

TAX FLASH NEWS

16 May 2019



The Supreme Court decision on the allowability of interest on capital borrowed

Recently, the Supreme Court in the case of Reliance Industries Ltd.¹ (the taxpayer) dealt with various issues including the allowability of interest on capital borrowed under Section 36(1)(iii) of the Income-tax Act, 1961 (the Act).

In the instant case, the taxpayer is engaged in the business of oil exploration, petrochemicals, polyester, fibre intermediate textiles, generation and distribution of power, operation of jetties, investments, etc.

Key issues raised² before the High Court were as follows:

- Whether the Tribunal was right in holding that interest of INR4.39 crore being the interest referable to funds given to subsidiaries is allowable, when this interest would not have been payable to banks, if funds were not provided to subsidiaries?
- Whether the Tribunal was right in deleting the disallowance made by the Assessing Officer (AO) under Section 14A of the Act of interest on funds utilised for exempt investment on the basis that own funds are more than investments made?

The High Court observed that the view of the AO is *ex facie* contrary to the settled principle that a presumption would arise that the investment would be out of the interest free funds generated or available with the company. Then, interest expenditure was deductible under Section 36(1)(iii) of the Act. The Tribunal held that the interest free fund available to the taxpayer is sufficient to meet its investment. It can be presumed that investments

were made from interest free funds available with the taxpayer. This position clearly emerges from the records. The High Court also observed that the Tribunal had followed the earlier view and there was nothing contrary in the factual material brought on record by the tax department. In such circumstances, the concurrent view on the disallowance of interest was reversed and the appeal of the taxpayer to that extent was partly allowed. However, the High Court observed that no substantial question of law was arising from such a view of the Tribunal.

The tax department filed an appeal before the Supreme Court on several issues like allowability of interest on borrowed capital under Section 36(1)(iii) of the Act, option to claim depreciation, allowability of pre-operative expenditure, deduction under Section 80M of the Act and transfer pricing. With reference to Section 36(1)(iii) of the Act, the question before the Supreme Court was whether the High Court is correct in holding that interest amount being interest referable to funds given to subsidiaries is allowable as deduction under Section 36(1)(iii) of the Act when the interest would not have been payable to banks, if funds were not provided to subsidiaries.

The Supreme Court observed that the said issue was a pure question of fact. The High Court had noted the findings of the Tribunal that the interest-free funds available to the taxpayer were sufficient to meet its investment. Hence, it could be presumed that the investments were made from the interest-free funds available with the taxpayer. The Tribunal had also followed its own order for AY 2002-03. Accordingly, the Supreme Court did not find any reason to interfere with the decision of the High Court on this issue.

¹ CIT v. Reliance Industries Ltd (Civil Appeal No. 10 of 2019)

² The tax department had raised several issues before the High Court like allowability of pre-operative expenditure, deduction under Section 80M, option to claim depreciation, transfer pricing, etc.

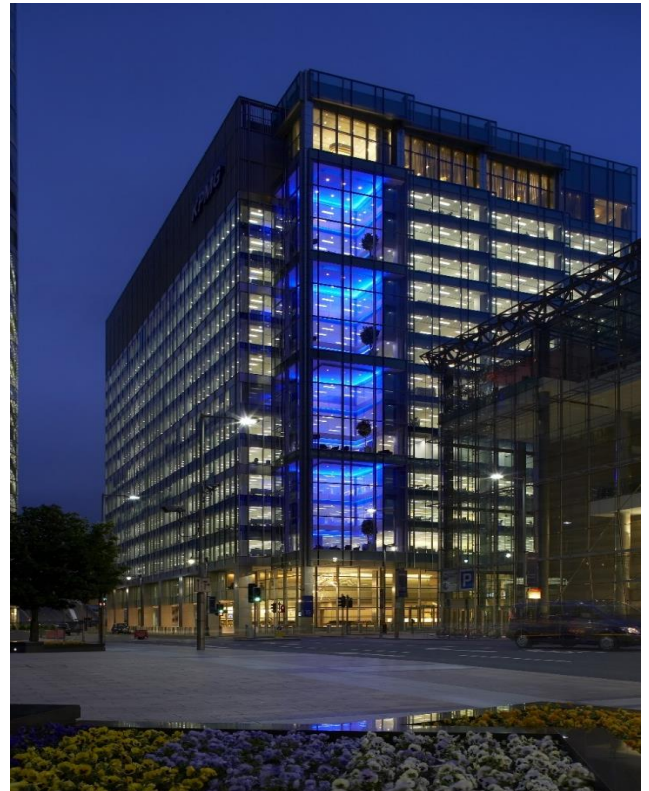
With respect to the issues on option to claim depreciation, allowability of pre-operative expenditure, deduction under Section 80M of the Act and transfer pricing, the Supreme Court set aside the High Court decision and restored back these matters to the High Court to facilitate a fresh exercise.

Our comments

In some of the cases³, the Courts have held that if there are funds available both interest free and loans taken, then a presumption would arise that investments would be out of the interest free funds generated or available with the company, if the interest free funds were sufficient to meet the investments and, therefore, interest was deductible under Section 36(1)(iii) of the Act.

In the instant case, the Supreme Court observed that the High Court had noted the findings of the Tribunal that the interest-free funds available to the taxpayer were sufficient to meet its investment. Hence, it could be presumed that the investments were made from the interest-free funds available with the taxpayer.

Various issues were raised before the Bombay High Court including an issue dealing with the disallowance of expenditure under Section 14A of the Act. However, the High Court had not admitted most of those issues. Further the issue on the disallowance of expenditure under Section 14A of the Act was not raised before the Supreme Court.



³ CIT v. Reliance Utilities & Power Ltd. [2009] 313 ITR 340 (Bom), CIT v. Gujarat State Fertilizers & Chemicals Ltd. [2013] 358 ITR 323 (Guj), CIT v. Amod Stamping (P.) Ltd [2014] 45 taxmann.com 427 (Guj)

home.kpmg/in

Ahmedabad

Commerce House V, 9th Floor,
902, Near Vodafone House,
Corporate Road,
Pralhad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071.
Tel: +91 80 3980 6000

Chandigarh

SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai

KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram

Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad

Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur

Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi

Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata

Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai

1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi,
Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida

Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune

9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara

Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada

Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2019 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

This document is meant for e-communication only