

REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTIONCivil Appeal No.527/2012

L.K. TRUST

Appellant(s)

VERSUS

COMMISSIONER OF INCOME TAX & ANR.

Respondent(s)

O R D E R

1. This appeal is at the instance of the assessee and is directed against the Judgment and Order passed by the High Court of Karnataka dated 1-3-2010 in Income Tax Appeal No. 175 of 2001 by which the appeal preferred by the Revenue against the Order passed by the Income Tax Appellate Tribunal came to be allowed.

2. The short point that falls for our consideration is whether the appellant - assessee is entitled to a deduction of Rs.21,74,234/- (Rupees Twenty One Lakh, Seventy Four Thousand, Two Hundred and Thirty Four only) being the interest paid by it in respect of the loan availed from the Corporation Bank under Section 36(1)(iii) of the Income Tax Act 1961 (for short, "the Act 1961").

3. It appears from the materials on record that the assessee borrowed a sum of Rs.3,80,00,000/- (Rupees Three Crore and Eighty Lakh only) from the Corporation Bank to purchase shares of Shaw Wallace and Company Limited in pursuance of an Agreement dated

19-11-1987. Under the said Agreement, the Company had committed to sell 7.80 lakh shares for a total consideration of Rs.3,80,00,000/-.

4. The assessee filed its return of income for the year 1989-90 declaring total income of Rs.7,55,67,530/- (Rupees Seven Crore, Fifty Five Lakh, Sixty Seven Thousand Five Hundred and Thirty only). The return was processed under section 143(1)(a) of the Act and later Notice was issued under Section 143(2). While passing the Assessment Order way back in 1992, the Assessing Officer noted that the assessee had availed a loan of rupees Rs.3,80,00,000/- from the Corporation Bank and had paid interest of Rs.21,74,234/-. However, the AO further noted that the amount had been transferred to M/s Gayatri Holdings Private Limited, a group company, through purchase of its shares, who in turn transferred the amount to one Shri G Venkateshwaran for the purchase of shares of M/s Shaw Wallace and Company Limited.

5. In such circumstances referred to above, the AO took the view that the assessee was not entitled to claim deduction under Section 36(1)(iii) of the Act and accordingly the interest paid on the loan was disallowed.

6. The assessee went in appeal before the CIT(A). The CIT(A) also disallowed the deduction. The matter went in appeal before the ITAT. The ITAT allowed the appeal preferred by the assessee holding as under:-

"13. Now coming to the second leg of issue i.e., whether or not the appellant is eligible for deduction of interest paid to the bank under Sec.36(1)(iii) of Income-tax Act. Section 36(1)(iii) is reproduced below:-

(1) "The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28

(iii) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession."

A plain reading of said section reveals that three principles are relevant to establish the allowability or otherwise of the interest expenses. We may mention here that the Hon'ble Supreme Court in the case of Madhav Prasad Jatia Vs. CIT., reported at 118 ITR 200 while dealing with Sec.10(2)(iii) of 1922Act (which was akin to the present section 36(1)(iii) in Income-tax Act, 1961) laid down three pre-requisites to be complied with before allowing the deduction for interest expenses. The three pre-requisites which would enable the appellant to claim deduction in respect of the interest expenses under the aforesaid section can be illustrated as:-

Firstly, the loan must have been borrowed by the appellant; secondly, it must have been borrowed for the purpose of appellant's business; and thirdly, appellant must have paid interest on the loan and claimed deduction for the same.

14. The first condition, namely, the assessee must have borrowed the monies, is fully satisfied in the instant case. The second condition is also satisfied in our view on the basis of detailed discussion in the foregoing paragraphs, wherein it has been concluded that the money has been raised and utilized for the purposes which are integral to the business of the appellant. Thirdly, the assessee has paid the entire interest of Rs.21,74,234/- to the bank on the borrowings made by it and has claimed the said amount as deduction by way of charge to P&L A/c.

15. Before we conclude on this, we may mention that it is observed that the appellant has more than one source of income under the head 'business' as it is deriving income from businesses of money-lending, speculation business, film distribution and also investment in shares. It is an admitted fact that the appellant-trust has maintained only one common set of books of account in which are incorporated entries pertaining to these business of film distribution, money lending, investments, speculation etc. The management of the entire set of operations is vested in the trustees as can -be observed from the trust deed discussed earlier and there is complete interlocking of funds. To emphasize, it is our view that the business of the appellant is also a composite one in as much as it carries on several businesses including the business of investment in shares through its subsidiaries.

16. The Hon'ble Supreme Court of India in the case of CIT Vs. Associated Fibre and Rubber Industries (P) Ltd. (1999) 236 ITR 471 has opined that as long as the assets purchased from borrowings have been treated as business assets the interest outgo on such borrowings is allowable. Also, the Apex Court in Vecumsees (supra) has taken the view that so long as the loans have been obtained for the purposes of business the fact that he particular part of the business for which the loans have been obtained were closed or

transferred subsequently did not alter the fact that the loans had, when raised, been for the purpose of assessee's business; and, that the interest paid on such loan cannot be denied as the management is common though the line or branch of business for which loan was raised is closed down. The relevant observation of Hon'ble Supreme Court as appearing at page 189 of 220 ITR 185 is reproduced below:-

"The fact that the Revenue had during the years when the assessee carried on the business of cinematographic films permitted as a deduction under Section 36(1)(iii) the interest on loans obtained by the assessee for the purpose of constructing the said theatre shows that at the time when the loans were obtained the said theatre was a part of the business of the assessee. It was interest on these loans, borrowed for the purpose of the business of the assessee, which was being paid in the years in question and the Tribunal was, in our view, right in concluding that such interest had to be treated as a deduction under section 36(1)(iii). The loans had been obtained for the purposes of the assessee's business. The fact that the particular part of the business for which the loans had been obtained had been transferred or closed down did not alter the fact that the loans had, when obtained, been for the purpose of the assessee's business. The test of "same business" appropriate for set-off of carry forward losses is not appreciate here."

An irresistible inference that can be drawn from the reading of the judgments of the Apex Court is that what is essential is the existence or otherwise of Composite nature of business to consider the allowability of interest on loans borrowed by an assessee.

17. As has been held by us in earlier paras, the business of the appellant is composite and the ratio of the Hon'ble Supreme court squarely applies to the facts and the circumstances of the instant case'.

18. In view of the aforesaid detailed discussions and respectfully following the judicial pronouncements, we conclude by holding that a sum of Rs.21, 74,234 /- paid by the appellant-trust as interest to the Corporation Bank on borrowings of Rs.3.80 crores is eligible for deduction under Sec.36(1)(iii) of Income-tax Act. Therefore, the assessee succeeds on this ground and the orders of the lower authorities are reversed."

7. The Revenue, being dissatisfied with the Order passed by the ITAT, went before the High Court.

8. The appeal preferred by the Revenue came to be admitted by the High Court on the following two substantial questions of law:

1. Whether the assessee who is carrying on film business is entitled to claim deduction under Section 36(1)(iii) of the Act in respect of interest of Rs.21,74,234/- on amount borrowed from

corporation bank to purchase shares of Shaw Wallace and Company Limited on behalf of itself and other film?

2. Whether the assessee and its beneficiaries who of Rs.3,80,00,000/- and borrowed transferred the same to M/s. Gayathri Holding Private Limited who in turn advanced this amount to G.Venkateswaran to purchase shares on his behalf and on behalf of M/s. Sujatha Films Limited, Sujatha Productions Private Limited, Aruna International Private Limited and Sujatha Estate (Private) Limited, from Shaw Wallace and Company Limited is nothing but a colourable devise adopted to seek benefit of interest allowance under Section 36(1) (iii) of the Income Tax Act?

9. The High Court answered the two questions of law, referred to above, in favour of the Revenue holding as under:-

"That the appellant Trust has borrowed a loan from the Bank in order to invest the same in its share business. It is also not in dispute that a sum of Rs.3,80,00,000/- has been transferred to M/s. Gayathri Holdings Private Limited by the assessee. It is also not in dispute that the assessee has paid the interest payable to the Bank on the entire borrowings. It is also not in dispute that out of Rs.3,80,00,000/- transferred to M/s. Gayathri Holdings Private Limited, certain amounts of shares of Shaw Wallace and Company are also transferred to the name of the assessee. Therefore, we are of the view that the Assessing Officer was justified in granting the relief to the assessee in respect of the value of the shares purchased by it through M/s. Gayathri Holdings Private Limited in respect of shares of Shaw Wallace and Company Limited. We are also of the view that the Assessing Officer is justified in disallowing the interest paid by the assessee to the Bank in respect of the amount which was lying with M/s. Gayathri Holdings Private Limited in the account of the assessee."

10. In such circumstances referred to above, the assessee is here before us with the present appeal.

ANALYSIS

11. Having heard the learned counsel appearing for the parties and having gone through the materials on record, the only question that falls for our consideration is whether the High Court committed any error in passing the impugned order?

12. Section 36(1)(iii) reads as follows:

*"36(1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in Section 28 -(i) and (ii) ******

(iii) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession :-

Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.

Explanation. - Recurring subscriptions paid periodically by shareholders, or subscribers in Mutual Benefit Societies which fulfill such conditions as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause."

13. The sub section has three important words or phrases, i.e., (i) Interest, (ii) Borrowed and, (iii) For the purpose of business or profession.

14. The definition of "interest" in Section 2(28A) means "interest payable in any manner in respect of any moneys borrowed or debt incurred". But for Section 36(1)(iii), "interest" is restricted to that on money borrowed and not on debt incurred. In other words, the essence of interest is that it is a payment which becomes due because the creditor has not had his money at his disposal. It may be regarded either as representing the profit he might have made if he had had the use of his money, or conversely, the loss he suffered because he had not that use. The general idea is that he is entitled to compensation for the deprivation.

15. The provisions of Section 36(1)(iii) concern capital borrowed and not other debts or liability. A loan of money undoubtedly

results in a debt, but every debt does not involve a loan. Liability to pay a debt may arise from diverse sources and a loan is one of such sources. The legislature has, under this clause, permitted as an allowance interest paid on capital borrowed for the purposes of the business; and the capital, in this context, means money and not any other asset purchased on credit [Bombay Steam Navigation Co. Pr. Ltd. v. CIT, 56 ITR 52 (SC)].

16. The expression "for the purpose of business" occurs in Section 36(1)(iii) and also in Section 37(1). A similar expression with different wording also occurs in Section 57(iii) which reads as "for the purpose of making or earning income". This issue came up for consideration before this Court in the case of Madhav Prasad Jatia v. CIT reported in (SC) 118 ITR 200. The Court held that the expression occurring in Section 36(1)(iii) is wider in scope than the expression occurring in Section 57(iii). Thus, meaning thereby that the scope for allowing a deduction under Section 36(1)(iii) would be much wider than the one available under Section 57(iii).

17. It appears on a plain reading of the impugned order that according to the High Court, the business of the subsidiary company cannot be considered in law as the business of the assessee. The High Court took the view that the finding of the tribunal based on commercial expediency is not correct. The High Court went on to observe that the amount borrowed was ultimately utilised for the benefit of the subsidiary company of the assessee and not for the business of the assessee as such.

18. We are afraid that the High Court fell in error in taking the aforesaid view.

19. In *Sharp Business System v. CIT* reported in 2025 SCC OnLine SC 2892, one of the questions considered by this Court was whether interest on borrowed funds invested by the assessee in its sister concern and its directors is an allowable business expenditure.

20. In aforesaid context, this court made an analysis of Section 36 of the Income Tax Act, 1961, more particularly, Section 36(1) (iii) thereof. After referring to its earlier decision in *S.A. Builders v. CIT* reported in 288 ITR(1), it has been opined that the court should examine the transfer of borrowed funds from the point of view of commercial expediency and not from the point of view whether the amount was advanced for earning profits.

21. In the facts of that case, it was held that the assessee was entitled to claim allowance of interest on the borrowed funds invested in a sister concern for acquiring controlling interest.

22. We are in complete agreement with the line of reasoning assigned by the ITAT insofar as the interpretation of Section 36(1) (iii) of the Act 1961 is concerned.

23. In the result, this Appeal succeeds and is hereby allowed.

24. The impugned Judgment and Order passed by the High Court is set aside.

25. It is declared that the assessee is entitled to seek deduction of the amount of the interest paid in respect of the capital borrowed to the tune of Rs.3,80,00,000/- for the purposes of the business.

26. Pending applications, if any, also stand disposed of.

.....J
(J.B. PARDIWALA)

.....J
(UJJAL BHUYAN)

NEW DELHI;
7TH MAY, 2026.