

Addition made under sec. 40A(2) set aside as interest was paid to related party at prevailing market rate

Summary – The High Court of Gujarat in a recent case of Cama Hotels Ltd., (the Assessee) held that where interest paid by assessee-company to persons covered under section 40A(2)(b) was commensurate with interest rate prevailing in open market, said payment was to be allowed

Facts

- The assessee company paid certain interest to persons covered under section 40A(2)(b) namely 'R' Ltd. and 'C' Ltd. Interest had been paid at the rate of 15 per cent in the case of 'C' Ltd. and at the rate of 16 per cent in the case of 'R' Ltd.
- The Assessing Officer allowed the interest payment at the rate of 12 per cent and disallowed the balance.
- The Commissioner (Appeals) deleted the disallowance. The Tribunal confirmed the order of Commissioner (Appeals).
- On revenue's appeal:

Held

- The Tribunal has noted that section 40A(2)(b) contemplates that if some undue benefit is being extended by the assessee to the persons mentioned in sub-clause (2)(b) of section 40A on account of their association with the assessee, then the deduction claimed for that benefit ought to be disallowed to the assessee. In other words, if the assessee can avail the facility from the open market at a lower price than similar facility availed from the persons covered under section 40A(2)(b), then that excess payment would not be allowed to the assessee as deduction.
- The question that arose before the Tribunal was that what was the fair market value of interest paid by the assessee on the loans obtained from the persons covered under section 40A(2)(b). The Assessing Officer was of the view that the loans ought to have been taken at the interest rate of 12 per cent and not at the interest rate of 15 or 16 per cent. On behalf of the assessee, it was contended that the bank interest was in between 15 to 16.08 per cent and in respect thereof, the assessee was required to produce security against such loans, whereas the loans secured by the assessee were unsecured loans. Thus, by availing of loans from associate concerns, it had avoided a lot of formalities.
- The Tribunal was of the opinion that the payment of interest at a little higher rate to the persons even if covered under section 40A(2)(b) cannot be termed as exorbitant when the fair market value of such interest cost is being considered. The Tribunal found, as a matter of fact, that the assessee had paid interest commensurate with the interest rate prevailing in the open market. In the light of the above findings of fact recorded by it, the Tribunal found that the assessee had not extended any

undue benefit to the persons covered under section 40A(2)(b) and rejected the said ground of appeal.

- Thus, the Tribunal has recorded a finding of fact to the effect that the interest paid by the assessee to the persons mentioned under section 40A(2)(b) was commensurate with the interest rate prevailing in the open market. In the light of such finding of fact, it is not possible to state that the conclusion arrived at by the Tribunal that the assessee has not extended any undue benefit to the persons covered under section 40A(2)(b), suffers from any legal infirmity warranting interference. The revenue's appeal is, therefore, dismissed.