

TAX FLASH NEWS

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Interest on loan given to sister-concerns for equity infusion in group companies cannot be allowed as deduction under the Income-tax Act

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Abhinav International Pvt. Ltd.¹ dealt with the issue of allowability of interest on loan given to sister-concerns for equity infusion in group companies. The Tribunal held that such interest cannot be allowed as deduction under the Income-tax Act, 1961.

Facts of the case

The taxpayer is engaged in the business of investment in shares. During the assessment year 2013-14, the taxpayer borrowed money from the financial institution and paid processing charges to avail such loan. The taxpayer provided borrowed funds to its sister/associates concerns as interest free advance/loan. As per the loan agreement, the loan amount should be utilised to infuse funds into subsidiaries/JVs for 'equity infusion'. Further, these aforementioned sister/associates concerns invested this borrowed fund in another associate/sister concern i.e. a listed company as a fresh allotment of equity shares. The taxpayer claimed deduction on account of interest paid for money borrowed under Section 36(1)(iii).

The Assessing Officer (AO) disallowed the interest and loan processing charges for diverting interest-bearing funds to the sister concerns and not utilising for business purpose. The Commissioner of Income-tax Appeal [CIT(A)] upheld the order of the AO.

Tribunal's decision

The loan was taken for the purpose of equity infusion in the associate concerns. The decision of the Supreme Court in case of Hero Cycles (P) Ltd.² relied on by the taxpayer is distinguishable on the facts of the present case. In that case the advance to a subsidiary company became imperative as a business expediency because the taxpayer had given an undertaking to the financial institutions that it would provide additional margin to the subsidiary company to meet working capital for meeting any cash losses. However, in the present case, funds were specifically borrowed for infusion of equity in the associate concerns which is totally different aspect from the case of Hero Cycles (P) Ltd. Accordingly, the Tribunal confirmed the order of the lower authorities and disallowed the interest on loan given to sister-concerns.

Our comments

The issue with respect to the allowability of interest on loan given to sister-concerns has been a subject matter of debate before the Courts.

The Supreme Court in the case of Madhav Prasad Jatia³ observed 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).

¹ Abhinav International Pvt. Ltd. v. DCIT [ITA No. 489/DEL/2017 (AY 2013-14)] – Taxsutra.com

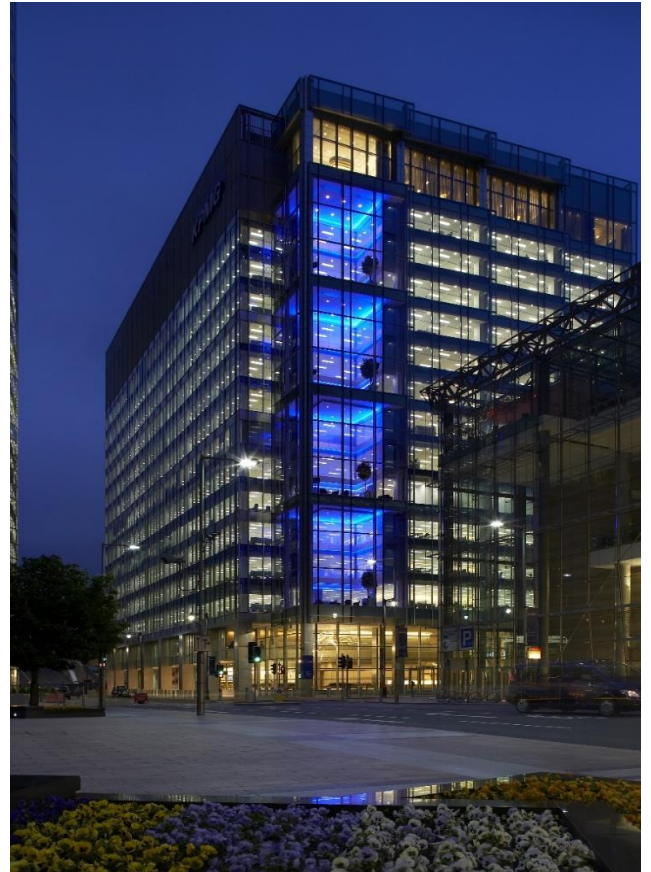
Note – The Tribunal dealt with various issues in this case. However, we have captured only one issue with respect to the allowability of interest on loan given to sister-concerns for equity infusion in group companies

² Hero Cycles (P) Ltd. v. CIT [2015] 379 ITR 347 (SC)

³ Madhav Prasad Jatia v. CIT [AIR 1979 SC 1291]

The Courts/Tribunal in various cases⁴ have held that the amount borrowed and advanced to a subsidiary company and used by that company for the purpose of business cannot be said to have been borrowed for the purpose of lender company's own business and hence cannot be allowed as deduction under Section 36(1)(iii).

The Tribunal in the present case has held that interest on loan given to sister-concerns for equity infusion in group companies cannot be allowed as deduction under Section 36(1)(iii).



⁴ Phaltan Sugar Works Ltd. v. CWT [1994] 72 Taxmann 325 (Bom), GVK Airport Developers Ltd. v. ITO [2018] 96 taxmann.com 236 (Hyd), C.R. Auluck & Sons Pvt. Ltd. v. ACIT (ITA No. 915/Chd/2008) (Chandigarh), ACIT v. Prasanna Purple Mobility Solutions Pvt. Ltd. (ITA No.158/PUN/2017)

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