable to the business of the assessee and thus eligible for deduction as business expenditure/loss in assessee's return of business income. The expenditure incurred by appellant or the debts that were recoverable from MMC, in our view, therefore, would certainly be deductible

expenditure under Section 28 of the Act."

13. In the case in hand also, it is not disputed that assessee was a promoter of BICL; that assessee had pledged 28,69,200 shares of BDL and that 25,15,200 shares were sold on 01.04.2008 at Rs.37.65 per share, accounting to Rs.9,46,97,280/-; and for the same transaction, BICL paid Rs.One Crore to assessee. In our view, the cycle is complete. It is also not disputed that BICL became a sick company and it could not repay the loan that it borrowed from ICICI Ltd.

14. As regards the submission of the Revenue that the pledging of shares of BDL by assessee to ICICI is not in the course of business activity, the fact is, assessee was a promoter of BICL. The shares were pledged, so as to enable the sister concern/group company to avail the loan from ICICI. Therefore, certainly, it has to be in the course of business.

15. It is not the Revenue's case that the decision to pledge the shares

or only accept Rs.One crore in full and final settlement was not *bona fide*. As held in *Mahindra and Mahindra (supra)*, whether to treat the debt as bad debt or as business loss/deduction is a commercial or business expediency of the assessee based on the relevant material and possession of the assessee. Once the assessee records the amount as business loss/deductions in his books of account, that would *prima facie* establish that it was not recoverable loss, unless the Assessing Officer for good reasons, holds otherwise. The burden would be on the Assessing Officer to make out cogent reasons, which is not so in the case here.

16. It is quite obvious therefore that the loss incurred by the assessee was for the business expediency of the group company.

17. Such loss/debt should be treated as having been incurred for the purpose of business and directly relatable to the business of the assessee and thus, eligible for deduction as loss or bad debt in their return of income. Otherwise, it would not reflect the true profit and gain of assessee. A sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of

commercial expediency, and in order indirectly to facilitate the carrying on the business, may yet be expended wholly and exclusively for the purposes of the trade *(Mahindra and Mahindra supra)*.

18. It will also be useful to reproduce paragraphs 16 to 18 of a judgment of the Bombay High Court in ***Vaman Prestressing Co. Pvt. Ltd. V/s. The Additional Commissioner of Income Tax***[2]

> *"16. The law on this is settled in as much as in S.A. Builders Ltd. (supra), the Hon'ble Apex Court was considering an almost identical situation. The assessee in that case had transferred a huge amount of Rs.82 Lakhs to its subsidiary company out of the Cash Credit Account of the assessee in which there was a huge debit balance. The Assessing Officer held that since the assessee had diverted its borrowed funds to a sister concern without charging any interest, proportionate interest relating to the said amount out of total interest paid to the bank deserved to be disallowed and he disallowed a particular sum. The Hon'ble Apex Court held that extending such a loan would fall under the expression used for the purpose of business. If the amount has been advanced as a measure of commercial expediency, the interest on funds borrowed by the assessee should be allowed as deduction under Section 36(1)(iii) of the Act. Paragraph Nos. 19 to 36 of S.A. Builders Ltd. (supra) read as under :*
>
> > *19. We have considered the submission of the respective parties. The question involved in this case is only about the allowability of the interest on borrowed funds and hence we are dealing only with that question. In our opinion, the approach of the High Court as well as the authorities below on the aforesaid question was not correct.*

2 ***[2023] 154 taxmann.com325 (Bombay)***

20. In this connection we may refer to Section 36(1)(iii) of the In- come Tax Act, 1961 (hereinafter referred to as the 'Act') which states that "the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession" has to be al- lowed as a deduction in computing the income tax under Section 28 of the Act.

21. In Madhav Prasad Jantia vs. Commissioner of Income Tax U.P. AIR 1979 SC 1291, this Court held that the expression "for the pur- pose of business" occurring under the provision is wider in scope than the expression "for the purpose of earning income, profits or gains", and this has been the consistent view of this Court.

22. In our opinion, the High Court in the impugned judgment, as well as the Tribunal and the Income Tax authorities have approached the matter from an erroneous angle. In the present case, the assessee borrowed the fund from the bank and lent some of it to its sister concern (a subsidiary) on interest free loan. The test, in our opinion, in such a case is really whether this was done as a measure of commercial expediency.

23. In our opinion, the decisions relating to Section 37 of the Act will also be applicable to Section 36(1)(iii) because in Section 37 also the expression used is "for the purpose of business". It has been consistently held in decisions relating to Section 37 that the expression "for the purpose of business" includes expenditure voluntarily incurred for commercial expediency, and it is immaterial if a third party also benefits thereby.

24. Thus in Atherton vs. British Insulated & Helsby Cables Ltd (1925)10 TC 155 (HL), it was held by the House of Lords that in order to claim a deduction, it is enough to show that the money is expended, not of necessity and with a view to direct and immediate benefit, but voluntarily and on grounds of commercial expediency and in order to indirectly to facilitate the carrying on the business. The above test in Atherton's case (supra) has been approved by this Court in several decisions e.g. Eastern Investments Ltd. vs. CIT (1951) 20 ITR 1,CIT vs. Chandulal Keshavlal & Co. (1960) 38 ITR 601 etc.

25. In our opinion, the High Court as well as the Tribunal and other Income Tax authorities should have approached the question of allowability of interest on the borrowed funds from the above angle. In other words, the High Court and other authorities should have enquired as to whether the interest free loan was given to the sister company (which is a subsidiary of the assessee) as a measure of commercial expediency, and if it was, it should have been allowed.

26. The expression "commercial expediency" is an expression of wide import and includes such expenditure as a prudent business- man incurs for the purpose of business. The expenditure may not have been incurred under any legal obligation, but yet it is allowable as a business expenditure if it was incurred on grounds of commercial expediency.

27. No doubt, as held in Madhav Prasad Jantia vs. CIT (supra), if the borrowed amount was donated for some sentimental or personal reasons and not on the ground of commercial expediency, the inter- est thereon could not have been allowed under Section 36(1)(iii) of the Act. In Madhav Prasad's case (supra), the borrowed amount was donated to a college with a view to commemorate the memory of the assessee's deceased husband after whom the college was to be named. It was held by this Court that the interest on the borrowed fund in such a case could not be allowed, as it could not be said that it was for commercial expediency.

28. Thus, the ratio of Madhav Prasad Jantia's case (supra) is that the borrowed fund advanced to a third party should be for commercial expediency if it is sought to be allowed under Section 36(1)(iii) of the Act.

29. In the present case, neither the High Court nor the Tribunal nor other authorities have examined whether the amount advanced to the sister concern was by way of commercial expediency.

30. It has been repeatedly held by this Court that the

expression "for the purpose of business" is wider in scope than the expression " for the purpose of earning profits" vide CIT vs. Malayalam Plantations Ltd. (1964) 53 ITR 140, CIT vs. Birla Cotton Spinning & Weaving Mills Ltd. (1971) 82 ITR 166 etc.

31. The High Court and the other authorities should have examined the purpose for which the assessee advanced the money to its sister concern, and what the sister concern did with this money, in order to decide whether it was for commercial expediency, but that has not been done.

32. It is true that the borrowed amount in question was not utilized by the assessee in its own business, but had been advanced as inter- est free loan to its sister concern. However, in our opinion, that fact is not really relevant. What is relevant is whether the assessee advanced such amount to its sister concern as a measure of commercial expediency.

33. Learned counsel for the Revenue relied on a Bombay High Court decision in Phaltan Sugar Works Ltd. Vs. Commissioner of Wealth- Tax (1994) 208 ITR 989 in which it was held that deduction under Section 36(1)(iii) can only be allowed on the interest if the assessee borrows capital for its own business. Hence, it was held that interest on the borrowed amount could not be allowed if such amount had been advanced to a subsidiary company of the assessee. With respect, we are of the opinion that the view taken by the Bombay High Court was not correct. The correct view in our opinion was whether the amount advanced to the subsidiary or associated company or any other party was advanced as a measure of commercial expediency. We are of the opinion that the view taken by the Tribunal in Phaltan Sugar Works Ltd (supra) that the interest was deductible as the amount was advanced to the subsidiary company as a measure of commercial expediency is the correct view, and the view taken by the Bombay High Court which set aside the aforesaid decision is not correct.

34. Similarly, the view taken by the Bombay High Court in Phaltan Sugar Works Ltd. vs. Commissioner of Wealth-

Tax(1995) 215 ITR 582 also does not appear to be correct.

35. We agree with the view taken by the Delhi High Court in CIT vs. Dalmia Cement (Bhart) Ltd. (2002) 254 ITR 377 that once it is established that there was nexus between the expenditure and the pur pose 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 its profit. 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. As already stated above, we have to see the transfer of the borrowed funds to a sister concern from the point of view of commercial expediency and not from the point of view whether the amount was advanced for earning profits.

36. We wish to make it clear that it is not our opinion that in every case interest on borrowed loan has to be allowed if the assessee advances it to a sister concern. It all depends on the facts and circumstances of the respective case. For instance, if the Directors of the sister concern utilize the amount advanced to it by the assessee for their personal benefit, obviously it cannot be said that such money was advanced as a measure of commercial expediency. However, money can be said to be advanced to a sister concern for commercial expediency in many other circumstances (which need not be enumerated here). However, where it is obvious that a holding company has a deep interest in its subsidiary, and hence if the holding company advances borrowed money to a subsidiary and the same is used by the subsidiary for some business purposes, the assessee would, in our opinion, ordinarily be entitled to deduction of interest on its borrowed loans.

17. In this case, from 2003-04 itself petitioner has been granting loans and advances to sister and associate concerns. Even for Assessment Years 2004-05 to 2008-09, the Revenue has not made any

disallowance of interest expense in those years thereby accepting that the deployment of funds is for business purpose. The disallowance made during Assessment Year 2003-04 has been set aside in appeal by CIT[A] as well as the ITAT. Moreover there can be no other reason but commercial expediency for petitioner to give loans and advances and capital to ICON. 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 a prudent businessman should act. The authorities must not look at the matter from their own point of view but that of a prudent businessman.

18. In view of what is recorded above, it is evident that there was absolutely no basis to respondent no.1 to form a belief that any income chargeable to tax has escaped assessment within the meaning of substantive provisions of Section 147 of the Act. As held by this court in Prashant S. Joshi (supra) Explanation 2 to Section 147 creates a deeming fiction of cases where income chargeable to tax has escaped assessment. Clause (b) deals with a situation "where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the A.O. that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return." For the purpose of Clause (b) to Explanation 2, the Assessing Officer must notice that the assessee has understated his income or has claimed excessive loss, deduction, allowance or relief in the return and taking of such notice must be consistent with the provisions of the applicable law. It cannot be at the arbitrary whim or caprice of the Assessing Officer and must be based on a reasonable foundation. Though the sufficiency of the evidence or material is not open to scrutiny by the court but the existence of the belief is the sine qua non for a valid exercise of power. Paragraph No. 20 of Prashant S. Joshi (supra) reads as under :

> *20. For all these reasons, it is evident that there was absolutely no basis for the first respondent to form a belief that any income chargeable to tax has escaped assessment within the meaning of the substantive provisions of section 147. Explanation 2 to section 147 creates a deeming fiction of cases where income chargeable to tax has escaped assessment. Clause (b) deals with a situation "where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the Assessing Officer that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return." For the purpose of clause (b) to*

explanation 2, the Assessing Officer must notice that the assessee has understated his income or has claimed excessive loss, deduction, allowance or relief in the return. The taking of such notice must be consistent with the provisions of the applicable law. The act of taking notice cannot be at the arbitrary whim or caprice of the Assessing Officer and must be based on a reasonable foundation. The sufficiency of the evidence or material is not open to scrutiny by the Court but the existence of the belief is the sine qua non for a valid exercise of power. In the present case, having regard to the law laid down by the Supreme Court it was impossible for any prudent person to form a reasonable belief that the income had escaped assessment. The reasons which have been recorded could never have led a prudent person to form an opinion that in- come had escaped assessment within the meaning of section 147. In these circumstances, the petition shall have to be allowed by set- ting aside the notice under section 148."

19. Therefore, the questions of law framed are answered in the affirmative.

20. The appeal is dismissed. There shall be no order as to costs.

(K.R.SHRIRAM, CJ.) (SUNDER MOHAN, J.)

03.06.2025

Index : Yes/No
Neutral Citation : Yes/No
tar

To

1.The Commissioner of Income Tax,
Chennai

2.The Income Tax Appellate Tribunal,
Madras, 'A' Bench

THE HON'BLE CHIEF JUSTICE
AND
SUNDER MOHAN, J.

(tar)

Tax Case Appeal No.22 of 2016

03.06.2025