

Sec. 36(1)(iii) disallowance was valid if Co. didn't have sufficient funds to give advances to its sister concern

Summary – The Pune ITAT in a recent case of H.I. Tamboli & Co., (the Assessee) held that where assessee availed cash credit facility from bank and at same time advanced interest free loans to its sister concern, since assessee did not have sufficient interest free funds at its disposal for advancing amount and also no commercial expediency was established, disallowance made under section 36(1)(iii) was justified

Where assessee had purchased printed packing material from manufacturer for purpose of packing of its finished products and no raw material was supplied by it to manufacturer for manufacturing such packing material, transaction was a 'contract of sale' and not a 'works contract' and, therefore, provisions of section 194C were not applicable

Facts - I

- The assessee was a partnership firm engaged in the business of manufacturing and selling of tobacco products.
- During the course of assessment proceedings, the Assessing Officer noticed that assessee had obtained loan from a bank, BOB and also cash credit facility from one, KUC Bank and at the same time assessee had granted interest free advance to its sister concern, HE. The Assessing Officer noted that the capital of firm was not sufficient to cover interest free advances and, therefore, advances were out of borrowed funds. He, accordingly, worked out the interest disallowance on the amount of interest free advance to sister concern.
- On appeal, the Commissioner (Appeals) also upheld the order of the Assessing Officer. However he noted that the Assessing Officer had disallowed the entire bank interest which was, not justified. The ledger account of HE as well as copy of the KUC Bank had been filed which showed that the advances made to the sister concern were through this cash credit account. The Assessing Officer was directed to disallow the proportionate interest expenditure relating to the interest free advance made to sister concern through KUC Bank account.
- On second appeal:

Held - I

- The issue in the present case is with respect to disallowance of interest on the interest free amounts advanced to sister concern. The Commissioner (Appeals) while granting partial relief to the assessee has noted that as against interest free advance higher amount to its sister concern, average balance of partner capital stood at much lesser amount meaning thereby that assessee did not have sufficient interest free funds at its disposal for advancing the amount. The Commissioner (Appeals) while granting partial relief has noted that no reasons were provided by assessee for advancing interest free advances. Assessee has not placed any material on record to demonstrate commercial

expediency. On perusal of ledger account of HE as well as copy of bank statement of KUC Bank that amount advanced to sister concern was through cash credit account. The Commissioner (Appeals) by a well reasoned and detailed order has decided the issue and granted partial relief to assessee. The Commissioner (Appeals) further directed to disallow the proportionate interest. Assessee has not placed any material on record to controvert the findings of Commissioner (Appeals). In view of the aforesaid facts, there is no reason to interfere with the order of Commissioner (Appeals) and thus this ground of the assessee is dismissed.

Facts - II

- The assessee was a partnership-firm engaged in the business of manufacturing and selling of tobacco products. The assessee had made payments to various persons on account of printing charges, on which assessee had not deducted TDS.
- The Assessing Officer was of the view that the provisions of section 194C were attracted and since assessee had not deducted TDS the amount was liable for disallowance under section 40(a)(ia).
- On appeal, the Commissioner (Appeals) noted that the sample copies of the printing bills of several printers were examined. Perusal of the same revealed that the amounts were charged as a consolidated figure inclusive of printing of zarda labels, kacchi misri labels, plate charges as well as packing and forwarding charges. Thus, the printing charges were fixed as per ream of plastic-coated colour printing done for packaging the end-product *i.e.*, zarda which was manufactured by the assessee. The work done by these printers falls within the definition of a works contract/sub-contract as specified in section 194C. The fact that there was no written contract was immaterial or that the transactions were routine transactions had no bearing to the applicability of section 194C and consequently, the disallowance made under section 40(a)(ia) was upheld.
- In instant appeal, the assessee with respect to disallowance of printing charges submitted that in the present case the assessee had purchased printing packing material from manufacturer for packaging of the finished product and no raw material was supplied by it to the manufacturer for making such packet material and the transaction was a 'contract of sale' and not a 'works contract' and, therefore, provisions of section 194C were not applicable.

Held - II

- The issue in the present case is with respect to disallowance of expenditure under section 40(a)(ia) with respect to the disallowance on account of the printing charges paid by the assessee. It is assessee's submission that no material was supplied by the assessee for printing of the packaged products and it was a 'contract of sale'. The aforesaid submission of the assessee has not been controverted by revenue. Punjab and Haryana High Court in the case of *CIT v. Dy. Chief Accounts Officer, Markfed Khanna Branch* [\[2008\] 304 ITR 17/173 Taxman 149](#) has held that when assessee had

purchased printed packing material from manufacturer for purpose of packing of its finished products and no raw material was supplied by it to manufacturer for manufacturing such packing materials transaction was a 'contract of sale' and not a 'works contract' and therefore it was outside the purview of section 194C. Further Bombay High Court in the case of *BDA Ltd. v. ITO* [\[2016\] 281 ITR 99](#) has held that when a manufacturer purchases material on his own and manufactures the products as per the requirement of the specific customer, it is a case of sale and not a contract for carrying out any work and the fact that the goods manufactured were according to the requirement of the customer does not mean or imply that any work was carried out on behalf of the customer. Revenue has not placed any contrary binding decision in its support. In such a situation, the decision of Bombay High Court in *BDA Ltd. (supra)* are applicable to the present facts of the case. In view of the aforesaid facts, no disallowance under section 40(a)(ia) was called for on the payment of printing charges paid by the assessee.