

Hero Cycles (P) Ltd. v. Commissioner of Income Tax (Central), Ludhiana

Civil Appeal No. 514 of 2008

[2015] 12 S.C.R. 55 | 2015-11-05

Whether interest deduction could be restricted by treating an undertaking-backed interest-free subsidiary advance and lower-interest loans to directors as diversions of bank borrowings, despite the accepted business-purpose and source-of-funds evidence.

36(1)(iii)

Two-judge bench | A.K. Sikri, J. | Rohinton Fali Nariman, J.

Assessment years: 1988-89

Two distinct grounds and headnote typo

The judgment concerns section 36(1)(iii), although the headnote prints section 31(1)(iii). The subsidiary advance was commercially expedient under the financing undertaking; directors' loans were supported by own-fund findings. The Tribunal was restored with final relief.

[paragraphs 12-14](#) / [PDF pages 7, 8, 9](#)

01 FACTS OF THE CASE

For AY 1988-89, Hero Cycles claimed bank-interest deduction of Rs. 20,53,120. The Assessing Officer disallowed Rs. 16,39,010, citing an interest-free advance of Rs. 1,16,26,128 to subsidiary Hero Fibres Ltd. and Rs. 34 lakh lent to the assessee's own directors at 10%, compared with the 18% bank borrowing rate (paragraphs 1-2).

Hero Cycles was the promoter with a controlling share in Hero Fibres. It had undertaken to three financial institutions to provide additional margin to support the subsidiary's working capital and cash losses. That undertaking enabled the subsidiary's institutional loan and required the advance; interest was not payable on the advance unless the subsidiary paid a dividend. CIT(A) accepted business expediency on this evidence (paragraphs 4-5).

For the directors' loans, the assessee demonstrated a credit balance when the loans were made on 25 March 1987, with Rs. 4,95,670 remaining after the Rs. 34 lakh cheques were encashed. CIT(A) found that the loans did not come from borrowed funds and that the Assessing Officer had failed to establish the alleged nexus. The Tribunal upheld CIT(A), but the Punjab and Haryana High Court reversed on 6 December 2006 (paragraphs 3 and 6-8).

Source: [reported judgment](#) / [paragraphs 1-8](#) / [PDF pages 3, 4, 5, 6](#) / [judgment](#)

02 DISCUSSION BY THE HON'BLE COURT

The High Court had not discussed the established facts for either category of advance. It relied on its *Abhishek Industries* judgment instead. The Supreme Court found that approach legally faulty and assessed the two categories separately (paragraphs 9-11).

For the subsidiary advance, paragraph 12 expressly cites *S.A. Builders*, (2007) 288 ITR 1 (SC), and reproduces its discussion of commercial expediency, including the contrast with a sentimental personal donation. Paragraph 13 also recounts *S.A. Builders'* approval of *Dalmia Cement*: once the business nexus is established, Revenue cannot substitute its own assessment of what a prudent businessman should spend or insist on maximum profit. This is an express use of the 2006 interest judgment, not the separate same-day section 32AB decision (paragraphs 12-13).

Applying that test, the Court held that *Hero Cycles'* undertaking to financial institutions made the advance a business necessity in the circumstances. Paragraph 15 additionally records later disposal of the shareholding to *Oswal Group* companies, repayment of the loan with interest, and offering that interest to tax when received. That subsequent recovery was noted in support; paragraph 14's operative commercial explanation remained the financing undertaking (paragraphs 14-15).

The directors' loans rested on a different factual basis. Revenue could not dispute the credit bank balance at the time of the Rs. 34 lakh advance; CIT(A) had also recorded reserves/surplus of almost Rs. 15 crore. Those findings supported funding from the assessee's own resources. The Court did not hold that the directors' personal borrowing was itself commercially expedient merely because they were directors, or that every difference between borrowing and lending rates is irrelevant regardless of the facts (paragraphs 6 and 16).

Source: [reported judgment / paragraphs 9-16 / PDF pages 6, 7, 8, 9 / judgment](#)

03 JUDICIAL DECISION

The assessee's appeal was allowed. The High Court order was set aside and the Tribunal's order restored, reinstating the full interest-deduction result reached by CIT(A) and upheld by the Tribunal. There was no remand for another commercial-expediency inquiry (paragraphs 3, 7 and 17).

Source: [reported judgment / paragraphs 17 / PDF pages 9 / judgment](#)

04 OUTCOME / IN WHOSE FAVOUR

In whose favour: Assessee

Appeal allowed; High Court set aside; Tribunal restored

Final relief on the disputed interest deduction on the accepted factual record

Subsidiary relief depends on the financial-institution undertaking and business purpose. Directors' loan relief rests on own-fund findings. The two rationales are not interchangeable.

Source: [reported judgment / paragraphs 3; 7; 14-17 / PDF pages 4, 5, 6, 9 / judgment](#)

05 AKHB REVIEW POINT

Present related-party advances in separate factual categories. For subsidiary support, produce the institutional loan terms, promoter undertaking, business relationship and use of funds. For directors' loans, prove actual bank balances and the source of available funds rather than relying only on a general reserve figure. Here, the bank-credit evidence and the accepted finding of no borrowed-fund nexus were important alongside reserves.

Hero Cycles is a concrete later application of S.A. Builders, with final relief on an established record. S.A. Builders itself required a remand. Do not present either as automatic permission to divert business borrowings for personal purposes or as a blanket exemption from all other disallowance provisions. Preserve the two source errors noted below when reproducing the reported text, and use the judicial paragraphs for the section and citation pinpoints. Check later law independently; no Income-tax Act, 2025 carryover or complete treatment certificate is given.

Source: [reported judgment / paragraphs 4-6; 12-17 / PDF pages 5, 6, 7, 8, 9 / judgment](#)

ADDITIONAL STATUTORY CONTEXT, NOT SEPARATE HOLDINGS

260A

PROVISION-SPECIFIC SCOPE

1.

Act: Income-tax Act, 1961

Section: 36(1)(iii)

Role: Interest-deduction provision decided

Basis: Paragraph 1 identifies the provision; paragraphs 12-16 apply commercial expediency and the separate own-fund findings.

2.

Act: Income-tax Act, 1961

Section: 260A

Role: Procedural background as described in paragraph 8

Basis: The judicial narrative describes Revenue's High Court challenge under section 260A, whereas the reported jurisdiction line calls the case ITR No. 162 of 1999. The note does not independently resolve that procedural-label discrepancy.

JUDICIAL AUTHORSHIP AND SEPARATE OPINIONS

A.K. Sikri, J.

ACT IDENTIFIED IN THE REVIEWED SOURCE

Income-tax Act, 1961

SPECIFIED PRECEDENT TREATMENT AND ITS LIMITS

Status: bounded reported judgments verified

Authority: S.A. Builders Ltd. v. Commissioner of Income Tax (Appeals), Chandigarh and Another, 14 December 2006

Case id: sc-2006-12-14-sa-builders-interest

Relationship: expressly relied on and applied

Summary: Paragraphs 12-13 recapitulate the commercial-expediency test; paragraph 14 applies it to Hero Cycles' financing undertaking. The earlier S.A. Builders report has unnumbered judicial text; the numbered passages reproduced in Hero are identified as Hero's quotation.

Source url: [Open cited source](#)

Paragraphs: 12-14

Pdf pages: 7; 8; 9

Cited source url: [Open cited source](#)

SOURCE & VERIFICATION

[Hon'ble Supreme Court source PDF \(reported judgment\)](#)

Identified source rendition: 9 PDF pages; SHA-256

fb33db95ee2827975a708c279faf901cd2b716d3861ed8961dfd1b2c9efaf8d8. Original bytes preserved.

Judgment paragraphs 1-17 begin on physical PDF page 3, printed SCR page 57, and end on physical page 9, printed page 63.

Earlier material consists of editorial headnote, references, jurisdiction and appearances. No adjacent-case material.

[Open cited source rendition](#)

Cover/headnote prints section 31(1)(iii); judicial paragraphs 1 and 12 expressly concern section 36(1)(iii). The statutory index follows the judicial text and the original remains unchanged.

Editorial case-law table assigns S.A. Builders to paragraph 11 and Dalmia Cement to paragraph 12; actual judicial discussion appears in paragraphs 12 and 13.

Paragraph 15 uses the awkward formulation that the assessee refunded the loan it had itself given. The note reports the recorded repayment with interest and tax offering without adopting that inconsistent payer label.

The jurisdiction line identifies ITR No. 162 of 1999, while paragraph 8 describes a section 260A appeal. Procedural background is not silently harmonised.

The subsidiary advance and directors' loans have distinct grounds; no blanket rate-comparison or mixed-fund presumption is inferred.

Reported citation verified on cover. Catalogue neutral citation 2015INSC832 is not independently verified and is not adopted.

AY 1988-89 is expressly stated in paragraph 1.

STATUTORY SCOPE

Historical Income-tax Act, 1961 provisions as discussed in this judgment and applied to its proceedings. No independent statutory-version audit.

No automatic Income-tax Act, 2025 crosswalk, comprehensive later-treatment audit or present-law certification.

LATER TREATMENT

Source checked 2026-10-04. Subsequent judicial treatment and later statutory changes have not been comprehensively verified. Any separately identified authority is a bounded check, not a citator or current-law certificate.

IDENTIFIED SOURCE LINKS

[reported judgment - PDF pages: 9](#)

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[Related note: S.A. Builders Ltd. v. Commissioner of Income Tax \(Appeals\), Chandigarh and Another](#)

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