
(1986) 12 AHC CK 0027

In the Allahabad High Court

Case No : Income-tax Reference No. 1139 of 1977

Commissioner of Income Tax

APPELLANT

Vs

Hari Nath and Co.

RESPONDENT

Date of Decision : 16-12-1986

Acts Referred:

Income Tax Act, 1961 — Section 40

Citation : (1987) 60 CTR 52 : (1987) 168 ITR 440 : (1987) 32 TAXMAN 69

Hon'ble Judges : Om Prakash, J;K.C. Agrawal, J

Bench : Division Bench

Advocate : S.N. Agrawal, for the Respondent

Final Decision : Dismissed

Judgement

K.C. Agrawal, J.—The following question has been referred by the Income Tax Appellate Tribunal under Sub-section (1) of Section 256 of the Income Tax Act:

"Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was legally correct in holding that payment of interest made to the partner, Shri Hari Nath, on his interest earning deposit account was not covered by Section 40(b) of the Income Tax Act, 1961, and in its deleting the additions of Rs. 7,083, Rs. 7,537, Rs. 3,882 and Rs. 5,914, respectively, made by the Income Tax Officer on this account? "

2. The assessee is a registered firm consisting of several partners. Hari Nath, one of the partners, in his individual capacity received interest on the amounts invested by him in the firm in his individual capacity. The Income Tax Officer added back these amounts to the total income of the assessee-firm. The assessee-firm appealed to the Appellate Assistant Commissioner. It was contended in the appeal that an individual and the Hindu undivided family are two different entities and are assessed separately. Consequently, the interest paid to Hari Nath on the loans advanced to the assessee-firm could not be added to the income of the firm. The Appellate Assistant Commissioner relied on the

decision of the Delhi High Court in *PANNALAL GIRDHARILAL Vs. COMMISSIONER OF Income Tax, DELHI.*, and held that interest paid to the partner in whatever capacity could not be treated as legitimate deduction and thus confirmed the addition of the amounts made by the Income Tax Officer. The assessee-firm filed an appeal before the Income Tax Appellate Tribunal which was allowed and the additions made by the Income Tax Officer of the amounts paid to Hari Nath by way of interest were directed to be deducted. The Income Tax Appellate Tribunal held that interest paid to a person in respect of his individual accounts when he is also a partner of the firm representing his Hindu undivided family was not covered by Section 40(b) of the Income Tax Act. The Revenue thereafter moved the application for reference under Sub-section (1) of Section 256 which was allowed. Hence, the reference.

3. There is a divergence of judicial opinion on the controversy whether interest paid to a partner in whatever capacity the payment is made is not allowable u/s 40(b).

4. In *Commissioner of Income Tax Vs. London Machinery Co.*, , this court held (headnote):

" When a person in his capacity as karta of a Hindu undivided family enters into a partnership with others, the karta is a partner only in his personal capacity. The firm can treat only the karta and not the other members of the Hindu undivided family as its partners. The capacity in which he receives the payment, namely, for and on behalf of the family or for his own benefit and interest, is immaterial. Payment to a person who is a partner is the only criterion for the purpose of Section 40(b) of the Income Tax Act, 1961, which prohibits in absolute terms any allowance in respect of any payment by way of interest, salary, bonus, commission or remuneration made by the firm to any of its partners and does not make any distinction in respect of the character or capacity in which the payment is made to the partner. If a partner makes deposits in the firm of monies belonging to his Hindu undivided family and also monies belonging to him individually, in fact and in law the partner brings in the money. In both cases, the payment of interest by the firm to such a partner is as a partner no matter who really has the beneficial interest in such payments."

5. This decision was followed by this court in *Commissioner of Income Tax Vs. Brijmohan Das Laxman Das*, . In *T.M.N.M. SOMASUNDARA NADAR SONS Vs. COMMISSIONER OF Income Tax, TAMIL NADU-IV.*, , the decision of this court has been dissented from. The Madras High Court held that Section 40(b) of the Income Tax Act would not apply to the payment of interest on loans advanced by a partner in his individual capacity. The same view has been taken by the Gujarat High Court in *CIT v. Sajjanraj Divanchand* [1980] 126 ITR 654. It was held that (headnote):

" ...there were two separate accounts and in the account of the Hindu undivided family it was shown that the Hindu undivided family was the creditor of the firm

and on the amount standing to the credit of the Hindu undivided family interest of Rs. 7,777 was paid by the firm to the Hindu undivided family. There was a separate account of the individual partner, SJ, and in that account no interest was paid in the relevant year. Therefore, the amount of Rs. 7,777 was paid by way of interest to the Hindu undivided family which was the creditor of the firm. The fact that the " karta " of the Hindu undivided family was a partner of the assessee-firm was not relevant because, u/s 40(b), it is only the interest paid to the partner which is not allowed to be deducted. Interest paid to any other creditor of the firm cannot be disallowed under the provisions of Section 40(b)."

6. We have noted above the view of this court in the year 1979. Since then, that decision holds the field. This decision is binding on us as the law of precedents is that a decision of the Division Bench given in an earlier case is binding on a subsequent Bench.

7. We are not inclined to accept the suggestion of the assessee's counsel that the controversy involved in this case be referred for decision by a larger Bench.

8. In *The Punjab University, Chandigarh Vs. Vijay Singh Lamba and Others*, , what was said about precedents is instructive and can, therefore, be quoted with advantage in this judgment. The Bench held (at page 1446):

" Precedents, as observed by Lord Macmillan, should be " stepping stones and not halting places." *Birch v. Brown* [1931] AC 605. But, Justice Cardozo's caution should not go unheeded that the weekly change in the composition of the court ought not to be accompanied by changes in its rulings."

9. For what we have said above, we answer the question in the negative by holding that the payment of interest made to the partner, Shri Hari Nath, on his interest earning deposit amount was covered by Section 40(b) of the Income Tax Act, 1961. Thus, in our opinion, the reference is to be decided in favour of the Revenue and against the assessee. There shall be no order as to costs.

Om Prakash, J.

10. I agree with my learned brother, K. C. Agrawal J., that the decision of a Division Bench given in an earlier case is binding on a subsequent Bench. Though it is queer, it is bound to happen in a federal union that a Central statute, like the Income Tax Act, operates differently in various States on account of varying interpretations by the High Courts. This can be obviated only if the cases involving divergent views are decided out of turn by the Supreme Court. Serious thought is required to devise a method to achieve unanimity on the provisions of a Central statute.

BY THE COURT.--For what has been said above, the reference is decided in favour of the Revenue and against the assessee.