

(1988) 05 AHC CK 0027
In the Allahabad High Court
Case No : Income Tax R. No. 616 of 1977

COMMISSIONER OF Income Tax

APPELLANT

Vs

NITRO PHOSPHETIC FERTILIZER.

RESPONDENT

Date of Decision : 09-05-1988

Acts Referred:

Central Sales Tax Act, 1956 — Section 15
Income Tax Act, 1961 — Section 119, 256, 30, 31, 32
Central Sales Tax Act, 1956 — Section 15
Income Tax Act, 1961 — Section 119, 256, 30, 31, 32
Central Sales Tax Act, 1956 — Section 15
Income Tax Act, 1961 — Section 119, 256, 30, 31, 32

Citation : (1988) 72 CTR 114 : (1988) 174 ITR 269

Hon'ble Judges : V. K. Mehrotra, J;K. C. Agrawal, J

Bench : Full Bench

Judgement

K. C. AGRAWAL J. (for himself and V. K. MEHROTRA J.) -This is a reference at the instance of Revenue and relates to the assessment years 1971-72 and 1972-73. R. N. Mehra was one of the partners of the respondent-assessee, Messrs Nitro Phosphetic Fertilizer, Lucknow. He joined the partnership representing the Hindu undivided family of which he was the karta.

In the books of account of the firm, there was a capital account for the Hindu undivided family and a deposit in the name of R. N. Mehra, individual. On the deposit in this account, the firm paid interest to the individual and the same was claimed as a deduction in the profit and loss account. The amounts of interest paid were as under :

Assessment year

Amount of interest

1971-72

Rs. 8,400

1972-73

Rs. 9,120

The assessee's contention was that since the status of R. N. Mehra, depositor, was different from the status of R. N. Mehra (HUF), partner, it was entitled to deduct the interest paid to R. N. Mehra in his individual capacity. The Income Tax Officer did not agree with the assessee. He held that since R. N. Mehra was a partner in his capacity as karta of the Hindu undivided family such payment of interest was not allowable according to the provisions of section 67(1)(b) of the Income Tax Act, 1961. He held that no distinction could be made in the two deposits, one made by R. N. Mehra in the capacity of karta of the Hindu undivided family and other in his capacity as individual. Consequently, the assessee's claim was disallowed and the interest was added to the total income of the firm in the relevant years.

On appeal, the Appellate Assistant Commissioner reversed the judgment of the Income Tax Officer holding that interest paid to the partner was only to be added u/s 40(b) and as R. N. Mehra, individual, was not the partner, the interest paid to his account could not be added u/s 40(b) of the Income Tax Act. The additions, in this behalf, made in his account were, therefore, deleted.

The Revenue took up the matter in appeal before the Income Tax Appellate Tribunal. The Tribunal upheld the judgment of the Appellate Assistant Commissioner.

The question that was referred to the High Court u/s 256(1) of the Income Tax Act for its opinion was :

"Whether, on the facts and circumstances of the case, the Tribunal was correct in upholding the orders of the Appellate Assistant Commissioner in allowing the assessee's claim for interest paid on the credit balance in the individual account of Sri R. N. Mehra amounting to Rs. 8,400 and Rs. 9,120 in the assessment years 1971-72 and 1972-73. respectively ?"

When the reference came up for hearing before a Division Bench of this court, the decision of our court in Commissioner of Income Tax Vs. London Machinery Co., was relied upon by the Revenue. The Division Bench felt that the said decision required reconsideration. Therefore, reference was made to a larger Bench. In pursuance of this reference, the case has come up before the Full Bench.

Section 40(b) of the Income Tax Act reads :

"40. Notwithstanding anything to the contrary in sections 30 to 39, the following amounts shall not be deducted in computing the income chargeable under the head Profits and gains of business or profession,...

(b) in the case of any firm, any payment of interest, salary, bonus, commission or remuneration made by the firm to any partner of the firm."

Before we come to the interpretation of the aforesaid provision, the language of which appears to be absolutely explicit and admits of no doubt, we may, briefly, refer to the object behind it.

This clause re-enacts the provision formerly contained in section 10(4)(b) of the 1922 Act, with the addition of the word "bonus". The object was to pre-empt partners siphoning off substantial profits in the guise of salary, interest, bonus, commission, etc., so that tax evasion is checkmated. In *Commissioner of Income Tax, Madras Vs. R.M. Chidambaram Pillai and Others*, , the Supreme Court held that payment of salary to a partner represents a special share of the profits and that salary paid to a partner retains the same character as income of the firm. Salary being part of the profit, there is no justification for deducting it from the taxable income. This view finds support from *A.S.K. Rathnaswamy Nadar Firm Vs. Commissioner of Income Tax, Madras*, and *GIRIDHARILAL GHASIRAM Vs. COMMISSIONER OF Income Tax, WEST BENGAL.*, .

The decisions referred to above are, no doubt, on disallowance of salary. The prohibition of the allowance of interest also to a case of a partner stands on par with the same force as salary. The partners in a firm are ultimately entitled to the entire profits of the firm, according to their share in the business. Therefore, the entirety of such profits should be brought to charge and no portion be exempted by giving the same away to a partner camouflaged as his salary, bonus, commission, remuneration or interest. A partner is bound to find the necessary finance for the partnership and, hence, any interest on capital supplied by the partner is not deductible.

In *R. A. GOODSIR AND CO., MADRAS Vs. COMMISSIONER OF EXCESS PROFITS TAX, MADRAS.*, and *N.M. Anniah and Co. Vs. Commissioner of Income Tax, Mysore*, , it was held that section 10(4)(b) made no distinction between a payment made to a partner as a partner and one made to him in a different capacity.

Clause (b) re-enacts the prohibition formerly contained in section 10(4)(b) of the Indian Income Tax Act, 1922, with the addition of the word "bonus ".

Under the amended provision any interest, salary, bonus, commission or remuneration paid by a firm to any one of its partners cannot be deducted by the firm as an expenditure in its profit and loss account, the reason being that the partners in a firm are ultimately entitled to the entire profits of the firm. Therefore, the entirety of such profits should be brought to charge and no portion be exempted by giving the same away to a partner as his salary, bonus, commission, remuneration, etc. (see *CIT v. B. S. Mining Co. [1922] 1 ITC 176* and *R.M. Chidambaram Pillai and Another Vs. Commissioner of Income Tax, Madras*, .

The Division Bench was influenced by *Chhotalal and Co. Vs. Commissioner of Income Tax, Gujarat*, while referring this case. This Full Bench held that in computing the business profits of the assessee-firm, the interest paid to a

partner on monies advanced by him from his individual fund could not be disallowed. The interest was not paid to him as a partner, but as a stranger.

The emphasis of the Full Bench of the Gujarat High Court is that a karta represents a different capacity when he joins a firm on behalf of his Hindu undivided family than when he makes deposit of the money belonging to him personally. The two capacities are different and, as such, interest paid on the deposit made by him in his individual capacity cannot be disallowed u/s 40(b).

It may not be disputable that a partner has a dual personality, one, as an individual and the other as a representative of the Hindu undivided family. But that by itself does not solve the question about the applicability of section 40(b). The controversy, which is required to be first examined, would be as to whether a Hindu undivided family can be a partner. In *The Commissioner of Income Tax, West Bengal Vs. Kalu Babu Lal Chand*, , S. R. Das C.J. held that (headnote) :

"It is now well settled that a Hindu undivided family cannot as such enter into a contract of partnership with another person or persons. The karta of the Hindu undivided family, however, may and frequently does enter into partnership with outsiders on behalf and for the benefit of his joint family. But when he does so, the other members of the family do not, vis-a-vis the outsiders, become partners in the firm. They cannot interfere in the management of the firm or claim any account of the partnership business or exercise any of the rights of a partner. So far as the outsiders are concerned, it is the karta who alone is, and is in law recognised as, the partner."

In *Kshetra Mohan-sannyasi Charan Sadhukhan Vs. Commissioner of Excess Profits Tax, West Bengal*, , it was laid down as follows (at p. 492) :

"A Hindu undivided family is no doubt included in the expression person as defined in the Indian Income Tax Act as well as in the Excess Profits Tax Act but it is not a juristic person for all purposes. The affairs of the Hindu undivided family are looked after and managed by its karta. When two kartas of two Hindu undivided families enter into a partnership agreement, the partnership is popularly described as one between the two Hindu undivided families but in the eye of the law it is a partnership between the two kartas and the other members of the families do not ipso facto become partners. There is, however, nothing to prevent the individual members of one Hindu undivided family from entering into a partnership with the individual members of another Hindu undivided family and in such a case it is a partnership between the individual members and it is wholly inappropriate to describe such a partnership as one between two Hindu undivided families."

In *Firm of Bhagat Ram Mohanlal Vs. The Commissioner of Excess Profits Tax, Madhya Pradesh, Nagpur and Another*, , the Supreme Court ruled that (at p. 525) :

"It is well settled that when the karta of a joint Hindu family enters into a

partnership with strangers, the members of the family do not ipso facto become partners in that firm. They have no right to take part in its management or to sue for its dissolution. The creditors of the firm would no doubt be entitled to proceed against the joint family assets including the shares of the non-partner coparceners for realisation of their debts. But that is because under the Hindu law, the karta has the right when properly carrying on business to pledge the credit of the joint family to the extent of its assets, and not because the junior members become partners in the business. In short, the liability of the latter arises by reason of their status as coparceners and not by reason of any contract of partnership by them."

In *Ram Laxman Sugar Mills Vs. Commissioner of Income Tax, Uttar Pradesh and Another*, , the Supreme Court observed (headnote) :

"A Hindu undivided family is undoubtedly a person within the meaning of the Indian Income Tax Act : it is, however, not a juristic person for all purposes, and cannot enter into an agreement of partnership with either another undivided family or individual. It is open to the manager of a joint Hindu family as representing the family to agree to become a partner with another person. The partnership agreement in that case is between the manager and the other person, and by the partnership agreement no members of the family except the manager acquire a right or interest in the partnership."

From the various decisions cited above, it appears that a karta joins the partnership as representing a Hindu undivided family, but the Hindu undivided family itself does not become a partner. The karta is the partner and will be taken as such. In *Commissioner of Income Tax Vs. London Machinery Co.*, , this court held as under (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 purposes 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 money 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.

Section 40(b) of the Act would, therefore, apply to the payment of interest to the three partners who were partners in their capacity as kartas of Hindu undivided

families and had deposited their individual money in the firm."

This decision has been followed by another Division Bench of this court in Commissioner of Income Tax Vs. Chandu Lal Surajpal, , by the Andhra Pradesh High Court in Commissioner of Income Tax Vs. T. Veeraiah and K. Narasimhulu, , by the Madras High Court in Dwarkadas Rameshwar Goenka Vs. Commissioner of Income Tax, Madras, , by the Delhi High Court in Sanghi Motors Vs. Commissioner of Income Tax, Delhi, , by the Madhya Pradesh High Court in Jalam Chand Mangilal (No. 1) Vs. Commissioner of Income Tax, , by the Karnataka High Court in Commissioner of Income Tax, Karnataka (Central) Vs. Khoday Eswarsa and Sons, and by the Patna High Court in Chandmul Rajgarhia Vs. Commissioner of Income Tax, . In Chhotalal and Co. Vs. Commissioner of Income Tax, Gujarat, , a different view had been taken. In this case, the court held that in computing the business profits of the assessee-firm, the interest paid to one of its partners on monies advanced by him from his individual funds could not be disallowed. The interest was not paid to him as a partner but as a stranger. The Gujarat High Court decision has been followed by a Full Bench of the Madhya Pradesh High Court in Commissioner of Income Tax Vs. Narbharam Popatbhai and Sons, . The Full Bench held that a karta of a Hindu undivided family being a partner of a firm representing the Hindu undivided family, if he lends to the firm monies belonging to him individually then the interest paid by the firm to such partner on the monies lent by him is deductible in computing the firms income. For the view taken, reliance was placed on a number of decisions including Balchand Hashmatrai and Co. Vs. Commissioner of Income Tax, , of the Bombay High Court in CIT v. Hansa Dyeing and Printing Works [1976] CTR 482 , Commissioner of Income Tax, Nasik Vs. Pannalal Hiralal and Co., , of the Madras High Court in Venkatesh Emporium v. CIT [1982] 137 ITR 593 and Commissioner of Income Tax, Tamil Nadu-IV Vs. Colombo Stores, and TERLA VEERAIHAH Vs. COMMISSIONER OF Income Tax, A.P., .

It is on account of the decision in Chhotalal and Co. Vs. Commissioner of Income Tax, Gujarat, , that the Division Bench in the present case, as cited above, referred the present case to the Full Bench. We are not persuaded to agree with that view and are of the opinion that Commissioner of Income Tax Vs. London Machinery Co., lays down the correct law. We have found above that a karta, when he enters into a partnership in a representative capacity has no distinct and separate personality, that of the Hindu undivided family, and therefore, monies invested by him from his individual account could not be treated as distinct and separate for the purposes of section 40(b) of the Income Tax Act. Section 40(b) of the Act attempts to prevent the diversion of its funds and avoiding liability to payment of Income Tax. It may be noted here that a partnership firm, even under the Partnership Act, 1932, has not been considered as, a distinct legal entity apart from the partners constituting it. The firm, as such, has no separate rights of its own in the partnership assets. The firms assets are the properties or the assets of all the partners. Our attention was drawn to section 10 of the Taxation Laws (Amendment) Act, 1984, by which the

following three Explanations had been inserted in section 40 of the Income Tax Act, after clause (b). The Explanations run thus :

"Explanation 1. - Where interest is paid by a firm to any partner of the firm who has also paid interest to the firm, the amount of interest to be disallowed under this clause shall be limited to the amount by which the payment of interest by the firm to the partner exceeds the payment of interest by the partner to the firm.

Explanation 2. - Where an individual is a partner in a firm on behalf, or for the benefit, of any other person (such partner and the other person being hereinafter referred to as partner in a representative capacity and person so represented respectively),

(i) interest paid by the firm to such individual or by such individual to the firm otherwise than as partner in a representative capacity shall not be taken into account for the purposes of this clause;

(ii) interest paid by the firm to such individual or by such individual to the firm as partner in a representative capacity and interest paid by the firm to the person so represented or by the person so represented to the firm, shall be taken into account for the purposes of this clause.

Explanation 3. - Where an individual is a partner in a firm otherwise than as partner in a representative capacity, interest paid by the firm to such individual shall not be taken into account for the purposes of this clause, if such interest is received by him on behalf, or for the benefit, of any other person."

Relying on the aforesaid Explanations, learned counsel for the assessee contended that what was implicit in clause (b) of section 40 has been made explicit by the insertion of the aforesaid Explanations and there is no doubt left now that any payment of interest to a karta of a Hindu undivided family on monies invested by him would be deductible as investment made by him and cannot be treated to be that of the Hindu undivided family of which he is the karta. Counsel urged that the two are distinct and separate individualities for the purpose of clause (b) of section 40.

We may note the second paragraph of the Statement of Objects and Reasons of the Bill. This is as under Controller of Estate Duty Vs. Hulaschand Baid, :

"These amendments are intended mainly to streamline procedures in the interest of better work management, avoid inconvenience to tax-payers, reduce litigation, remove certain anomalies in, and rationalise some of the provisions of, these enactments and counteract tax avoidance and tax evasion."

The Taxation Laws (Amendment) Act, 1984, came into force with effect from the assessment year 1985-86. Learned counsel for the assessee, however, contended that since the Explanations are clarificatory in character, they must govern assessments prior to the assessment year, 1985-86. This was refuted by

Sri V. K. Rastogi, who appeared on behalf of the Revenue, before us. The amending Act was noticed by the Division Bench of the Madhya Pradesh High Court in *Balchand Hashmatrai and Co. Vs. Commissioner of Income Tax*, . The Bench held that where a member of a Hindu undivided family is a partner in his individual capacity, interest paid to him as a representative of the Hindu undivided family cannot be disallowed.

In *N.T.R. Estate Vs. Commissioner of Income Tax*, , the same view was taken. The Andhra Pradesh High Court held that the Explanations are clarificatory in nature and must govern assessments prior to the assessment year 1985-86. It has taken the same view in *CIT v. Chitra Kalpana* [1988] 169 ITR 678 .

The settled principle of law is that a new state of law ought to affect the future, not the past. A statute will not be presumed to have retrospective effect.

It was precisely for that reason that the Andhra Pradesh High Court held the amending Act to be clarificatory in nature and by applying the rule of interpretation, it held that the amendment would apply to previous years also. It may be correct that the presumption against the retrospective operation is not applicable to declaratory statutes as stated in *Craies on Statute Law*, VII Edition, p. 58 :

"For modern purposes, a declaratory Act may be defined as an Act to remove doubts existing as to the common law, or the meaning or effect of any statute. Such Acts are usually held to be retrospective.

The usual reason for passing a declaratory Act is to set aside what Parliament deems to have been a judicial error, whether in the statement of the common law or in the interpretation of statutes. Usually, if not invariably, such an Act contains a preamble, and also the word declared as well as the word enacted."

An Act can be considered declaratory when a provision is made to that effect in the amending Act itself. In the instant case, nothing was said by Parliament indicating its intention as to whether it wanted to affect the past assessment years as well. If the intention had been to affect the past years as well, one would have expected a provision for reopening of assessments which had become final-Its absence is a clue to the view that the amendment is not retrospective. Parliament was aware of the same and it was for this reason that the Explanations were made applicable with effect from 1985-86 In the absence of any indication either in the statement of Objects and Reasons, it is difficult to hold that the said section was retrospective. We have noticed above that no court had ever held section 40(b) to be suffering from ambiguity. There was, no doubt, a difference of opinion amongst the courts about the interpretation of section 40(b), but that could not be considered to be an omission for the clearing of which the Explanations have been added. One line of thinking can be that the Explanations have been added with the object of laying down that in future, that is, after 1985-86, the interest paid by an individual on the investments of his monies would be liable to be deducted. In *Central Bank of India v. Their*

Workmen [1959] 29 Comp Cas 367, the proviso introduced in section 10(b)(iii) of the Banking Companies Act, 1949, by the amending Act of 1956, though held to be remedial, was not applied for a period anterior to the date of operation of the amending Act. S. K. Das J., in that case, observed (at p. 392) :

"A remedial Act, on the contrary, is not necessarily retrospective; it may be either enlarging or restraining and it takes effect prospectively, unless it has retrospective effect by express terms or necessary intendment."

Section 10 of the Taxation Laws (Amendment) Act, 1984, neither is, nor purports to be, declaratory or retrospective from a date prior to the assessment year 1985-86. At least, if the amending Act had been made retrospective, one could have thought it was a clarificatory piece of legislation. But the Legislature has given effect to the amending Act from 1985-86. This would mean that the Explanations as inserted by the Taxation Laws (Amendment) Act, 1984, would not apply to earlier assessment years. In *State of U.P. and Another Vs. Malik Zarid Khalid*, , the question arose as to what are the requirements necessary to be found for declaring an amending Act as declaratory or clarificatory. The Supreme Court held (p. 138) :

"If its intention in carrying out the amendment had been misunderstood by the High Court or found ambiguous, the Legislature was expected to rectify the situation by a piece of retrospective or declaratory legislation."

In *Dattatraya Govind Mahajan and Others Vs. State of Maharashtra and Another*, , Bhagwati J. (as he then was), speaking for the Bench observed :

"It is true that the orthodox function of an Explanation is to explain the meaning and effect of the main provision to which it is an Explanation and to clear up any doubt or ambiguity in it. But, ultimately, it is the intention of the Legislature which is paramount and mere use of a label cannot control or deflect such intention. It must be remembered that the Legislature has different ways of expressing itself and in the last analysis the words used by the Legislature alone are the true repository of the intent of the Legislature and they must be construed having regard to the context and setting in which they occur. Therefore, even though the provision in question has been called an Explanation, we must construe it according to its plain language and not on any a priori considerations."

Bearing the aforesaid observations in mind, let us cast a glance at the Objects and Reasons since the intention can best be gathered from the contextual backdrop of the legislation. It gives five reasons for the legislation, namely, better work management, avoidance of inconvenience to tax-payers, reduction of litigation, removal of certain anomalies and rationalisation of some of the provisions.

We have already seen the reasons for the enactment of the Explanations in question. They have not been enacted with a view to either give effect to or undo

the effect of any judicial pronouncement. Thus, the enactment cannot be said to be declaratory. Therefore, it cannot ipso facto have retrospective operation.

Apart from it, there is no other fact or circumstance which may lead us to hold that the legislation operates retrospectively. The tenor of the provision is plain enough. It militates against assignment of retrospectivity.

For what has been said above, it is held that Commissioner of Income Tax Vs. London Machinery Co., , lays down the correct law.

R. R. MISRA J. - For the reasons to be given by me later, I hereby make the operative order right now.

In my opinion, the case of Commissioner of Income Tax Vs. London Machinery Co., does not lay down the correct law and the assessee-firm is entitled to the deduction claimed for by it. Accordingly, I answer the question referred in the affirmative and against the Commissioner of Income Tax.

I have had the advantage of reading the judgment prepared by honble K. C. Agrawal J., which has been agreed to in toto by honble V. K. Mehrotra J. Having given my anxious and careful consideration to the matter, I, however, do not feel persuaded to agree with the view taken by brother, K. C. Agrawal J. In view of the same on an earlier occasion on the eve of transfer of brother V. K. Mehrotra J., I had delivered the operative part of my judgment and had stated that I shall be setting out my reasons for/the same later. Here are the said reasons.

I may now scan the facts of this case which lie in a short compass and are not in dispute. The assessee, Messrs. Nitro Phosphetic Fertilizer, Lucknow, is a registered firm constituted under a partnership deed dated January 28, 1971. A copy of the said deed has been filed as annexure A to the statement of case submitted by the Tribunal to this court. It has been recited in clause (6) of the said partnership deed that Sri Rameshwar Nath Mehra has entered into the partnership as karta representing his Hindu undivided family (in short "the HUF") constituted by him along with his son and wife and that the remaining two other partners have entered into the partnership in their individual capacity.

The account books of the said firm reveal that during the assessment years 1971-72 and 1972-73 with which we are concerned in this reference the capital account of the Hindu undivided family represented by Sri R. N. Mehra is there. Besides this, there also existed deposits with the firm in another account of Sri R. N. Mehra which account admittedly is in his individual capacity. During the said two years in question the assessee-firm paid interest on the individual deposit account of Sri R. N. Mehra and claimed the same as deduction while computing its taxable income. The claim of the assessee was that the said interest had been paid to Sri R. N. Mehra in a capacity, different from that in which he was inducted as a partner in the firm. The Income Tax Officer disallowed the said claim in view of the provisions contained in section 40(b) of the Income Tax Act 1961 (hereinafter referred to as "the Act"). On appeal, the Appellate Assistant

Commissioner of Income Tax allowed the appeal by accepting the contention of the assessee and holding that the assessee-firm was entitled to the deduction claimed by it. Aggrieved against the said order of the Appellate Assistant Commissioner, the Income Tax Officer took the matter in second appeal before the Income Tax Tribunal, but the Tribunal found no merits in the same and agreed with the view taken by the Appellate Assistant Commissioner of Income Tax. Consequently, a question of law as stated by my brother has been referred to this court for opinion.

Thereafter, a Division Bench of this court felt that the decision rendered by this court in Commissioner of Income Tax Vs. London Machinery Co., relied upon by the Revenue required reconsideration by a larger Bench. Accordingly, the said Bench has referred the aforesaid question of law to a larger Bench to hear and decide this reference. Thus, the matter has come up before this Full Bench.

It is by now settled law that when a karta of a Hindu undivided family joins the partnership, the firm can treat only such karta as its partner and not the whole family. This position of the karta has been affirmed by this court in Commissioner of Income Tax Vs. London Machinery Co., . But that Bench, however, went on to consider and state that the capacity in

which any payment is received by the karta whether for or on behalf of the family or for his own benefit is immaterial. Emphasis has been laid in the said judgment on the person who is a partner by saying that the only criterion for the purpose of section 40(b) of the Act is payment to a partner and no distinction has been made in the said case in respect of the character or capacity in which the payment is made to the partner. To illustrate, if a partner has two accounts in the firm, one a capital account of the Hindu undivided family as represented by him as karta and the other his own individual account, as in the case before us, in such a situation, the view taken by the Division Bench in the case of Commissioner of Income Tax Vs. London Machinery Co., is that in both the cases the payment of interest by the firm to such a partner is as a partner irrespective of the distinction between the two capacities in which the two accounts stand in the books of the firm.

To consider the debated question which arises for consideration in the present case, it is profitable to refer to certain definitions and provisions of the Act. Sub-section (23) of section 2 of the Act reads as follows :

"Firm, partner and partnership have the meanings respectively assigned to them in the Indian Partnership Act, 1932 (9 of 1932), ..."

Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. In the definition of "partnership" under the Indian Partnership Act, 1932, two principles always come to be recognised. The first is that there must be an agreement between persons and, secondly, the doctrine of agency between the partners inter se is recognised in the latter part of the said definition. The business carried on by a firm is in law

the business carried on by the partners. Profits of the firm are profits earned by all the partners in carrying on the business. Since a firm is nothing but a compendious expression of the relationship between the partners who constitute it and it cannot be said that a partner is an employee of that partnership and any salary received by a partner from the firm is in essence, a part of the share of the profits of the firm itself. Therefore, even if the partnership stipulated that any of the partners may draw salary from the firm, such a payment in reality is, in the eye of law, only a mode of division of part of the profits of the firm. In order to prevent such an activity of the firm, certain provisions of the Income Tax Act intervened. Under the Indian Income Tax Act, 1922, in view of section 10(4)(b) of the said Act, any salary, commission or remuneration paid by a firm to any of its partners would not be entitled to deduction in the computation of the income of the firm. Similar provisions now exist u/s 40(b) of the 1961 Act which reads as follows :

"40. Notwithstanding anything to the contrary in sections 30 to 39, the following amounts shall not be deducted in computing the income chargeable under the head Profits and gains of business or profession,...

(b) in the case of any firm, any payment of interest, salary, bonus, commission or remuneration made by the firm to any partner of the firm."

Care has been taken under the new Act to include and prohibit some more ways of distributing the profits of the firm to its partners and thereby providing a prohibition to the deduction of the said items while computing the taxable income of the firm. The basic idea underlying the disallowance of such items of payment is that such payments made by a firm to a partner are in principle a part of his share of the profits of the firm. The principle behind the rule is that such payment made by the firm to a partner in his capacity as a partner would, therefore, not be regarded as emanating from a source different from the one from which he derives the share of the profits. By the Taxation Laws (Amendment) Act, 1984, certain explanations have been added to section 40(b) of the Act.

To construe properly the meaning of the expression "any payment made to a partner" occurring in section 40(b) of the Act, at this stage, let us take into account certain principles for the construction of statutes. In the Interpretation of Statutes by K. P. Chakravarty, 1978 Edition, at page 47, it has been observed as follows :

"Though the courts often hesitate to resort to external aids as a means to determine the legislative intent, nevertheless, they refer to such aids not for construing the statute, but for widening the concept of the context. Literal construction may have to be discarded if such construction purports to defeat the purpose of the statute ...

As Justice Learned Hand puts it very effectively : Statutes should be construed not as theorems of Euclid, but with imagination of purpose behind them ...

Although judges have certain limitations beyond which they are not to traverse, yet they are to see that the purpose of the law is not defeated because the entire legislative process is influenced by considerations of justice and reason which constitute general legislative intent in every piece of legislation."

As early as in the year 1966, the Supreme Court has observed in the case of K. Narasimhiah Vs. H.C. Singri Gowda, , "to ascertain the intention, the court has to examine carefully the object of the statute, the consequences that may follow from insisting on a strict observance of the particular provision and above all the general scheme of the other provisions of which it forms a part".

Yet in another case of Saroj Aggarwal Vs. Commissioner of Income Tax, U.P., , the Supreme Court has set out certain tests for interpretation of statutes. The Supreme Court has, at page 508, observed as follows :

"Facts should be viewed in natural perspective, having regard to the compulsion of the circumstances of a case. Where it is possible to draw two inferences from the facts and where there is no evidence of any dishonest or improper motive on the part of the assessee, it would be just and equitable to draw such inference in such a manner that would lead to equity and justice. Too hyper-technical or legalistic approach should be avoided in looking at a provision which must be equitably interpreted and justly administered ... Courts should, whenever possible, unless prevented by the express language of any section or compelling circumstances of any particular case, make a benevolent and justice-oriented inference. Facts must be viewed in the social milieu of a country ..."

In the case of R.S. Nayak Vs. A.R. Antulay, , it has been held that a construction which leads to absurdity must be avoided.

In the case of Glaxo Laboratories (I) Ltd. Vs. Presiding Officer, Labour Court, Meerut and Others, , it has been observed :

"11. No canon of construction of a statute is more firmly established than this that the purpose of interpretation is to give effect to the intention underlying the statute and, therefore, unless the grammatical construction leads to an absurdity, it is safe to give words their natural meaning because the framer is presumed to use the language which conveys the intention. If two constructions are possible, it is equally well established that the construction which advances the intention of the legislation, and remedies the mischief, to thwart which it is enacted, should be accepted."

Further, it is well known that while interpreting a statute if two constructions are possible the one which avoids anomalies and creates reasonable results should be preferred.

Consequently, where the suggested construction operates harshly, ridiculously or in any other manner contrary to prevailing conceptions of justice and reason, it would seem that the apparent or suggested meaning of the statute was not the one intended by the law-makers.

That apart, I also find that the controversy involved in the present case is not res integral. The partner may have more than one personality, viz., he may be a partner in a representative capacity as in the present case and yet he may be having another account in his individual capacity.

In the case of Additional Commissioner of Income Tax Vs. Vallamkonda Chinna Balaiah Chetty and Co., , a firm consisted of four partners. One of them represented his Hindu undivided family. There was also an individual account of the same person. The person concerned had entered into the partnership in his individual capacity. It was held by the Andhra Pradesh High Court that the amount paid as interest in the joint family account was not a payment made as partner as it was a payment made to a person who had advanced the amount. So the payment does not come within the mischief of section 40(b) of the Act.

The above line of argument was followed by the same High Court in the case of TERLA VEERAIHAH Vs. COMMISSIONER OF Income Tax, A.P., . The ratio of the decision is that if a payment of interest is made to a person not in his capacity as a partner of a firm, in that event the provisions of section 40(b) of the Act are not attracted.

In the later case of N.T.R. Estate Vs. Commissioner of Income Tax, , where salary and interest was paid by the firm to some of the partners as individuals, while they had become partners as karta of the Hindu undivided families, it was held by the Andhra Pradesh High Court that such payments made to individuals could not be regarded as payment to the partners and could not be disallowed u/s 40(b) of the Act.

In the case of Venkatesh Emporium v. CIT [1982] 137 ITR 593, a Hindu undivided family of which V was the karta had advanced certain monies for interest to a firm in which V was a partner in his individual capacity. The interest paid by the firm was to the family of V in respect of the loan, in contradistinction to V, who was a partner in his individual capacity. It was held by the Madras High Court that disallowance of the interest to the family of V as lender of money was not justified.

In the case of Commissioner of Income Tax, Nasik Vs. Pannalal Hiralal and Co., , it has been held by the Bombay High Court that where one V was a partner in the assessee-firm in his capacity as karta of the Hindu undivided family but if he advanced a personal loan, the interest paid in respect of the personal loan cannot be treated as interest paid to the Hindu undivided family which is a partner through the karta. It is noteworthy that the point involved in this decision is identical to the present case.

A Full Bench of the Gujarat High Court in the case of Chhotalal and Co. Vs. Commissioner of Income Tax, Gujarat, , after elaborately considering the case law on the point, has taken the view that, where V, the karta of an Hindu undivided family was a partner in the assessee-firm representing the family but had advanced monies to the firm from his own individual funds and the assessee-

firm had paid interest on such loans, such payment of interest paid to V on the monies advanced by him from his individual fund could not be disallowed and the same is not hit by the provisions of section 40(b) of the Act. While setting out the above principle of law, the Full Bench has, at page 285, observed as follows. :

"We should point out an anomaly if a different view is taken. Supposing a stranger advances a substantial sum of money to a firm on interest and the interest is being paid by the firm to that stranger, such interest payments could be deductible as revenue expenditure u/s 37. If by some fortuitous circumstance, such stranger becomes a trustee of a trust, the previous trustee of which was a partner of that firm, can it, for that reason, be said that the interest which had to be paid to him as was done earlier, not as trustee but on his own individual account, should no longer be an item of expenditure to be deducted ? We see neither reason nor logic in such an approach. If the Income Tax authorities are to act on the basis of real facts and not on any assumptions, then, for the purpose of section 40(b), they will have to consider the Hindu undivided family as represented by Shri C. S. Virani as the partner and if that is so, what is paid to Shri C. S. Virani as representing the Hindu undivided family by way of interest will alone fall within the section."

In the case of *Balchand Hashmatrai and Co. Vs. Commissioner of Income Tax*, , it was held by the Madhya Pradesh High Court that no disallowance can be made u/s 40(b) if the interest is paid by the firm to the partner in a capacity other than the capacity of a partner.

A Full Bench of the Madhya Pradesh High Court in *Commissioner of Income Tax Vs. Narbham Popatbhai and Sons*, , has, while dissenting from the view taken in the case of *Commissioner of Income Tax Vs. London Machinery Co.*, , held that if a person is a partner in a firm in a representative capacity as karta, if such partner lends to the firm monies belonging to him individually, then the interest paid by the firm to such partner on the monies lent by him is deductible in computing the firms income.

The latest case on the point is a decision of the Andhra Pradesh High Court in the case of *CIT v. Chitra Kalpana* [1988] 169 ITR 678. It has been observed at page 682 :

"Section 10(4)(b) of the 1922 Act corresponds to section 40(b) of the 1961 Act. Section 10(4)(b) was incorporated in the 1922 Act in the year 1939. The legislative history is sufficient to indicate that the provisions contained in section 40(b) of the 1961 Act are intended to prevent the siphoning off of the firms income to partners in order to reduce tax liability in the hands of the firm. A part of the income earned by the firm, which is liable to be taxed in its hands, may be diverted to the partners so that the incomes so diverted, if deducted in the firms hands, do not either suffer tax in the hands of the partners or suffer a lesser rate of tax.

Income earned by the firm can be diverted into partners hands by making

payments on account of salary, bonus, interest, commission or other remuneration. Section 40(b) of the Act takes care of such attempts to avoid tax by making impermissible the deductions claimed by the firm to the partners on account of salary, bonus, interest, commission or remuneration ...

The decision of a Full Bench of the Allahabad High Court in *The Commissioner of Income Tax Vs. Ram Laxman Sugar Mills, Mohiuddinpur*, is a direct authority in respect of the above proposition. In that case, payments by way of remuneration were made to certain partners, not in pursuance of an agreement of partnership, but under the directions of the Central Government. The partners acted as authorised controllers and performed certain functions for which remuneration was paid by the firm to the partners. The Allahabad High Court held that the payments so made by the firm to the partners are allowable as deduction although the amounts were paid by way of remuneration to the partners for services rendered. The distinction is that the services of authorised controllers were rendered by the partners. without there being a legal or contractual obligation to so render and, consequently, the payments are not hit by the provisions contained in section 10(4)(b) of the 1922 Act. We are in complete agreement with the aforesaid distinction Thus, the character in which the partner received the amount from the firm is relevant and significant for the purpose of determining whether the provisions of section 40(b) of the Act are applicable."

In the present case, while lending money to the firm as an individual, Sri R. N. Mehra does not act as an agent of the other partners of the firm. Such a payment of interest made to Sri Mehra for the money lent by him in his individual account cannot be said to form part of the profits of the firm nor can such a payment be said to be an attempt to siphon off the profits of the firm. The said interest has been paid to him not as a partner but as a stranger to the firm. To my mind, the real test in such a case is to find out as to in what capacity the payment of interest is being made by the firm. If the payment has been made not in the capacity of a partner, then if it is just a chance that the same person happens to hold a dual capacity, that by itself will not be the consideration for holding that such payment is hit by the provisions of section 40(b) of the Act, as had been held in the case of *Commissioner of Income Tax Vs. London Machinery Co.,* . On the other hand, I find from a Full Bench decision of this court in *The Commissioner of Income Tax Vs. Ram Laxman Sugar Mills, Mohiuddinpur*, , wherein, after laying emphasis on the capacity of the person receiving the payment, it has been held that payments made to persons in the capacity other than that of a partner are allowable as deductions.

At page 5 (p. 275, supra) of his judgment, brother K. C. Agrawal J. has observed as follows :

"A partner is bound to find the necessary finance for the partnership and, hence, any interest on capital supplied by the partner is not deductible."

Obviously, there is a difference between the capital of a partnership business and the finance required for the said business. The distinction lies in this that "capital" is contributed by the partners under the agreement in their capacity as partners while finance is provided by the lenders. Such lenders may be either the partners or even persons other than partners. It cannot be averred even that a person who provides finance to the firm becomes in any way a partner of the said firm. The Indian Partnership Act also does not make it obligatory on the part of the partners to contribute capital to the firm. The same is always subject to contract between the parties. In the present case, clause (5) of the partnership agreement reads as follows :

"That the capital required for this partnership business shall be contributed and/or arranged by the partners in the manner mutually decided between them from time to time."

It is, therefore, clear that under the partnership agreement the obligation of a partner was only to contribute and/or arrange for capital. It was not necessary even under the agreement that the partner should himself contribute some capital as he could even arrange for the same. However, we are not concerned with the aspect of the matter of contribution of capital in the present case. From the quotation stated above, it is manifestly clear that in the present case as regards the finance of the partnership, the partners were under no obligation to provide the same. In our case, there is nothing on the record to show that there was any agreement between the partners regarding finance of the firm apart from capital. Therefore, on the facts of this case, the very basis that a partner was bound to find necessary finance for the partnership business was lacking in the present case. Therefore, it was open to Sri R. N. Mehra to provide finance to the firm in his capacity as lender. It will be very peculiar to say that in case a person who also happens to be a partner of the firm and has got money to provide finance in the capacity as lender to the firm, yet, in case he lends money, any payment of interest made to him in that capacity is liable to be disallowed so as to ultimately increase the computation of income of the firm thereby affecting all the partners of the firm. Obviously, payment of interest to the lender of money can by no stretch of imagination be taken to be siphoning off the profits of the firm. If the interpretation as held by my brother Agrawal J., is put, it will compel a firm to find out finance for the firm only from persons who are lenders but not partners of the firm in any capacity whatsoever. Such strange results could not be expected to follow. In this view of the matter also, I find that there is considerable force in the submission made on behalf of the assessee that while making the payment of interest the capacity of the person to whom such payment is made is the decisive factor.

In the interpretation of statutes, courts have steered clear of the rigid stand of looking into the words of the section alone but have attempted to make the object of the enactment effective and to render its benefits unto the person in whose favour it is made.

Maxwell on the Interpretation of Statutes, 12th Edition, while dealing with construction of words, has stated at page 86 that they are to be construed in accordance with the intention and has further observed as follows :

" The object or policy of this legislation often affords the answer to problems arising from ambiguities which it contains. For, it is a canon of interpretation that all words, if they be general and not precise, are to be restricted to the fitness of the matter (Bacon, Maxims, 10; Wandsworth Board of Works v. United Telephone Co. [1884] 13 QBD 904)."

Legislatures are entrusted with the task of only making laws. Interpretation has to come from the courts. Section 40(b) of the said Act, on its terms, does not say that it would disallow any payment to a person in his capacity as a partner. In case the submission made on behalf of the Income Tax Department is accepted, it will defeat the very purpose for which the section has been enacted. A construction that promotes the purpose or object of the Act should be preferred to a literal construction and an interpretation that would lead to injustice should always be avoided.

There is, in my opinion, yet another reason as to why on the admitted facts of this case payment of interest in the account of Sri R. N. Mehra as an individual is liable to be allowed as a deduction while computing the income of the assessee-firm. It is by now settled that the prohibition of allowing of interest to a partner stands at par with the same force as salary. While saying so, I share the view expressed in the judgment prepared by my brother, K. C. Agrawal J., and the view expressed by the Andhra Pradesh High Court to the same effect in the case of N.T.R. Estate Vs. Commissioner of Income Tax, . Therefore, proceeding further, when we refer to the decisions of the Supreme Court in V.D. Dhanwatey Vs. The Commissioner of Income Tax, M.P. Nagpur, , Commissioner of Income Tax, Mysore Vs. Gurunath V. Dhakappa, and Commissioner of Income Tax, Mysore Vs. D.C. Shah, and a host of other cases decided by the Supreme Court and various other High Courts bearing on the point, we find that the test laid down is as to who is the real recipient of salary. The principle enunciated is that if the real recipient of the salary is the joint family although it was paid ostensibly to the partner, then the salary paid falls to be disallowed u/s 40(b) of the Act. If it is established that the salary received by the karta of the joint family from a firm in which he is a partner in a representative capacity was for services rendered by him individually and that there was no real and sufficient connection between the investment of the joint family assets in the firm and the salary or remuneration paid to him, the salary or remuneration received by the karta could not be treated as income of the family.

Applying the above test to the facts of the case, I find that in the present case we are not concerned with the payment of interest in the capital account of Sri R. N. Mehra as representing the Hindu undivided family but in respect of the sum lent by Sri R. N. Mehra as an individual to the firm. Therefore, the real recipient of the amount of interest in question is not the Hindu undivided family but Sri R.

N. Mehra as an individual. It is the case of neither party that there was any real and sufficient connection between the capital account of the Hindu undivided family and the interest paid to Sri R. N. Mehra in his individual account. It is for this reason also that I am of the opinion that on the admitted facts of this case interest in question paid to Sri R. N. Mehra in respect of the amount standing to his credit in the individual account cannot be disallowed u/s 40(b) of the Act.

Having regard to the relevant provision of law and the object underlying the same and the principles of statutory construction as aforesaid and the interpretation put thereon in the various cases noted above, I am firmly of the view that a karta when he enters into a partnership in a representative capacity as karta has no doubt a personality distinct and separate from that of an individual in regard to the monies lent by him from his individual account. The view taken to the contrary by my brother K. C. Agrawal J. is, with profound respect, in my opinion, not sound.

Upon the rival contentions raised by learned counsel for the parties, the next question that falls for consideration is as to whether the Explanation as appended to section 40(b) of the Act by the Taxation Laws (Amendment) Act, 1984, is prospective or retrospective and what is the true nature of the said provision. To embark on an enquiry into these difficult and delicate questions, we must appreciate the scope, purpose and legal effect of the Explanation. It is now well-settled that an Explanation added to a statutory provision is not a substantive provision in any sense of the terms but as the plain meaning of the word itself shows it is merely meant to explain or clarify certain ambiguities which may have crept in the statutory provision.

V. P. Sarathi in *Interpretation of Statutes*, IIIrd Edn., while dwelling on the various aspects of an Explanation at page 326 observes as follows :

"(a) The object of an Explanation is to understand the Act in the light of the Explanation.

(b) It does not ordinarily enlarge the scope of the original section which it explains, but only makes the meaning clear beyond dispute."

Bindra in the *Interpretation of Statutes* (5th Edn.), at page 67, states thus :

"An Explanation does not enlarge the scope of the original section that it is supposed to explain. It is axiomatic that an Explanation only explains and does not expand or add to the scope of the original section... The purpose of an Explanation is, however, not to limit the scope of the main provision ... The construction of the Explanation must depend upon its terms, and no theory of its purpose can be entertained unless it is to be inferred from the language used. An Explanation must be interpreted according to its own tenor."

The principles laid down by the aforesaid authors are fully supported by various decisions of the Supreme Court. To quote only a few, in *Burmah Shell Oil Storage and Distributing Co. of India, Ltd. and Another Vs. The Commercial Tax Officer*

and Others, , a Constitution Bench decision, Hidayatullah J., speaking for the court, observed thus :

"Now, the Explanation must be interpreted according to its own tenor, and it is meant to explain clause (I)(a) of the article and not vice versa. It is an error to explain the Explanation with the aid of the article because this reverses their roles."

In *Bihta Co-operative Development Cane Marketing Union Ltd., and Another Vs. The Bank of Bihar and Others*, , the court observed thus :

"The Explanation must be read so as to harmonize with and clear up any ambiguity in the main section. It should not be so construed as to widen the ambit of the section."

In *Hiralal Rattanlal Vs. State of U.P. and Another etc. etc.*, the court has observed thus :

"On the basis of the language of the Explanation, this court held that it did not widen the scope of clause (c). But from what has been said in the case, it is clear that if on a true reading of an Explanation it appears that it has widened the scope of the main section, effect must be given to legislative intent notwithstanding the fact that the Legislature named that provision as an Explanation."

In *Dattatraya Govind Mahajan and Others Vs. State of Maharashtra and Another*, , Bhagwati J. observed thus :

It is true that the orthodox function of an Explanation is to explain the meaning and effect of the main provision to which it is an Explanation and to clear up any doubt or ambiguity in it... Therefore, even though the provision in question has been called an Explanation, we must construe it according to its plain language and not on any a priori considerations."

It has been held in the case of *Coromandel Fertilizers Ltd. Vs. Union of India (UOI) and Others*, , that the Explanation forms part of the main provision. It neither controls nor alters the main provision, but only explains it.

Thus, from a conspectus of the authorities referred to above, it is manifest that the object of an Explanation to a statutory provision is -

- (a) to explain the meaning and intent of the Act itself;
- (b) where there is any obscurity or vagueness in the main enactment, to clarify the same so as to make it consistent with the dominant object which it seems to subserve.

An Explanation cannot in any way interfere with or change the enactment or any part thereof but where some gap is left which is relevant for the purpose of the Explanation, in order to suppress the mischief and advance the object of the Act it can help or assist the court in interpreting the true purport and intent of

the enactment, and consequently, we find that the function of an Explanation to a statutory provisions is :

(c) to provide additional support to the dominant object of the Act in order to make it meaningful and purposeful;

(d) to help or assist the court in interpreting the true purport and intendment of the enactment, in order to suppress the mischief and advance the object of the Act where some gap is left which is relevant for the purpose of the Explanation though it cannot in any way interfere with or change the enactment or any part thereof.

Now, in order to arrive at the true intendment of a statute, the court should pose to itself the questions : (1) what was the situation prior to the provision under construction, (2) what mischief or defect was noticed before introducing the provision, (3) whether it was remedial, and (4) the reason for the remedy. (See Babaji Kondaji Garad Vs. Nasik Merchants Co-operative Bank Ltd., Nasik and Others, .

Applying the above tests, we find that in so far as our case is concerned, admittedly, the provision regarding disallowance of payment of salary or interest to a partner under the Indian Income Tax Act, 1922, and thereafter under the Income Tax Act, 1961, was designed to meet the mischief noticed before introducing the provision to prevent siphoning off the profit of the firm by making such payments. But despite the said provision, the problem persisted in another form as to the interpretation to be put on the words "payment to a partner" occurring u/s 40(b) of the Act. Some High Courts took the view that any payment made to a partner is to be disallowed irrespective of his capacity. A contrary view was taken by other High Courts. This conflict of case law between the various High Courts has been noticed in the judgment of brother K. C. Agrawal J. Parliament was aware of the said conflicting judgments and, therefore, to set at rest the said divergence of opinion, it came out with the Explanation aforesaid appended to section 40(b) of the Act.

In the same view in the case of N.T.R. Estate Vs. Commissioner of Income Tax, , the Andhra Pradesh High Court has opined as follows :

"We consider that the present amendment to section 40(b) of the Act through Explanations 2 and 3 above referred to is to avoid inconvenience to taxpayers, reduce litigation and in that view, the spirit of Explanations 2 and 3 introduced by the Taxation Laws (Amendment) Bill, 1984, should be followed with respect to the preceding assessment years also in order to avoid unnecessary litigation. It cannot be gainsaid that the Legislature was fully aware of the conflict of judicial opinion in this matter among the various High Courts in the country and the present amendment to section 40(b) through Explanations 2 and 3 is brought about to set at rest the controversy."

In the case of Balchand Hashmatrai and Co. Vs. Commissioner of Income Tax, , it

has been observed by the Madhya Pradesh High Court at page 127 :

"Though this Explanation is not applicable to the present case as it was brought into effect from April 1, 1985, still the Explanation so added points out the effect of interest paid in such cases. That apart, it was not disputed that there is a circular issued by the Department, which is binding on the Department."

In a most recent decision in the case of CIT v. Chitra Kalpana [1988] 169 ITR 678, the Andhra Pradesh High Court has at page 685 made the position explicit by saying :

"Thus, the character in which the partner received the amount from the firm is relevant and significant for the purpose of determining whether the provisions of section 40(b) of the Act are applicable ... This principle has since received statutory recognition by the Taxation Laws (Amendment) Act, 1984, which added three Explanations to section 40(b) of the Act. Explanation 2, newly added, provides that, where an individual is a partner in a firm in a representative capacity, the interest paid by the firm to such individual otherwise than as partner in a representative capacity shall not be taken into account for the purposes of clause (b) of section 40 of the Act. The reason for recognising the above principle statutorily is stated in the Statement of Objects and Reasons, as mainly to streamline the procedures in the interest of better work-management, avoid inconvenience to taxpayers, reduce litigation, remove certain anomalies in, and rationalise some of, the provisions and counteract tax avoidance and tax evasion. It is, therefore, clear that an amount paid to a partner by a firm otherwise than in the capacity of a partner is not caught by the provisions contained in section 40(b) of the Act."

I fully agree with the aforesaid view taken in the case of Chitra Kalpana [1988] 169 ITR 678.

The next aspect of the question that falls for consideration is, although nothing has been indicated in the Amending Act of 1984 except adding the Explanation, as to how to construe the said words "payment made to a partner" occurring in section 40(b) of the Act with reference to the relevant latter enactment by the Taxation Laws (Amendment) Act, 1984.

In this regard, in Maxwell on the Interpretation of Statutes, Twelfth Edition, at page 70, the position regarding construction by reference to later legislation has been dealt with as under :

"Where the provisions of the later Act could only operate indirectly as an aid to the construction of words in the earlier Act those provisions can only be used for that purpose if certain conditions apply to the earlier Act when it is considered by itself. For the later statute to become relevant, there must be something obscure or ambiguous, or readily capable of more than one interpretation in the earlier one, some phrase fairly and equally open to diverse meanings (Ormond Investment Co. v. Betts [1928] AC 143, per Lds. Atkinson and Buckmaster at pp.

164, 156). If such an ambiguity can be found, it becomes permissible to look at the later Acts not perhaps to construe the earlier statute, but to see the meaning which Parliament puts on the self-same phrase in a similar context, in case it throws any light on the matter (Payne v. Bradley [1962] AC 343, per Lord Denning at p. 357) ."

Further light is shed by the decision of the Supreme Court in the case of Manickam and Co. v. State of Tamil Nadu [1977] 39 STC 12. The question that arose was as to whether the appellant was entitled to claim refund of sales tax paid under the State Act in respect of the yarn sold by it in the course of inter-State trade in accordance with section 15(b) of the Central Act (prior to its amendment by the Central Sales Tax (Amendment) Act, 1972 (61 of 1972)), and the proviso to section 4 of the State Act read with rule 23 of the Tamil Nadu General Sales Tax Rules, 1959. In the said case, the High Court had negatived the claim of the appellant. On appeal, the said question was answered by the Supreme Court in the aforesaid decision at page 17 as follows :

"Assuming that there was some ambiguity in the language of clause (b) of section 15, as it existed at the relevant time, the matter is made clear by the amendment made in the Central Act by the Central Sales Tax (Amendment), Act 1972 (Act No. 61 of 1972). As a result of the amendment, clause (b) of section 15 of the Central Act reads as under :

(b) Where a tax has been levied under that law in respect of the sale or purchase inside the State of any declared goods and such goods are sold in the course of inter-State trade or commerce, and tax has been paid under this Act in respect of the sale of such goods in the course of inter-State trade or commerce, the tax levied under such law shall be reimbursed to the person making such sale in the course of inter-State trade or commerce in such manner and subject to such conditions as may be provided in any law in force in that State.

The amended provision makes it plain beyond any pale of controversy that the tax levied under the State Act in respect of declared goods has to be reimbursed to the person making sale of those goods in the course of inter-State trade or commerce in such manner and subject to such conditions as may be provided in the law in force in that State. According to the notes explaining the different clauses appended to the Statement of Objects and Reasons of the Bill, which emerged as the amending Act, the amendment made in clause (b) makes it clear that local sales tax would be reimbursed to the person making the sale in the course of inter-State trade and commerce. The amendment made in clause (b) can thus be taken to be an exposition by the Legislature itself of its intent contained in the earlier provision. We are not impressed by the argument of the learned Additional Solicitor-General that the amendment made in clause (b) was intended to mark a departure from the position in law as it existed before the amendment. The fact that the amendment of clause (b) of section 15 was not like some other provisions given retrospective effect, would not materially affect the position. As already mentioned above, the Legislature, as a result of the

amendment, clarified what was implicit in the provisions as they existed earlier. An amendment which is by way of clarification of an earlier ambiguous Provision can be useful aid in construing the earlier provision, even though such amendment is not given retrospective effect. We may refer in this context to the observations on page 147 of Craies on Statute Law (Sixth Edn.) which read as under :

... In *Cape Brandy Syndicate v. IRC* [1921] 2 KB 403 Lord Sterndale, M. R. said : "I think it is clearly established in *Attorney-General v. Clarkson* [1900] 1 QB 156, that subsequent legislation may be looked at in order to see the proper construction to be put upon an earlier Act where that earlier Act is ambiguous. I quite agree that subsequent legislation if it proceeded on an erroneous construction of previous legislation cannot alter that previous legislation; but if there be any ambiguity in the earlier legislation, then the subsequent legislation may fix the proper interpretation which is to be put upon the earlier".

Looking to all the facts, we are of the view that the appellant-firm is entitled to be paid the amount of sales tax levied under the State Act in respect of the goods sold by it in the course of inter-State trade provided the appellant has paid the sales tax under the Central Act in respect of those sales ..."

On this vexed question, it is pertinent to refer to yet another decision of the Supreme Court in the case of *Channan Singh v. Smt. Jai Kaur*, AIR 1970 SC 349. The relevant facts in this case were as follows :

On the death of Sri Santa Singh, he left a widow and a daughter. The widow sold some land to the appellants. The daughter filed a suit for possession by pre-emption of the land so sold. On the rival contentions raised between the parties, the High Court held that the daughter being not the daughter of the vendor-widow because she was the daughter of the step wife of late Sri Santa Singh, therefore she had no right of pre-emption u/s 15(2) of the Punjab Pre-emption Act, 1913, as amended by the Punjab pre-emption (Amendment) Act 1960. The contention raised on behalf of the appellants before the Supreme Court was that there is no indication in the Amendment Act of 1964 that it was to have retrospective operation and therefore the amendment made by it should be deemed to be only prospective. After considering the scheme of the Act, the Supreme Court relied upon the predominant idea that the property must not go outside the line of the last male holder and the right has been given to his male lineal descendants. The principle that has been kept in view is that the person on whom the right of pre-emption is conferred must be a male lineal descendant of the last male holder of the property sold. Therefore it could never be intended that if a female has had a previous husband who has either died or with whom the marriage has been dissolved and the female has remarried and succeeded to the property of her second husband, the brother or the brother's son of her previous husband should be able to claim the right of pre-emption when they had nothing whatsoever to do with the property sought to be pre-empted. It would, therefore, follow that under clause (b) the right of pre-emption would

vest firstly in the son or daughter of the husband of the female meaning thereby either her own off-spring from the husband whom she has succeeded or the son or daughter of that husband even from another wife. The Supreme Court ultimately at page 351 held :

"It appears to us that the Amendment Act of 1964 was merely of a clarificatory or declaratory nature. Even in the absence of the words which were inserted by the Amendment Act of 1964 in section 15(2)(b) the only possible interpretation and meaning of the words in the son or daughter of such female could have reference to and cover the son or daughter of the husband of the female. The entire scheme of sub-section (2) of section 15 is that the right of pre-emption has been confined to the issues of the last male holder from whom the property which has been sold came by inheritance."

Later on, in the said case of Channan Singh, AIR 1970 SC 349, at the same page, the Supreme Court has held that there can be no difficulty in attributing a retroactive intention to the Legislature when the Amendment Act of 1964 was enacted. The principle that the Supreme Court laid down was as follows :

"It is well settled that if a statute is curative or merely declares the previous law retroactive operation would be more rightly ascribed to it than the legislation which may prejudicially affect past rights and transactions.."

In this connection, the observations of the Supreme Court in the case of Chettian Veetil Ammad and Another Vs. Taluk Land Board and Others, may also be referred to :

"It has always been considered permissible, and even desirable, for a court, while interpreting a statute, to take note of the history of the statute and the circumstances in which it was passed or the mischief at which it was directed. The reason is that the meaning which is to be given to a statute should be such as will carry out its object

In fact, as has been stated in Craies on Statute Law, seventh edition, at page 395, to explain a former statute, the subsequent statute has relation back to the time when the earlier Act was passed. In such a case, as the Act is declaratory, the presumption against construing it retrospectively so as to respect vested rights, is not applicable."

Regarding retrospectivity of statutes it is not only that the declaratory or clarificatory statutes can be given retrospective effect, but in a recent decision in the case of Bharat Singh v. Management of New Delhi Tuberculosis Centre AIR 1986 SC 482, the Supreme Court has gone further even to hold that in appropriate cases, retrospective effect can be given even to a prospective statute in case there are no words in the section to compel the courts to hold that it cannot operate retrospectively. This was so done by the Court on the basis that once the intention of the Legislature is discerned in the context of the background in which a particular section is enacted, the courts have necessarily

to give a purposeful or functional interpretation. A construction that promotes the purpose of the legislation should be preferred to a literal construction. In our case, we find that the intention of the Legislature in enacting section 40(b) was only to prevent attempts to siphon off the profits of the firm and no more. Hence also retrospective effect is to be given to the Explanation in question added in the year 1984.

Now, coming to the two cases referred to by my brother K. C. Agrawal J., I find that the quoted observations made by the Supreme Court in the case of *State of U.P. v. Malik Zarid Khalid*, AIR 1988 SC 132, were made in a different context. In that case, the State of U.P. had taken on lease a premises at Barabanki belonging to the respondent for the purpose of running a Leprosy Training Centre. The respondent was the landlord and the appellant was the tenant. In a suit filed by the landlord for the eviction of the defendant, the State of U.P. the defence was that the premises in question were governed by the provisions of the U.P. Urban Buildings (Regulation of Letting, Rent and Eviction) Act (13 of 1972). The respondent sought to overcome this hurdle by contending that the premises in question are not one of the classes of buildings covered by the Rent Act. The point, therefore, that fell for consideration was as to whether a building taken on lease by the State Government falls squarely within the definition of public building and is, therefore, exempt from the application of the Act by reason of section 2(1) as amended in 1976. No doubt, prior to the amendment in 1976, only buildings of which the Government was owner or landlord were excluded from the Act. But, the Legislature clearly intended a departure from the earlier position. In the said amendment it significantly omitted the crucial words present in the earlier legislation which had the effect of restricting the exclusion to tenancies created by the Government, either as owner or as landlord. The Supreme Court held that full effect must be given to the new definition in section 3 (o) of the Act and the conscious departure in language in reframing the exclusion.

The Supreme Court has in its judgment set out in detail five reasons for putting the said construction. While dealing with the 4th reason in paragraph 14 (at p. 138), the court observed as follows :

"Fourthly, in this case, the legislature has applied its mind to the situation more than once subsequently. If its intention in carrying out the amendment had been misunderstood by the High Court or found ambiguous, the Legislature was expected to rectify the situation by a piece of retrospective or declaratory legislation. The 1977 Ordinance was, but the later Ordinances and the 1985 Act, are not, of this nature. They neither are, nor purport to be, declaratory or retrospective from 5-7-1976."

In our case, we find that there has been no earlier amendment in section 40(b) of the Act.

The fifth reason that prevailed with the Supreme Court in putting the said

construction is also absent in our case. Obviously, that situation does not operate in the present case.

The background of the quotation in the other case referred to by my brother K. C. Agrawal J., in the case of *The Central Bank of India Vs. Their Workmen*, is that in that decision the Supreme Court was considering the distinction between a declaratory Act and a remedial Act.

It was held that a declaratory Act is usually held to be retrospective whereas a remedial Act, on the contrary, is not necessarily retrospective. The remedial Act may be either enlarging or restraining and it takes effect prospectively, unless it has retrospective effect by express terms or necessary intendment. With profound respect, I find that, brother K. C. Agrawal J., in his judgment, has referred to that quotation which deals with the remedial Act and is wholly distinctive of a declaratory Act. In our case, the subsequent Explanations added to section 40(b) of the Act are in the nature of declaratory Act and not remedial Act. Similarly, the plea regarding the nature of the Explanation being explanatory cannot be negated on the ground that it would have the effect of reopening past assessments. This is so, for two reasons, firstly, that the explanatory provision does not lay down any new law and all that it says is to explain a particular provision specifically. Secondly, if the effect is given to the Explanation, it is only a case of rectification of the earlier assessments within limits permissible under the law and no reopening is involved in the same.

Thus, from a close analysis of the above, it is manifestly clear that the aforesaid Explanations added by the Taxation Laws (Amendment) Act, 1984, are clarificatory in nature and shall apply retrospectively to the years in dispute also.

That apart there is one more factor which is a pointer to the same conclusion. The Central Board of Direct Taxes is the apex authority u/s 119 of the Act to issue orders, instructions or directions to the Income Tax authorities as it deems fit for the proper administration of the tax Act.

What is the true nature and effect of a circular issued by the Central Board of Direct Taxes fell to be considered in the case of *The State of Orissa Vs. Dinabandhu Sahu and Sons*. In that case, arising under the Central Sales Tax Act, the question referred by the Tribunal to the High Court was as follows :

"(2) Whether the communication No. 4 (8) ST/57, dated 31st January, 1958, issued by the Government of India which is only an official communication having no statutory sanction behind it can have any legal effect to hold the goods in question as oil-seeds as understood in common parlance and whether such an official communication is binding on the State Government."

The Supreme Court has, after considering the rival contentions, at page 1564, held :

"It is true the High Court has rightly observed that the aforesaid notification of the Government of India has no statutory force and as such is not binding on the

Sales Tax Officer. It cannot, however, be denied that the Ministry of Finance, Department of Economic Affairs, is intimately conversant not only with the policy of legislation for the purpose of implementation of the provisions of the Central Act but is also familiar with the nature and quality of the commodities as also their use from time to time. If, therefore, such an authority issued a notification including certain commodities under the head of Oil seeds, as defined under the Central Act, it cannot be said that the Tribunal and the High Court were not right in preferring such an opinion of the Government as good evidence for its conclusion, to the opinions relied upon by the Andhra Pradesh High Court on which great reliance has been placed by the appellant."

To the same effect is also a decision of this court in the case of *CST v. Om Engineering Works* [1986] UPTC 55, [1987] 65 STC 465

After the elucidation of the nature and effect of such instructions/ circular issued by the Central Board of Direct Taxes, let us now revert back to the concerned instructions.

According to a report appearing in *Commissioner of Income Tax, Tamil Nadu-Vs. K.S.M. Guruswamy Nadar and Sons*, , the Central Board of Direct Taxes, has also issued instructions in regard to the provisions of the Taxation Laws (Amendment) Act, 1984, which includes the aforesaid Explanation. Under the same, it has set out the Objects and Reasons for the said Act. The part played by these Objects and Reasons has been indicated by the Supreme Court succinctly in the case of *Bharat Singh Vs. Management of New Delhi Tuberculosis center, New Delhi and Others*, . In paragraph 10 (at p. 844) of the report, it has been stated thus (at p. 132 of 69 FJR) :

"The Objects and Reasons give an insight into the background why this section was introduced. Though Objects and Reasons cannot be the ultimate guide in interpretation of statutes, it oftentimes aids in finding out what really persuaded the Legislature to enact a particular provision."

In the said instructions, the Statement of Objects and Reasons for the said Act has been classified into four categories. A reading of the same indicates that the interpretation of the Explanation in question fell in the second category of "Reducing litigation". It has been stated (at p. 127 of 149 ITR (St.))

"(2) A number of amendments have been made to bring out the legislative intention more clearly so that further controversy and litigation regarding the true intent and purport of these provisions is avoided. To illustrate :

(a) It has been clarified that in cases where a firm pays interest to a partner as well as receives interest from him, only the net amount paid by the firm to the partner will be disallowed u/s 40(b) of the Income Tax Act in computing the income of the firm.

(b) It has also been clarified that where a person is a partner in his representative capacity, interest paid to him in his individual capacity will not be

disallowed under the abovementioned provision and vice versa".

Regarding retrospective amendments, it has been stated at page 128 of 149 ITR (St.) thus :

"Retrospective amendments made by the Taxation Laws (Amendment) Act, 1984, fall into two categories, namely, one consisting of amendments which are beneficial to taxpayers and the other consisting of amendments which, though not beneficial, merely seek to bring out the legislative intention more clearly. Amendments falling in the second category (reducing litigation), therefore, do not cast any fresh liability or burden on the taxpayers, but merely seek to eliminate continued and unnecessary litigation regarding the true import of these provisions."

After spelling out the true import of the above instructions issued by the Central Board of Direct Taxes, to my mind, the position is affirmed that the Explanation in question added by the Taxation Laws (Amendment) Act, 1984, is only clarificatory. At any rate, the said instructions are certainly binding on the Commissioner of Income Tax, the applicant in the present reference, and the authorities subordinate to him.

Hence, in view of the aforesaid tests, the decisions of the Supreme Court regarding payment of salary where the principles are at par with payment of interest, the ratio underlying the decision of a Full Bench of court in G.R. Govindarajulu Naidu and Another Vs. Commissioner of Income Tax, and also the view of the two full benches of the Gujarat and Madhya Pradesh High Courts, Chhotalal and Co. Vs. Commissioner of Income Tax, Gujarat, and Commissioner of Income Tax Vs. Narbharam Popatbhai and Sons, , the law laid down on the mooted question in the three decisions cited above including CIT v. Chitra Kalpana [1988] 169 ITR 678 that the Explanation is only clarificatory in nature, the instructions of the Central Board of Direct Taxes and the discussion stated by me above, the overall result is that, in our case, I am firmly of the view that the assessee is entitled to the deduction claimed for by it in the years in question and that the case of Commissioner of Income Tax Vs. London Machinery Co., does not lay down the correct law.

BY THE COURT. - In view of the majority, the Tribunal was wrong in upholding the order of the Appellate Assistant Commissioner in allowing the assessee's claim for interest paid of the credit balance in the individual account of Sri R. N. Mehra amounting to Rs. 8,400 and Rs. 9,120 in the assessment years 1971-72 and 1972-73, respectively. The question is answered in this manner. In the circumstances, we direct the parties to bear their own costs.