
(1997) 05 P&H CK 0086

In the Punjab And Haryana At Chandigarh

Case No : Income-tax Reference No. 107 of 1983

Commissioner of Income Tax

APPELLANT

Vs

Four Fields (P.) Ltd.

RESPONDENT

Date of Decision : 14-05-1997

Acts Referred:

Income Tax Act, 1961 — Section 24(1)

Citation : (1998) 144 CTR 676 : (1998) 231 ITR 262

Hon'ble Judges : Iqbal Singh, J; Ashok Bhan, J

Bench : Division Bench

Advocate : B.S. Gupta and Sanjay Bansal, for the Appellant; None, for the Respondent

Judgement

Ashok Bhan, J.—At the instance of the Revenue, the Income Tax Appellate Tribunal, Amritsar (hereinafter referred to as "the Tribunal"), has referred the following question of law to this court for its opinion :

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is right in law in holding that the assessee is entitled to the deduction of interest of Rs. 13,358 u/s 24(1)(vi) of the Income Tax Act, 1961 ?"

2. The dispute pertains to the assessment year 1978-79. The assessee, a private limited company, was a partner in the firm, Four Fields Poultry Products, Amritsar. The partnership stood dissolved with effect from July 1, 1975, by a dissolution deed of the same date. The assessee-company took over the entire business of Four Fields Poultry Products along with all its assets and liabilities. The value of the assets acquired was Rs. 3,09,521. As on July 1, 1975, the account of the assessee in the books of the Four Fields Poultry Products showed a credit balance of Rs. 1,24,785.02. There were four other partners, namely, Jagdish Chander Mehra, Jugal Kishore Mehra, Jai Gopal Mehra and Joginder Lal Mehra. Each of them had credit balances of Rs. 42,000 to Rs. 48,000 in the aforesaid firm. The assessee having been permitted to take over the business of Four Fields Poultry Products along with all its assets and liabilities, was required

to make payment of Rs. 1,82,037 in aggregate to all the partners in the settlement of the dues upon the dissolution of the firm. The dissolution deed provided that if the assessee was able to clear the liability of the outgoing partners by December 31, 1976, no interest was to be charged but if it was not able to clear the liability till that date interest at the rate of 15 per cent. per annum was to be charged. One of the assets taken over by the assessee comprised a building, the value of which was shown in the balance-sheet at Rs. 2,16,973 as on June 30, 1975. This was a tenanted property and fetched a rent of Rs. 30,000 per annum, the profit and loss of the assessee for the year concerned showed a sum of Rs. 24,000 on the credit side as rent receipt. Proceeding on this basis, the Income Tax Officer assessed the income derived from the property at Rs. 19,634 and included the same in the total income of the assessee. The assessee made a claim that Rs. 13,358 payable as interest on the borrowed capital to the erstwhile partners of the Four Fields Poultry Products should be allowed as interest payable on borrowed capital. The Income Tax Officer did not accept the plea of the assessee and disallowed the claim of interest against the income derived from the property. According to him, the property had not been acquired with any borrowed capital and, therefore, the question of allowing any interest on the borrowed capital did not arise. The assessee disputed this view of the matter by claiming that the building which had been subjected to assessment by the Income Tax Officer formed part of the business of Four Fields Poultry Products and, therefore, the interest on the liability credited in favour of the outgoing partners should be considered as interest paid on the borrowed capital. The assessee became entitled to the building and obtained the ownership only because it had made itself liable to the outgoing partners for a sum of Rs. 1,82,037. But the Income Tax Officer did not accept this plea of the assessee and turned down its request for allowing deduction of interest from the income derived from the property. The order of the Income Tax Officer was upheld by the Commissioner of Income Tax (Appeals).

3. Aggrieved against the rejection of his appeal by the Commissioner of Income Tax (Appeals), the assessee approached the Tribunal, by way of second appeal. The Tribunal, after consideration of facts and relying upon a judgment of this court in Commissioner of Income Tax Vs. N.D. Radha Kishan and Co., , accepted the appeal and allowed the claim of the assessee for deducting interest from the income of the property. It was held that the assessment of the property under Sections 22 and 23 of the Income Tax Act, 1961 (hereinafter referred to as "the Act"), proceeds on the basis that the assessee is the owner of the property. If the assessee is not the owner of the property, he would not be liable under these provisions in respect of the income derived from the property. The Income Tax Officer, having accepted the assessee as the owner of the property whose rental income was subjected to assessment, could not in law ignore the arrangement under which the ownership had passed to the assessee following the dissolution of the partnership firm. As a result of the arrangement brought about by the dissolution deed, the assessee had taken over the running business comprising

assets and liabilities, which, in other words, implied that the ownership of the assets including that of the building had passed on to the assessee. By virtue of this, the assessee had become liable to pay a sum of Rs. 1,82,037 to the erstwhile partners for the ownership of all the assets including the building. It was held that if the assessee had borrowed the sum from a third party and had cleared the account of the erstwhile partners, the Income Tax Officer would not have possibly any objection to the claim of the assessee to allow interest on the borrowed capital. It was true that the assessee had not borrowed the sum of Rs. 1,82,037 from the erstwhile partners. Instead of borrowing the funds from the third party, the assessee agreed to pay interest to its partners in case it failed to clear the liability within the stipulated period. It was held that there was not much difference in the two situations. The transactions were alike and did not admit of any material difference which could distinguish one from the other. It was observed that whether the assessee raised a loan from the third party or even the partners and paid interest thereon or whether the assessee makes himself liable to the erstwhile partners for a consideration and pays interest on the amount of the liability, the situation remains the same. Accordingly, it was held that the assessee was entitled to the deductions u/s 24(1)(vi) of the Act.

4. The Revenue filed a petition u/s 256(1) of the Act before the Tribunal to refer the question of law arising out of the order of the Tribunal to this court. Finding that a question of law did arise, the Tribunal has referred the question of law reproduced in the earlier part of the judgment to this court for its opinion.

5. The assessee is not represented before us in spite of service. The actual date notice under the registered A. D. cover was sent which remained unresponded.

6. In this case, we have to examine as to whether the interest paid to the outgoing partners was on borrowed capital, thus, making it admissible as a deduction from income from house property under 24(1) read with Clause (vi) of the Act. Section 24(1) of the Act reads as under :

"24. Deductions from income from house property.--(1) Income chargeable under the head "Income from house property" shall, subject to the provisions of Sub-section (2), be computed after making the following deductions, namely:--

(i) in respect of repairs,--

(a) where the property is in the occupation of the owner, or where the property is let to a tenant and the owner has undertaken to bear the cost of repairs, a sum equal to one-sixth of the annual value ;

(b) where the property is in the occupation of a tenant who has undertaken to bear the cost of repairs,--

(i) the excess of the annual value over the amount of rent payable for a year by the tenant ; or

(ii) a sum equal to one-sixth of the annual value, whichever is less ;

(ii) the amount of any premium paid to insure the property against risk of damage or destruction ;

(iii) Omitted by the FA, 1968, wef. 1-4-69.

(iv) where the property is subject to an annual charge (not being a charge created by the assessee voluntarily or a capital charge) the amount of such charge ;

(v) where the property is subject to a ground rent, the amount of such ground rent ;

(vi) where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital ;

(vii) any sums paid on account of land revenue or any other tax levied by the State Government in respect of the property ;

(viii) any sums spent to collect the rent from the property, not exceeding six per cent. of the annual value of the property ;

(ix) where the property is let and was vacant during a part of the year, that part of the annual value which is proportionate to the period during which the property is wholly unoccupied or, where the property is let out in parts, that portion of the annual value appropriate to any vacant part, which is proportionate to the period during which such part is wholly unoccupied ;

Explanation.--The deduction under this clause shall be made irrespective of whether the period during which the property or, as the case may be, part of the property was vacant precedes or follows the period during which it is let ;

(x) subject to such rules as may be made in this behalf, the amount in respect of rent from property let to a tenant which the assessee cannot realise."

7. u/s 24, income chargeable to tax under the head "Income from house property" is made subject to charge after certain deductions, which are mentioned in the ten clauses in this section. No exception other than the ones mentioned in these clauses is permissible. From a plain reading of clause (vi), it is clear that interest is chargeable on the borrowed capital which has been utilised for acquiring the property, construction, reconstruction, repair or renewal of the property, the income from which is being taken into consideration for computing the charge of income. Interest deductible is on the borrowed capital which postulates the existence of a borrower and a lender. The relationship of a borrower and a lender must come into existence before it can be said that any money is borrowed by one person from another. The transaction should be real.

8. In this case, there has been no specific borrowing to acquire the property. It is clear that what the assessee-company took over as on June 30, 1975, were all the assets and liabilities of the old firm which no doubt included the immovable

property worth Rs. 2,16,973 but which also comprised other properties including plant and machinery. The value of assets acquired was Rs. 3,09,521. After excluding the credit balance of Rs. 1,24,785.02, a sum of Rs. 1,82,037 remained as liability payable to the outgoing partners. Incurring of this liability cannot be considered as capital borrowed for acquiring, constructing, repairing, renewing or reconstructing the building under reference. The Tribunal was in error in accepting the assessee's argument that but for the building, its money was enough to meet the other expenses of the assets acquired and the deposits of the directors, in respect of which interest is being claimed, may be allowed as a borrowing. The assessee took over all the assets and liabilities of the firm. When all the assets and liabilities were taken over, it cannot be said that one particular asset out of the total assets of the firm, was taken over with the aid of the outstandings due to the outgoing partners.

9. Section 28 deals with profits and gains of business or profession. Section 29 provides that income referred to in Section 28 shall be computed in accordance with the provisions contained in Sections 30 to 43A. Various expenses known as revenue expenses are mentioned from Section 30 onwards. Section 36(1)(iii) provides that the amount of the interest paid in respect of capital borrowed for the purposes of business or profession is deductible while computing the income referred to in Section 28. Section 37 provides that any expenditure not being expenditure of the nature described in Sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee, laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".

10. The Tribunal relied upon Commissioner of Income Tax Vs. N.D. Radha Kishan and Co., to arrive at the view it has taken. It is to be noticed that interest in the above case was allowed by the Tribunal u/s 37, which was upheld by the High Court treating it to be an expenditure laid out for the purposes of business and not as an interest on the borrowed capital u/s 36(1)(iii). Payment of interest is an expenditure for the purposes of business or profession u/s 37 but it is different than a deduction of the amount of interest paid in respect of capital borrowed for the purposes of business or profession u/s 36(1)(iii). Commissioner of Income Tax Vs. N.D. Radha Kishan and Co., is, therefore, of no assistance to the assessee. The Tribunal erred in placing reliance on the abovesaid case to hold that the assessee was entitled to deduction u/s 24(1)(vi) of the Act. The judgment in N. D. Radha Kishan's case [1983] 140 ITR 863 was rendered in a totally different set of facts, which are not relateable to the facts of the present case.

11. Clause (vi) of Section 24(1) is in tune with Section 36(1)(iii). It permits the deduction of any interest on borrowed capital for the acquisition, construction, repair or reconstruction of the building in question. What is necessary for the purpose of claiming deduction of interest is that the borrowing should have a nexus with the acquisition, construction, etc., of the property. In the present

case, there was no borrowing by the assessee from the outgoing partners. As per the deed of dissolution, on the amount payable to the erstwhile four partners, no interest was payable up to December 31, 1976, by which date the entire amount had to be paid to them. It was agreed that in case the amount is not paid by December 31, 1976, then, with effect from January 1, 1977, the assessee would pay interest at the rate of 15 per cent. per annum on the amount due from it which does not establish that interest was paid for the purpose of borrowing capital used to acquire the immovable asset of building worth Rs. 2,16,973. No relationship of borrower and lender came into existence, in the absence of which, it cannot be said that the interest paid was on the borrowed capital. At the most, the assessee became liable to pay interest on the sum of Rs. 1,82,037, due from it to the outgoing partners. Under the circumstances, the question of allowing any deduction u/s 24(l)(vi) does not arise. It cannot be held that the assessee acquired the asset of immovable property with the aid of borrowed capital.

12. The Supreme Court of India examined this point in BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY, . In that case, pursuant to a scheme of amalgamation between two shipping companies, the assessee-company was incorporated on August 10, 1953, to take over certain passenger and ferry services carried on by one of the former. The assessee-company took over assets, which were finally valued at Rs. 81,55,000 and agreed that the price was to be satisfied partly by allotment of 29,990 fully paid up shares of Rs. 100 each and the balance was to be treated as a loan and secured by a promissory note and hypothecation of all movable properties of the assessee-company. The balance remaining unpaid from time to time was to carry simple interest at 6 per cent. During the relevant accounting years, the assessee paid interest on the balance outstanding and the question was whether the interest paid was allowable as a deduction u/s 10(2) (iii) or (xv) of the Indian Income Tax Act, 1922, in computing its profits. It was held that the expression "capital" used in 10(2)(iii), in the context in which it occurred, meant money and not any other asset. There was no capital borrowed by the assessee and the agreement to pay the balance of consideration due by the purchaser did not give rise to a loan. The claim for deduction of the amount of interest u/s 10(2)(iii) was held to be inadmissible. It was observed that the interest paid by the assessee could be treated as business expenditure and allowable u/s 10(2) (xv) but the same could not be treated as a deduction under 10(2){iii}. In this context, it was observed by their Lordships that (page 57) :

"In our judgment this is not a permissible approach in ascertaining the true nature of the transaction. The parties had agreed that assets of the value of Rs. 81,55,000 be taken over by the assessee-company from the Scindias. Out of that consideration Rs. 29,99,000 were paid by the assessee-company and the balance remained unpaid. For agreeing to deferred payment of a part of the consideration, the Scindias were to be paid interest. An agreement to pay the balance of consideration due by the purchaser does not in truth give rise to a loan. 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 only one of such sources. Every creditor who is entitled to receive a debt cannot be regarded as a lender. If the requisite amount of consideration had been borrowed from a stranger, interest paid thereon for the purpose of carrying on the business would have been regarded as a permissible allowance ; but that is wholly irrelevant in considering the applicability of Clause (iii) of Sub-section (2) to the problem arising in this case. The Legislature has under Clause (iii) permitted as an allowance interest paid on capital borrowed for the purposes of the business ; if interest be paid, but not on capital borrowed, Clause (iii) will have no application."

13. Section 10(2)(iii) of the Indian Income Tax Act, 1922 , corresponds to Section 36(1)(iii) of the Act. The ratio of the law laid down by the Supreme Court in BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY., , would be applicable to this case because both under Sections 24(1)(vi) and 36(1)(iii), the interest is to be paid on the borrowed capital. The undischarged liability payable to the outgoing partners was not borrowed capital as there was no relationship of borrower and lender, in the absence of which, it cannot be said that any money is borrowed by one person from another.

14. Learned counsel for the Revenue referred to (1975) 101 ITR 748 (Guhawati); Commissioner of Income Tax, Andhra Pradesh Vs. Visakhapatnam Port Trust, ; Commissioner of Income Tax Vs. United India Roller Flour Mills Limited, ; Commissioner of Income Tax Vs. Lucas TVS Ltd., ; Rekhchand Gopaldas Mohta Spinning and Weaving Mills Ltd. Vs. Commissioner of Income Tax, Bombay South, ; and Commissioner of Income Tax Vs. Orient Trading Co., to contend that the relationship of borrower and lender must come into existence before it can be said that any amount, capital or any other money is borrowed by one person from another to bring it within the ambit and scope of borrowed capital.

15. We have gone through all these judgments and find that in all of these judgments, it has been held that there has to be a real transaction of borrowing and lending in order to amount to any borrowing. We concur with the observations made in these judgments to that effect. In fact, we have taken the same view and that is why we are not referring to the detailed facts of those cases and the principles deduced by the different High Courts on the facts determined.

16. For the reasons stated above, it is held that the Tribunal was wrong in law in holding that the assessee is entitled to deduction of interest of Rs. 13,358 u/s 24(1)(vi) of the Act. The question referred is answered in the negative, i.e., in favour of the Revenue and against the assessee.