
(1996) 10 MAD CK 0015
In the Madras High Court
Case No : Tax Case No. 1218 of 1984

COMMISSIONER OF INCOME TAX

APPELLANT

Vs

THULASIDAR and CO.

RESPONDENT

Date of Decision : 01-10-1996

Acts Referred:

Income Tax Act, 1961 — Section 256(1)

Citation : (1997) 139 CTR 21

Hon'ble Judges : Thanikkachalam, J

Bench : Division Bench

Judgement

THANIKKACHALAM, J. :

In compliance with the direction of this Court in TCP No. 342 of 1982 dt. 4th April, 1983 the Tribunal referred the following question for the

opinion of this Court under s. 256(2) of the IT Act, 1961, hereinafter referred to as the Act :

Whether, on the facts and in the circumstance of the case, the Tribunal was correct in law in holding that the provisions of s. 40(b) are not

attracted in respect of the sum of Rs. 75,439 being the interest paid to the partner, Shri Ponniah, on loans taken by him and advanced to the firm

?

2. The assessee is a partnership firm and the assessment involved is 1979-80. For the previous year being the calendar year ended with 31st Dec.,

1978 the assessee-firm had no bank account of its own. Mr. Pooniah, who was a partner, was previously carrying on identical business as carried

on by the assessee. After the conversion of the business into partnership, no separate bank account was opened by the firm. All the transaction of

the firm were put through the bank account in the name of Mr. Pooniah. In respect of such transactions of the firm a sum of Rs. 75,439 was paid

by the firm to the partner Pooniah. According to the assessee, since the partnership firm has no account of its own in the bank, the accounts were

operated through Mr. Pooniah, who was having the bank account. According to the assessee, inasmuch as the partner Pooniah advanced the

amount borrowed from the bank for the purpose of the business of the firm, the interest was paid to the bank through Mr. Pooniah. Hence no

interest was paid to the partner. Therefore, according to the assessee, s. 40(b) would not be applicable to the facts of this case. However, the ITO

did not accept this explanation offered by the assessee. The ITO disallowed the payment of interest of Rs. 75,439 since it is hit by s. 40(b) of the

Act. According to the ITO there is no nexus between the partnership firm and the bank in the matter of borrowing the amount. Insofar as the bank

is concerned, Pooniah is the partner and borrowed the amount from the bank. Thereafter it was said, he was advancing the amount to the firm.

Hence there is no direct link between the partnership firm and the Bank in the matter of monetary transaction. Therefore, the ITO came to the

conclusion that the interest was paid to the partner and, therefore, it was disallowed under s. 40(b) of the Act. Aggrieved, the assessee filed an

appeal before the CIT(A). The CIT(A) also agreed with the view taken by the ITO in disallowing a sum of Rs. 75,439 under s. 40(b) of the Act.

3. Aggrieved, the assessee filed a second appeal before the Tribunal. The Tribunal believed the submissions made by the assessee-firm that

inasmuch as the firm had no bank account, the amount was borrowed through the partner, Mr. Pooniah and the interest paid on the borrowed

amount really reached the bank and the interest was not paid to Mr. Pooniah. Therefore, s. 40(b) of the Act has no application to the facts arising

in the case. Accordingly, the Tribunal held that the interest payment made by the firm would not be hit by the provisions of s. 40(b) of the Act. In

that view of the matter, the disallowance made under s. 40(b) was deleted by the Tribunal.

4. Before us learned standing counsel for the Department submitted that the assessee-firm had no bank account of its own. There is no evidence

on record to show that the assessee-firm is operating its accounts through its partner Mr. Pooniah. There is nothing in the account books of the firm

to show that the amounts were borrowed from the bank and interest was paid thereon. According to learned standing counsel, there is no evidence

on record to show that Mr. Ponniah has acted only as an agent between the assessee-firm and the bank. In the absence of evidence on record to

show that the amount borrowed from the bank by Mr. Pooniah reached the firm, it is not possible to say that the interest paid by the firm to Mr.

Ponniah was really for the amount borrowed from the bank. It was, therefore, submitted that the Tribunal was not correct in deleting the

disallowance made under s. 40(b) of the Act.

5. On the other hand, learned counsel for the assessee submitted that Mr. Ponniah was originally conducting the business and that the bank

account was in his name, Later on, the individual business was converted into partnership firm. Since the partnership firm had no bank account, all

the transactions were done through Mr. Ponniah. Mr. Ponniah used to borrow amount from the bank and advance the same to the partnership

firm. So also the interest payment made by the firm was handed over to Mr. Ponniah since he is only acting as a conduit pipe between the bank

and the firm. Therefore, according to learned counsel, though the interest was paid by the partnership firm to Mr. Ponniah, it would really be

payment of interest by the bank on the amount borrowed. Therefore, inasmuch as no interest was paid to the partner, the provisions of s. 40(b)

would not be applicable to the facts of this case.

6. We have heard both learned standing counsel for the Department as well as learned counsel for the assessee. The fact remains that the

assessee-firm made an interest payment of Rs. 75,439 to its partner Mr. Ponniah. According to the assessee-firm, the amounts were borrowed

from the bank through Mr. Ponniah since the partnership firm had no bank account. So also the interest payment made to Ponniah by the

partnership firm is really meant for interest payment to the bank. According to the assessee the amount was borrowed for business purposes.

These are all the facts which were to be established by producing evidence. In the books of account maintained by the partnership firm, there was

no mention with regard to the amount borrowed from the bank. There was also no mention with regard to the interest payment made to the bank.

As per the accounts of the firm, the amounts were received from the partner

Ponniah and the interest payment was also made to him. There is no link between the amount borrowed by the firm and the amount advanced by the Bank. Mr. Ponniah also had no evidence to substantiate his plea that after he borrowed the amount from the bank, he was advancing the same to the firm. Therefore, in the absence of any evidence on record to show that the firm borrowed the amount from the bank through Mr. Ponniah and repayments were made to the bank through Mr. Ponniah, it is not possible to accept the case put forward by the assessee-firm that the interest payment was made only to the bank and not to the partner Mr. Ponniah.

7. In the partnership agreement cl. (8)(b) states that the partner shall also have the right to operate bank accounts opened in the name of the firm to purchase or sell on behalf of the firm. As per the partnership deed, the partnership firm is directed to maintain accounts and a balance-sheet shall be prepared in accordance with the profit and loss account statement. Two account-books and the balance sheet were produced but in those documents there is no mention with regard to the borrowal of the amounts from the bank or payment of any interest to the bank as such. But the firms account would go to show that the amount was borrowed through the partner Ponniah and the interest thereon was paid to him. Under such circumstances, in the absence of any evidence on the side of the assessee-firm to show that the amount was really borrowed from the bank and the interest was paid only to the bank and not to the partner Mr. Ponniah, it is not possible to accept the case put forward by the assessee-firm that the provisions of s. 40(b) cannot be made applicable to the facts of this case. The Tribunal in its order said that there is implied authority on the partners to borrow the amount for the business of the firm. But, this statement made by the Tribunal is not in accordance with the clause contained in the partnership deed. As already pointed out, in cl. (8) it is clearly stated that the partner shall also have the right to operate the bank account opened in the name of the firm. In the present case no such account was opened in the name of the firm.

8. According to the facts arising in the case of Commissioner of Income Tax Vs. Agra Tannery, the partners of the assessee-firm took loans from the Life Insurance Corporation of India. The amounts taken as loan were credited

to the respective capital accounts. The assessee-firm paid the interest on those loans to the LIC and claimed it as deduction. The Tribunal held that the disallowance was not justified. On a reference Punjab & Haryana High Court held that the interest paid by the firm to the LIC, was in fact, interest paid to the partners and the provisions of s. 40(b) of the Act were clearly attracted to it. The interest paid by the assessee-firm to the LIC was not deductible. Learned counsel for the assessee relied on a decision of the Gujarat High Court in the case of Commissioner of Income Tax Vs. Abdul Rehman and Sons, . According to the facts arising in that case, the loans taken by the partners has been transferred to the bank account of the assessee-firm on the same day on which the loans were taken. In the books of account of the assessee-firm the amount borrowed stood credited to the banks account and the interest on the amounts borrowed was paid directly to the bank. Apart from that, there was a clear finding by the Tribunal to the effect that it was the assessee's firm which had borrowed money from the bank through its partners. Since it was the assessee-firm which had borrowed the money for the purpose of business, the Gujarat High Court held that the interest paid to the bank could not be disallowed under s. 40(b). But, according to the facts arising in the present case, we have already pointed out that there is no nexus between the amount borrowed from the bank and the interest paid by the partnership firm. In the absence of such nexus it is not possible to hold that s. 40(b) would not be applicable to the facts of this case. Therefore, according to us, the Tribunal was not correct in deleting the disallowance made under s. 40(b) of the Act. Accordingly, we answer the question referred to us in the negative and in favour of the Department. No costs.