

INCOME TAX : Where assessee claimed deduction under section 57(iii) on interest paid on loans taken by it from its relatives, since assessee had specifically stated that loans were availed through proper banking channels and interest amounts were paid to lenders, who had disclosed same in their respective return of income and tax was remitted by them on interest income, revenue was unjustified in disallowing assessee's claim for deduction under section 57(iii) in respect of interest paid and, thus, matter was to be remanded

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[2020] 120 taxmann.com 293 (Madras)

HIGH COURT OF MADRAS

Rajendra Kumar Jain

v.

Income Tax Officer, Non-Corporate Ward, 2(3), Chennai

T.S. SIVAGNANAM AND MRS. V. BHAVANI SUBBAROYAN, JJ.

TAX CASE APPEAL NO.744 OF 2019

OCTOBER 5, 2020

Ms. V. Logheswari and V. Raghavachari *for the Appellant.* **Mrs. R. Hemalatha** *for the Respondent.*

JUDGMENT

T.S. Sivagnanam, J. - We have heard Ms.V. Logheswari, learned counsel appearing for Mr.V. Raghavachari, learned counsel on record for the appellant - assessee and Mrs. R. Hemalatha, learned Senior Standing Counsel appearing for the respondent - Revenue.

2. This appeal, filed by the assessee under section 260A of the Income-tax Act, 1961 (for short, the Act) is directed against the order dated 22-12-2016 made in ITA.No.2110/Mds/2016 on the file of the Income-tax Appellate Tribunal, Chennai 'A' (SMC) Bench (for brevity, the Tribunal) for the assessment year 2011-12.

3. The assessee filed this appeal by raising the following substantial questions of law :

- "i.* Whether, in the facts and circumstances of the case, the interest expense of the assessee on such moneys borrowed be disallowed under section 57(iii) of the Income-tax Act, 1961 merely because of the Assessing Officer's claim that the assessee is financially sound ?
- ii.* Whether, in the facts and circumstances of the case, the Assessing Officer's action in disallowing the assessee's claim of interest deduction under section 57(iii) amounts to a review of accepted views by the Department in the earlier years? And
- iii.* Whether, in the facts and circumstances of the case, the interest expense claimed under section 57(iii), not being a capital expense and having corresponding income offered under the income from other sources, be disallowed by the Assessing Officer on the ground of commercial expediency of loans obtained by the assessee?"

4. The assessee is an individual and is said to be a partner in five family run partnership firms, which

were established in 1980s. The assessee filed the return of income for the assessment year under consideration namely AY 2011-12 on 27-6-2012 admitting a total income of Rs. 11,82,660/-. The case was selected for scrutiny and a notice under section 143(2) of the Act was issued. The assessee sent a reply giving details as to the five partnership firms, in which he was a partner and also the names of persons, from whom, he availed loan.

5. The case of the assessee is that those persons, who had lent money to the assessee, were also income tax assesseees and that the interest paid to them by the assessee were duly accounted for in their respective return of income filed by them. The Assessing Officer, while completing the assessment, *vide* order dated 24-3-2014 under section 143(3) of the Act, found that the assessee did not furnish the details of dates of receipt of loans, copies of agreements, modes of receipt of loans and other details. Apart from that, the Assessing Officer observed that the financial position and liquidity ratio of the assessee appeared to be sound. Accordingly, the deduction claimed to the extent of Rs. 7,36,579/- was disallowed and the assessment was completed.

6. Aggrieved by the same, the assessee preferred an appeal before the Commissioner of Income-tax (Appeals) -2, Chennai-34 [for short, the CIT(A)]. Among other things, the assessee contended that the amounts of loan were received through proper banking channels and from family members, that therefore, the necessity of obtaining the promissory note did not arise, that the persons, from whom monies were borrowed, were assessed to income tax and they filed income tax returns regularly and that the interest paid to them had been offered to tax. The CIT(A), on considering the facts noted by the Assessing Officer, dismissed the appeal primarily on the ground that the assessee failed to produce necessary evidence to establish his claim for interest payment to the relatives nor made out any case for deduction of such interest under section 57(iii) of the Act.

7. As against the order passed by the CIT(A), the assessee preferred further appeal before the Tribunal by contending that the interest paid were all loans, which were borrowed in the prior years and which had been allowed as deduction year on year and the CIT(A) had not considered the statement of confirmations given evidencing that no new loan was taken during the financial year relevant to the assessment year under consideration. The assessee further contended that the CIT(A) erred in not allowing the interest expense even though the assessee was following mercantile system of accounting. Without prejudice to the above submissions, the assessee also contended that the interest receipts on loan given had to be set off with the interest payments before disallowing the interest payments.

8. However, the Tribunal dismissed the appeal filed by the assessee by the impugned order and in doing so, proceeded on a totally different basis by observing that the assessee borrowed the amount for the purpose of investment in other firms as capital of the assessee and therefore, it could not be allowed as deduction and in this regard, followed the decision of the Kerala High Court in the case of *CIT v. Popular Vehicles and Services Ltd.* [2010] 325 ITR 523. Further, with regard to earlier assessments, the Tribunal held that those assessments were accepted by intimation given under section 143(1) of the Act and none of them was scrutiny assessment. The assessee is before us by way of this appeal challenging the order passed by the Tribunal.

9. Admittedly, the assessee had given the names of persons, from whom he borrowed money and also stated that the interest paid had been allowed as a deduction from year to year. It may be true that the earlier assessments stood concluded upon intimation being issued under section 143(1) of the Act and in none of the years, there was a scrutiny assessment under section 143(3) of the Act. However, the assessments for the previous years had not been disturbed by the Revenue. Neither they were selected for scrutiny nor there was a reopening by way of issuance of a notice under section 148 of the Act. Therefore, the assessments could not have been brushed aside and an attempt ought to have been made to examine the genuineness of the stand taken by the assessee especially when the assessee contended

that he is a partner in five firms, which were all established in 1980s.

10. That apart, the assessee specifically stated that the loans were availed through banking channels and the interest amounts were paid to the lenders, who have disclosed the same in their respective return of income and tax had been remitted by them on the interest income. Had the Assessing Officer directed the assessee to produce those lenders to appear for an enquiry by issuing notice, probably correct factual decision would have been ascertained.

11. In the grounds of appeal filed before the Tribunal, the assessee contended that the CIT did not consider the statement of confirmations given evidencing that no new loan was taken during the year under consideration. This aspect had not been dealt with in the impugned order passed by the Tribunal. As mentioned earlier, the Tribunal proceeded on a totally different footing, which neither appears to be the case of the assessee nor that of the Revenue. The assessee cannot be worse off before the Tribunal in his own appeal. Thus, considering the facts and circumstances of the case and taking note of the nature of business activities done by the assessee, we deem it appropriate to *set aside* the orders passed by the Assessing Officer, the CIT(A) and the Tribunal and remand the matter to the Assessing Officer for a fresh consideration.

12. Accordingly, the above tax case appeal is allowed, the orders passed by the Assessing Officer, the CIT(A) and the Tribunal are *set aside* and the matter is remanded to the Assessing Officer for a fresh consideration. Before the Assessing Officer, the assessee shall produce all the relevant details to establish his case. The Assessing Officer shall consider the documents and take a fresh decision on merits and in accordance with law. The substantial questions of law raised are left open. No costs.

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