**(1990) 02 PAT CK 0005**

**In the Patna High Court**

**Case No :** Taxation Case No. 125 of 1980

Commissioner of Income Tax APPELLANT

Vs

Eastern India Agencies RESPONDENT

**Date of Decision :** 01-02-1990

**Acts Referred:**
Income Tax Act, 1961 — Section 40

**Citation :** (1990) 83 CTR 134 : (1990) 185 ITR 171 : (1990) 53 TAXMAN 457

**Hon'ble Judges :** G.G. Sohani, C.J;Bimalendu Narayan Sinha, J

**Bench :** Division Bench

**Advocate :** B.P. Rajgarhia and S.K. Sharan, for the Appellant; None, for the Respondent

# Judgement

1. By this reference u/s 256(1) of the Income Tax Act, 1961 (hereinafter referred to as "the Act"), the Income Tax Appellate Tribunal, "B" Bench, Patna, has referred the following question to this court for its opinion :

"Whether, on the facts and in the circumstances of the case, the assessee is entitled to get adjustment of the interest received from the firm out of the interest paid to the firm and the net amount of interest only is to be added back under the provisions of Section 40(b) of the Income Tax Act in computing the total income of the firm ?"

2. The material facts giving rise to this reference, briefly stated, are as follows :

The assessee was assessed in the status of a partnership firm. During the assessment year 1976-77, the assessee-firm paid interest to its partners amounting to Rs. 48,897. The Income Tax Officer rejected the contention advanced on behalf of the assessee that the amount of interest to be added as paid to partners should be taken at Rs. 34,773 after deducting a sum of Rs. 11,856 on account of interest received from the two partners of the firm. The Income Tax Officer held that in view of the provisions of section 40(b) of the Act, the gross amount of interest paid to the partners amounting to Rs. 48,897 was required to be included in the income of the firm. Aggrieved by the order passed by the Income Tax Officer, the assessee preferred an appeal before the Appellate Assistant Commissioner. That appeal was dismissed. On further appeal before the Tribunal, the Tribunal upheld the contention urged on behalf of the assessee that only the net interest should be taken into consideration. In this view of the matter, the Tribunal allowed the appeal. Aggrieved by the order passed by the Tribunal, the Revenue sought a reference and it is at the instance of the Revenue that the aforesaid question of law has been referred to this court for its opinion.

3. None appeared on behalf of the assessee. Shri Rajgarhia, learned counsel for the Revenue, contended that in view of the provisions of Section 40(b) of the Act, the entire amount of interest paid, to the partners of the firm was required to be included in computing the total income of the firm chargeable to tax and the Tribunal erred in holding that only the net amount of interest paid to a partner was required to be added back u/s 40(b) of the Act. Reliance was placed on the decision in Commissioner of Income Tax Vs. O.M.S.S. Sankaralinga Nadar and Co., . The contention deserves to be upheld. Under the provisions of Section 40(b) of the Act, any payment of interest made by a firm to any partner cannot be deducted in computing the income of the firm chargeable to tax. The claim of the assessee-firm that two of its partners had independent account with the firm and that as the firm had received interest from these partners, that amount of interest should be adjusted against the interest payable by the firm to those partners was rightly disallowed by the Income Tax Officer. As held in Commissioner of Income Tax Vs. O.M.S.S. Sankaralinga Nadar and Co., , when section 40(b) of the Act speaks of payment of interest by the firm to a partner as the subject of disallowance, it can only be payment of gross interest in the particular account in which interest is payable. We respectfully agree with that decision.

4. On the facts and in the circumstances of the case, therefore, the Tribunal, in our opinion, erred in holding that the assessee was entitled to get adjustment, of the interest received by the firm from its parters towards the interest paid by the firm to that partner and that only the net amount, of interest was required to bo added back under the provisions of Section 40(b) of the Act, in computing the total income of the firm.

5. The reference is answered accordingly in favour of the Revenue and against the a.ssessee. As none has appeared on behalf of the a.ssessee, the parties shall bear their own costs of this reference.

6. Let a copy of this judgment be forwarded by the office of this court to the Assistant Registrar, Income Tax Appellate Tribunal, "B" Bench, Patna.