
(1984) 12 AP CK 0024

In the Andhra Pradesh High Court

Case No : Referred Case No. 282 of 1980

Commissioner of Income Tax

APPELLANT

Vs

S. Subba Reddy

RESPONDENT

Date of Decision : 04-12-1984

Acts Referred:

Income Tax Act, 1961 — Section 37, 5, 67(3)

Citation : (1985) 49 CTR 291 : (1986) 159 ITR 120 : (1985) 22 TAXMAN 344

Hon'ble Judges : Y.V. Anjaneyulu, J;K. Amareswari, J

Bench : Division Bench

Advocate : M.S.N. Murthy, for the Appellant; S. Dasaratharama Reddy, for the Respondent

Judgement

Amareswari, J.—This reference pertains to the assessment year 1977-78.

2. The assessee was the karta of a Hindu undivided family consisting of himself, his minor son, Jagadiswara Reddy, and his wife, Seetharavamma and two minor unmarried daughters. This Hindu undivided family, through its karta, was having interest in two partnership firms. In both the partnership firms, the family was getting 12% as interest on the capital invested. On September 1, 1974, there was a partition and the capital in the two firms was divided between the two coparceners, i.e., between the father and the minor son. In the firm of M/s. A. Rami Reddy & Co, the family's partnership share was 6/64ths. Upon the division, each of the coparceners was allotted 3/64ths share. Similarly, in the case of another firm, M/s. Sri Lakshmiprasanna Sugar Factory, the family had 10% share and, on the division, each of the coparceners got 5% share. The two firms, in which the capital was standing in the name of the karta, refused to make necessary entries in their books giving effect to the division made in the family of Subba Reddy to the benefits of the partner-ships.

3. According to the partition arrangement, it was decided that the partnership shares would continue to stand in the name of the karta and that the shares should thenceforward be enjoyed by both the divided coparceners as equal

tenants. Since the capital of Rs. 2,82,919 was standing in the name of the karta, he should pay his son, his share capital of Rs. 1,41,660 with interest at the rate of 12% per annum and the interest that was paid to the account of the karta by the two firms would be received by him. This agreement was reduced to writing on September 15, 1964. According to the arrangement, there was also another amount of Rs. 1,09,497 which the father owed to the son.

4. For the assessment year 1976-77, the partition was accepted by the Income Tax Officer by his order dated February 18, 1977. For this assessment year, both the firms paid interest to the assessee in respect of the investment standing in his name in those two firms. The assessee was Paid interest of Rs. 16,975 on the total capital. The assessee also realised Rs. 5,192 as interest. Thus, a net interest of Rs. 11,783 was paid to his son by the end of the assessment year, i.e., August 31, 1975. This amount of interest paid by him to his son was claimed u/s 67(3) of the Income Tax Act, 1961, from out of the share income received by him amounting to Rs. 54,465. The Income Tax Officer, however, allowed interest of Rs. 11,294 which is half of the interest amounting to Rs. 22,595 and disallowed the rest. The reason given by the Income Tax Officer was that, out of the interest received by the assessee, 50% should go to the son in the same manner as the profit was divided. It may be mentioned in this context that, so far as the profit given to the assessee's son in accordance with the partition arrangement, there was no dispute since, even according to the Income Tax Officer, there was an overriding title in respect of the share income received by the assessee from the two firms.

5. For the assessment year 1977-78, i.e., the year with which we are concerned, the assessee paid interest of Rs. 12,026 to his divided son on his running account while the assessee received interest of Rs. 22,074 from the two firms. In this year, the Income Tax Officer, however, did not allow any interest out of the income of the assessee. The Appellate Assistant Commissioner, on appeal, confirmed the disallowance on the ground that section 67(3) does not permit the claim for deduction of interest inasmuch as the assessee had not borrowed any amount towards the capital. It was also held that there was no condition in the partnership deeds that a particular amount of capital should be held by the assessee in the two firms. On further appeal to the Tribunal, it was contended OIL behalf of the assessee that, as per the partition arrangement, the assessee was to pay interest in respect of the share capital invested in the two firms. Alternatively, it was contended that interest received by the assessee from the two firms must be held to belong to his son as in the case of profit. It was further contended that the general provisions of section 37 permits deduction of interest. These contentions were resisted by the Revenue.

6. The Tribunal held that section 67(3) cannot come to the aid of the assessee as nothing was borrowed by the assessee from the divided son and invested in the firms. The Tribunal dealt with the partition arrangement and held that from a reading of the partition deed, it is manifest that the assessee has to part not only

with his half share of the profit but also half share of interest that he receives from the two partnership firms and to that extent the assessee is holding the share profit and the interest received from the two firms not only for himself but also for the benefit of his son. The Tribunal further held that there is an overriding title not only in respect of share of profit but also in respect of interest received by the father and that the assessee was obliged to part with half of the interest which he receives from the two partnership firms. Alternatively, the Tribunal held that interest can be allowed u/s 37. It also relied upon a decision of this court in CIT v. Smt. Janaki, Bai, [1973] 87 ITR 645.

7. The Tribunal, however, rejected the assessee's claim of interest at 12% on the amount standing to the credit of the son in the books of the assessee, since the assessee has not been able to establish that he was obliged to retain that money in the two firms, that is to say, the interest that was claimed by the assessee in respect of the amount standing to the credit of his son cannot be allowed, but the assessee can claim that his son has to receive half of the interest received on the entire share capital standing in the assessee's name in the two firms. On these findings, both the Revenue as well as the assessee sought for reference and the following three questions are referred, the first being at the instance of the Revenue and the second and third at the instance of the assessee :

"(1) Whether, on the facts and in the circumstances of the case, half of the interest receivable by the assessee from the firm in which the assessee is a partner was deductible from the assessee's income u/s 37 of the Income Tax Act at the instance of the Revenue ?

(2) Whether, on the facts and in the circumstances of the case, the partnership capital allotted to the assessee's (divided) son would constitute borrowal for the purpose of section 67(3) of the Act at the instance of the assessee ?

(3) If the answer to question No. (2) is in the negative, whether the interest is deductible u/s 37 ?"

8. So far as the first question is concerned, we think it is unnecessary to answer this question, i.e., whether interest can be allowed u/s 37 or not, in view of the Tribunal's finding that, to the extent of the interest of the assessee's minor son, it cannot be treated as the income of the assessee as there is an overriding title. That finding is not disputed by the Revenue. If that be so, the assessee is certainly entitled for a deduction of a sum of Rs. 11,037, i.e., half of Rs. 22,074, which income admittedly belongs to the assessee's son. In this view, we think it unnecessary to go into the question whether the assessee is entitled to claim deduction u/s 37 of the Act. We answer the question accordingly.

9. The learned counsel for the assessee has not pressed questions Nos. (2) and (3), which were referred at his instance. We, therefore, decline to answer these two questions. Question No. (1) is answered accordingly. No costs.