(2005) 08 AHC CK 0039

In the Allahabad High Court

Case No : Income Tax Reference No''s. 226 of 1992 and 82 of 1997

Commissioner of Income Tax APPELLANT

Vs

Shri Aji Prasad RESPONDENT

Date of Decision : 09-08-2005

Acts Referred:
Income Tax Act, 1922 — Section 10(1)
Income Tax Act, 1961 — Section 143(1), 24, 256(1), 256(2), 263

Citation : (2006) 204 CTR 292 : (2006) 283 ITR 142

Hon'ble Judges : Rajes Kumar, J;R.K. Agrawal, J

Bench : Division Bench

Advocate : A.N. Mahajan and S.C, for the Appellant; S.P. Kesarwani, for the Respondent

Judgement

R.K. Agrawal, J.—In Income Tax Reference No. 226 of 1992 relating to the Assessment Year 1983-84, the Income Tax Appellate Tribunal, Delhi (hereinafter referred to as the Tribunal) has referred the following question of law u/s 256(2) of the Income Tax Act, 1961, hereinafter referred to as the Act, f6r opinion to this Court:

"Whether, on the facts and in the circumstances of the case, the Tribunal was wrong in holding that the interest charged by the firm M/s Eves Picture House on the debit balance of the assessee partner in his capital accounts was allowable as expenditure incurred to earn his share of profit u/s 67(3) from the firm?"

2. Whereas in Income Tax Reference No. 82 of 1997 relating to the Assessment Years 1984-85 and 1985-86, the Tribunal has referred the following question of law u/s 256(1) of the Act, for opinion to this Court.

"Whether, on the facts and in the circumstances of the case, the Tribunal was wrong in law in holding that the interest charged by the two firms M/s Eves Picture House and M/s Apsara Cinema on the debit balance of the assessee partner in the capital account was allowable as expenditure incurred to earn his share of profit u/s 67(3) from the two firms?".

3. As the respondents assessees are partners in M/s Eves Picture House and M/s Apsara Cinema and the question of law referred to us is common, both the References have been heard together and are being decided by a common order.

4. Briefly stated the facts giving rise to the present References are as follows:

The respondent assessee, Ajit Prasad, who is the respondent in Income Tax Reference No. 226 of 1992, is a partner in the firm called M/s Eves Picture House, Meerut whereas Anil Prasad and Sons, who is the respondent in Income Tax Reference No. 82 of 1997, is a Hindu Undivided Family having share income in the partnership firms, namely, M/s Eves Picture House, Meerut and M/s Apsara Cinema. Both the respondents assessees were charged interest by the firm on their debit balance in the books of account. The respondents assessees claimed deduction of the said amount from their income which was, in the case of Ajit Prasad, accepted by the Assessing Officer as the assessment order was passed under u/s 143(1) of the Act. However, in the case of Anil Prasad and Sons the claim was disallowed by the Assessing Officer as in his view it did not relate to the business income. In the case of Ajit Prasad the Commissioner of Income Tax initiated proceedings u/s 263 of the Act and after setting aside the assessment directed the Assessing Authority to disallow the interest. In the case of Anil Prasad and Sons in further appeal preferred by the assessee, the disallowance was deleted by the Commissioner of Income Tax (Appeals). The Revenue as also Sri Ajit Prasad feeling aggrieved, preferred separate appeals before the Tribunal. The Tribunal has set aside the order passed by the Commissioner of Income Tax u/s 263 of the Act and has held that the interest was an allowable deduction. The order of the Commissioner of Income Tax (Appeals) in the case of Anil Prasad and Sons has, however, been confirmed.

5. We have heard Sri A.N.Mahajan, learned standing counsel for the Revenue and Sri S.P.Kesarwani, learned counsel appearing for the respondent assessee in both the cases.

6. Learned standing counsel submitted that interest is allowable either u/s 37 or u/s 67(3) of the Act and if the amount of interest paid by the assessee is not for carrying out business or not for brining in capital for partnership firm as a partner, the same cannot be allowed as it would be expenditure of personal nature. In support of his submission he has relied up the following two decisions:

(I) S. Gopal Reddy Vs. Commissioner of Income Tax, and

(2) C. Bhaskaran Nair Vs. Commissioner of Income Tax, .

7. Sri S.P.Kesarwani, learned counsel for the respondent assessee, however, submitted the provisions of Section 67(3) of the Act, which permits deduction of interest under certain circumstances, is not exhaustive. According to him it is now a settled law that though a firm and its partners are distinct assessees for the purposes of Income Tax, the Act still recognizes the principle that a firm is

only a compendious name for its partners and that the business carried on by the firm is also a business carried on by each of the partners too. He thus submitted that any interest paid by a partner to the firm on his debit balance is towards carrying on business and, therefore, is entitled for deduction. In support of his aforesaid pleas he has relied upon the following decisions:

(i) M/s. Garden Silk Weaving Factory, Surat Vs. The Commissioner of Income Tax, Gujarat, Ahmedabad, ;

(ii) Commissioner of Income Tax, Bihar Vs. Ramniklal Kothari, ;

(iii) Commissioner of Income Tax Vs. Jabarmal Dugar, ;

(iv) Commisioner of Income Tax, New Delhi v. Ganpajt Raj Jaggi and Co. (1972) 86 ITR363 ;

(v) Commissioner of Income Tax Vs. Smt. P. Janaki Bai (legal representative of late P. Ananda Rao), and

(vi) Commissioner of Income Tax Vs. Smt. Shanti Devi Jalan, .

8. Having heard the learned counsel for the parties, we find that under the terms of the partnership deed of both the firms the partners were to pay interest at the specified rate to the firms on their debit balances, The question is as to whether u/s 67(3) of the Act the interest paid by them is an allowable expenditure or not.

9. Under the scheme of the Act interest incurred is allowed as a deduction while computing the income under the following provisions:

10 u/s 24 of the Act where the property, has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital shall be allowed as deduction while determining the income from house property. If the income is chargeable under the head "Profits and gains of business or profession" the deduction u/s 37 is permissible in respect of the interest on borrowed capital. However, it should not be in the nature of personal expenditure of the assessee. u/s 57(3) of the Act all expenditure laid out or expended wholly or exclusively for the purpose of earning such income is allowed as deduction which would cover interest on sums borrowed for earning interest or other income chargeable under the head ''Income from other sources". u/s 67(3) of the Act if any partner borrows any, money for the purpose of investment in the firm and pays any interest on such borrowed money the amount of interest is to be deducted while computing his income chargeable under the head "Profits and gains of business of profession" in respect of the share income of the firm. Thus a person is entitled to claim deduction of interest only if the interest has been paid on the money borrowed for earning income or for investment as capital in the firm in the case of any partner otherwise not. Interest paid on money borrowed from any source for defraying the personal expenditure is not to be allowed as deduction while computing the income chargeable to tax under the Act.

11. No doubt, it is true as held by the Apex Court in M/s Garden Silk Weaving factory (supra) that the Act still recognizes the principle that a firm is only a compendious name for its partners and that the business carried on by the firm is also a business carried on by each of the partners too but that will not the make the interest paid by the respondent assessee to the firm as interest paid by the partner for carrying on the business of the firm for the simple reason that in the present case the respondents assessees have borrowed money from the firm for their personal use and not for the purpose of business of the firm.

12. In the case of Ramniklal Kothari (supra) the Apex Court has held that the business carried on by a firm is business carried on by the partners. Profits of the firm are profits earned by all the partners in carrying on the business. The share of the partner is business income in his hands for the purpose of Section 10(1) the Income Tax Act, 1922, and being business income, expenditure necessary for the purpose of earning that income and appropriate allowances are deductible therefrom in determining the taxable income of the partners. The respondent, who was a partner in four firms but did not carry on any independent business, was entitled to deduct from his share of the profits from the firm amounts paid as salary and bonus to staff, expenses for maintenance and depreciation of motor cars and travelling expenses expended by him in earning of income from the firms. The aforesaid decision is of no help to the petitioner as the personal expenses not connected with any business either individual or of the firm can be allowed as deduction under the Act.

13. In the case of Jabarmal Dugar (supra) the Rajasthan High Court has held that if a deduction could be claimed under any other provision of the Act, that right would not be taken away merely by the provisions of Section 67(3) of the Act. The rule of harmonious construction requires that full effect should be given to both Section 67(3) and Section 37(1) of the Act and the assessee would be entitled to the deduction permitted by Section 37(1) of the Act.

14. In the case of Ganpat Raj-Jaggi and Co. (supra) the Delhi, High Court has held if a deduction is admissible in respect of a partner''s share in the income of the firm u/s 37 of the Act, it would have to be allowed even though it may not fall within the ambit of Section 67(3) of the Act. There is nothing in Section 67(3) of the Act to indicate that that provision is exhaustive and that deductions other than those mentioned therein cannot be allowed to a partner.

15. In the case of Smt P. Janaki Bai (supra) the assessee was the owner of a building and a partner in the firm running hotel business in the said building. The assessee claimed deduction of depreciation on the premises in which the hotel was being run and also a deduction of the property tax paid in respect of the said premises, from her share of income from the firm. The claim was disallowed by the Income Tax Officer and Appellate Assistant Commissioner. On further appeal, the Appellate Tribunal held that the assessee was entitled to the deduction claimed. On a reference made to the High Court at the instance of the revenue, it was contended that Section 67(3) of the Act, which provides for deduction of

interest payable by the partner in respect of the capital borrowed for the purposes of investment in the firm from his share of income from the firm, is exhaustive of the permissible deductions in computing a partner''s share in the income of the firm and that provisions in Sections 30 to 37 of the Act, which provide for various deductions, have no application to the case of a partner''s share in the income of the firm. The Andhra Pradesh High Court has held that there is nothing which either expressly or impliedly precludes the application of Sections 30 to 37 to the case of a partner''s share in the income from the firm that Section 67 and Sections 30 to 37 have to be read together in such cases; and that the Tribunal was right in holding that the deduction was permissible in respect of the building owned by the assessee.

16. In the case of Smt. Shanti Devi Jalan (supra) the Calcutta High Court has held that Section 67(3) of the Act is not exhaustive. It merely provides for a case where a particular interest paid by a partner of a firm is allowable as a deductible expenses. But it is not comprehensive in the sense that it cannot be said that no other kind of interest can be deductible. If such interest complies with the requirements of the other provisions of the Act, which allow a deduction, there is no reason why such deduction should not be allowed merely because of the provisions of Section 67(3) of the Act. Where the debit balance is made up of the personal drawings of the partner and also the loss of the firm, interest paid to the firm on the portion of the debit balance in the capital account of the partner which is attributable to the partner''s share in the loss of the firm is allowable as a deduction in assessing the partner.

17. In the case of S. Gopal Reddy (supra) the Andhra Pradesh High Court has held that in order to claim deduction u/s 67(3) of the Act it is necessary to show that capital was borrowed by the assessee for the purposes of investment in the firm. Unless this condition is satisfied, the claim for interest is not allowable.

18. In the case of C. Bhaskaran Nair (supra) the Kerala High Court has held that the Tribunal had found that the interest payment was not for capital borrowed as the interest payment was only on the debit balance of the partner and such debit balance arose on account of the losses sustained by the firm. Hence, the interest was not deductible u/s 36(l)(iii) of the Act. Section 67(3) of the Act also was not applicable as it was not interest on capital borrowed for investment in the firm. Since the interest payment was not for earning profits, interest was not also deductible u/s 37 of the Act.

19. Applying the principle laid down in the aforesaid cases to the facts of the present case, admittedly in the present case the respondents assessees have borrowed money from the firm for defraying their personal expenses like interest payment, C.D.S. payment etc. The amount was not taken for carrying on any business. Even if under the terms of the partnership deed they were liable to pay interest on their debit balance it cannot be treated as if the amount have been borrowed for carrying out business of the firm or the payment of interest was for the purposes of carrying out business. In the absence of any specific provision

under the Act entitling a person to claim deduction of interest paid on sums borrowed for personal expenses, the same cannot be allowed as a deduction,

20. In view of the foregoing discussions we answer the questions referred to us in the affirmative, i.e. in favour of the Revenue and against the assessee. However, there shall be no order as to costs.

