

(1987) 08 AP CK 0033

In the Andhra Pradesh High Court

Case No : Referred Case No. 264 of 1982

Commissioner of Income Tax

APPELLANT

Vs

Gopal Reddy

RESPONDENT

Date of Decision : 05-08-1987

Acts Referred:

Income Tax Act, 1961 — Section 256(1), 36(1)(iii), 36(1)(m), 67, 67(3)

Citation : (1987) 34 TAXMAN 392

Hon'ble Judges : Y.V. Anjaneyulu, J;B.P. Jeevan Reddy, J

Bench : Division Bench

Advocate : M.S.N. Murthy and Krishna Koundinya, for the Appellant; S. Dasaratharami Reddy, for the Respondent

Judgement

Y.V. Anjaneyulu, J.—At the instance of the assessee, the Tribunal made this reference u/s 256(1) of the income tax Act, 1961 ("the Act"). The question referred relates to the assessment year 1977-78 and is extracted below: Whether, on the facts and in the circumstances of the case, the disallowance of interest of Rs. 16,834 is correct in law either u/s 67(3) or u/s 36(1)(iii) of the income tax Act, 1961?

The assessee and his three minor sons constituted a Hindu joint family. The family held shares in two partnership firms known as "Rami Reddy & Co." and "Sri Laxmi Prasanna Sugar Factory". On behalf of the family, the karta held the shares in the partnership firms in a representative character. The total investment of the joint family in the two partnership concerns was Rs. 2,25,558 as on 31-8-1974. There was a partition of the joint family assets on 31-8-1974, between the assessee and his three minor sons. The partnership interest in the two firms was divided among the karta and his three minor sons in equal shares in the course of such partition. It is not clear, but it does appear that in the books of joint family, entries were recorded in support of the division of partnership interest as on 31-8-1974. It would, however, appear that corresponding entries were not made in the books of the partnership firms with the result that so far as

the partnership firms were concerned, the investment still stood in the name of the karta of the family without formal division among the karta and his three minor sons. It is stated that the division was not made in the partnership books on account of certain practical difficulties. It is claimed that there was an understanding between the karta of the family and his three minor sons that the capital which fell to the share of the three minor sons in the course of partition on 31-8-1974 should be allowed to stand in the name of the karta in the books of the two partnership firms, In consideration of the above understanding, it appears that the karta agreed to pay to the three minor sons the share of income corresponding to their one-fourth share and also interest. There is nothing on record to show how the understanding was arrived at between the karta and his three minor sons. The revenue, however, did not dispute that such understanding existed. In connection with the assessment year 1976-77, the assessee claimed deduction of Rs. 17,635 by way of interest payable to the three minor sons in respect of the share of capital belonging to them which stood invested in" the partnership firms. While completing the assessment, the ITO restricted the deduction of interest from out of the assessee"s share income t o the extent of only Rs. 7,602 on the ground that the assessee had received only that amount of interest from the two partnership firms. The claim for deduction of balance amount was rejected. It appears that the assessee did not appeal against the disallowance of the balance amount.

2. For the assessment year 1977-78 which is under consideration, the previous year ended on, 31-8-1976. The assessee claimed deduction of Rs. 16,834 as interest payable to his three minor sons. The ITO declined to allow any portion of the claim on the ground that the assessee did not receive any interest at all from the two partnership firms and, therefore, there was no question of allowing the deduction in the hands of the assessee either u/s 67(3) or u/s 36(1)(iii) of the Act.

3. Against the disallowance by the ITO of the claim for deduction of interest of Rs. 16,834, the assessee filed an appeal before the AAC, who upheld the order of the ITO. Thereupon, a second appeal was filed by the assessee before the Tribunal which confirmed the order of the authorities below. It was in these circumstances that the petitioner applied for a reference u/s 256(1) and the Tribunal referred the question of law for the consideration of this Court which we have already indicated.

4. We have heard Shri S. Dasaratharami Reddy, the learned counsel for the assessee and also the learned standing counsel for the income tax Department, Shri M.S.N. Murthy. It seems to us that the claim of the assessee for deduction is clearly inadmissible u/s 67(3) or alternatively u/s 36(1)(m). Section 67 provides for the method of computing partner"s share in the income of the firm. Sub-section (3) of section 67 provides that any interest paid by a partner on capital borrowed by him for the purposes of investment in the firm shall, in computing his income chargeable under the head "Profits and gains of business or

profession" in respect of his share in the Income of the firm, be deducted from the share. In order that an assessee is entitled to claim deduction under this provision, it is necessary to show that capital was borrowed by the assessee for the purposes of investment in the firm. Unless, this condition is satisfied, the claim for interest is not allowable. In the present case, the finding recorded by the Tribunal is that the capital which was invested earlier in the two firms was withdrawn by the assessee for being utilised in his personal capacity. We may refer to the following finding of the AAC affirmed by the Tribunal in its order:

It is also noticed that the partnership concerns were paying interest till the earlier years and this is absent for the current year. Obviously, the amounts have been withdrawn from the partnership concerns to the karta for being utilised in his personal capacity.

The correctness of the aforesaid finding is not challenged by the assessee. If it is, therefore, true to say that no capital stood invested in the partnership firm during the previous year relevant for the assessment year 1977-78, the question of allowing any interest upon capital allegedly borrowed for investment in the partnership firm does not arise. The claim for deduction u/s 67(3) should, therefore, fail.

The assessee's alternative claim for deduction u/s 36(1)(iii) is equally untenable. According to section 36(1)(iii) the amount of interest paid in respect of capital borrowed for the purpose of business or profession is allowable as deduction. The petitioner's claim is that the share of capital in the two partnership firms payable to each one of the three minor sons according to the partition arrangement remained unpaid and it must, therefore, be presumed that that capital was borrowed for the purpose of business or profession. In the first place, the provision for deduction u/s 36(1)(iii) relates to the business carried on by the assessee. The claim for deduction in the present case is made out of the assessee's share income and not from any other business income of the assessee. Indeed, the assessment order for the year 1977-78 does not show that the assessee has any income from his own business (with the exception of paltry interest of Rs. 423 from money-lending). The claim was also made for the deduction of interest from out of the share income. In that event, the correct provision that is applicable is u/s 67(3) which specifically provides for deduction of interest from out of share income in respect of capital borrowed for investment in partnership firms. It is not the assessee's case that the amount owing to the three minor sons was invested in any business carried on on account by the assessee so that the interest payable thereon to the three minor sons could be allowed by way of deduction u/s 36(1)(iii). It is not also shown as to how the sum payable to the three minor sons was utilised for the purpose of the assessee's business so that interest could be allowed u/s 36(1)(iii). In the absence of any details supporting the claim, the authorities below were quite justified in considering the assessee's alternative claim u/s 36(1)(iii) as equally untenable. In any view of the matter, we are satisfied that the decision of the

Tribunal affirming the disallowance of the interest of Es. 16,834 is correct. We, accordingly, answer the question in the affirmative, i.e., in favour of the revenue and against the assessee. No costs.