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Interest disallowed on borrowings advanced to sister concerns for further equity infusion

The Delhi Bench of the Indian Income-tax Appellate Tribunal disallowed interest paid on borrowings (given as an interest-free advance to sister concerns) for further equity infusion in another sister concern

Facts of the case:

- Abhinav International Pvt ltd (the taxpayer)[1] is an Indian company engaged in the business of investment in shares.
- During the Financial Year (FY) 2012-13, corresponding to Assessment Year (AY) 2013-14, the taxpayer borrowed INR 130 million (~US$ 1.73 million) from Tata Capital Finance Services Limited (TCFSL).
- As per the terms and conditions of the loan agreement with TCFSL, the purpose of the loan facility was infusion of funds into subsidiaries / joint ventures and equity infusion.
- The taxpayer gave the borrowed funds to its following sister / associate concerns as an interest free advance:

Sr. No.	Name of the sister / associate concern	Amount in INR	Amount in US$
1	Hanung Infra & Power Ltd.	50 million	~0.67 million
2	C K Software Pvt. Ltd.	50 million	~0.67 million
3	Glofin Investment Pvt. Ltd.	26 million	~0.35 million
	Total	**126 million**	**~1.69 million**

  The said sister / associate concerns invested the funds in another associate / sister concern i.e. Hanung Toys & Textiles Limited (listed on stock exchange) by way of subscription to fresh equity shares.

- The taxpayer claimed the interest expenditure of INR 7.90 million (~US$ 0.11 million) incurred during the FY 2012-13 on the borrowings from TCSFL.
- Considering that the entire loan funds were diverted for equity infusion in sister/associate concern, the Assessing Officer (AO) held that the loan funds were not utilised for business purposes. Accordingly, the AO disallowed the entire interest expenditure of INR 7.90 million (~US$ 0.11 million).
- On appeal, the Commissioner of Income-tax Appeals [CIT(A)] upheld the order of the AO.

[1] Abhinav International Pvt. Ltd. v. DCIT ITA No. 489/Del/2017

- Aggrieved by the order of the CIT(A), the taxpayer filed an appeal before the Delhi Bench of the Income-tax Appellate Tribunal (ITAT).

Decision of the ITAT :

- The ITAT held that the case of Hero Cycles (P) Ltd. v. CIT[2] relied upon by the taxpayer was on a different aspect and not applicable in the facts of the current case, since:
  - In the case of Hero Cycles (P) Ltd. v. CIT, advance of loan to subsidiary company had become imperative as a business expediency. The same was in view of the undertaking given to financial institutions by the taxpayer to effect that it would provide additional margin to subsidiary company, to meet working capital for meeting any cash losses.
  - In the case under consideration, funds were specifically borrowed for equity infusion in sister / associate concerns.
- Considering that the loan was taken by the taxpayer for the purposes of equity infusion in sister / associate concerns, the ITAT held that the interest expenditure incurred in connection with the loan was not incurred wholly and exclusively for business purposes and hence, was not deductible.

Comments:

- Taxpayers may want to evaluate impact of this ruling on their arrangements.

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