
(1979) 12 AHC CK 0032

In the Allahabad High Court

Case No : Income-tax Reference No. 165 of 1978

Premier Colonisers

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 03-12-1979

Acts Referred:

Income Tax Act, 1961 — Section 36(1)

Citation : (1981) 132 ITR 514

Hon'ble Judges : R.R. Rastogi, J;C.S.P. Singh, J

Bench : Division Bench

Advocate : K.B. Bhatnagar, for the Appellant; R.K. Gulati and A. Gupta, for the Respondent

Judgement

Rastogi, J.—The assessee, a partnership firm, carries on business in real estate and colonisation. For the assessment year 1972-73, the previous year ended December 31, 1971, the assessee claimed deduction of a sum of Rs. 27,751 being interest paid on certain borrowings. The assessee's sister concern, M/s. Premier Enamel Works, had taken some loans amounting to over Rs. 3 lacs. The assessee took over the liability to pay those loans and for that purpose necessary book entries were made by it in its accounts. It was in respect of those loans that the assessee claimed deduction of the aforesaid amount as interest paid to the creditors. The ITO did not accept the assessee's claim for which the main reason given was that the assessee itself had not utilized the borrowed capital in its business and as such the payment of interest being on behalf of a different person could not be treated as incidental to the carrying on of its business. The same view was taken on appeals by the AAC and the Appellate Tribunal, and now, at the instance of the assessee, the following question has been referred to this court for its opinion ;

"Whether, on the facts and in the circumstances of the case, the assessee is entitled to the deduction of interest amounting to Rs. 27,751 in the computation of its business income u/s 36(1)(iii) of the Income Tax Act, 1961 ?"

2. It was submitted before us on behalf of the assessee by Dr. K. B. Bhatnagar, advocate, that, on the facts found, the view taken by the Tribunal was erroneous and that the claim was clearly allowable. In our opinion there is little substance in this submission. We may again mention that the facts found by the Tribunal are that the assessee and M/s. Premier Enamel Works are two different partnership firms, though the partners are common to them. The loans had originally been taken by M/s. Premier Enamel Works and the borrowed capital was utilised by that firm in its business. The assessee took over the liability to pay that loan to the creditors and for that purpose necessary entries were made in the books. According to the Appellate Tribunal, the mere fact that the assessee had taken over the liability for repaying these loans would not make those loans the borrowings of the assessee for the purposes of its business. According to the Appellate Tribunal, admittedly, the appellant-firm did not borrow these loans for the purposes of real estate business nor were these funds invested in the lands appearing on the assets side of the balance-sheet of the appellant-firm. In view of this finding, it cannot be said that the amount of interest allegedly paid by the assessee on the aforesaid loans could be treated as a legitimate deduction u/s 36(1)(iii) of the Act. The case of Mills Store Co. Vs. Commissioner of Income Tax, Bombay City II, , on which reliance was placed by Dr. Bhatnagar, proceeded entirely on different facts and the ratio laid down therein would not have any application to the present case.

3. In that case, a partnership firm constituted of six partners was carrying on business at Karachi with branches, amongst other places, at Bombay. At the end of March, 1948, that partnership was dissolved and the accounts were made up. As from 1st April, 1948, three of the six partners took over the Karachi business and continued it in the same name and the three remaining partners took over the Bombay business and continued in the same old name under the partnership with two new partners. In the accounting year 1948-49, ending on 31st March, 1949, the assessee debited a sum of Rs. 3,94,823 to the account of the Karachi firm and corresponding credit was given to certain parties who were creditors of the Karachi firm for an equivalent amount. In the accounting year 1950-51, the Bombay firm wrote off as bad debt its outstanding claim against the Karachi firm and simultaneously debited a like amount to the capital account of its partners maintained by it in its books of account. In its assessment for 1951-52, the Bombay firm claimed the interest it had paid to the creditors as interest on capital borrowed for the purposes of the business. The view taken by the Bombay High Court on these facts was that by the transfer entries made by the assessee in its books in the accounting year 1948-49, the assessee obtained an asset of an exactly equivalent amount in its favour of a claim or debt due to it by the Karachi firm. The genuineness of the debit to the Karachi firm and credit to the said creditors was not in dispute. Apart from that, the bona fides of havala entries could not be challenged because of two reasons. Firstly, because in the same accounting year the Karachi firm remitted to the assessee-firm an aggregate sum of Rs. 5,98,300 which by far exceeded the amount of the havala

entries and, secondly, because when the assessee-firm subsequently wrote off its outstanding claim against the Karachi firm as a bad debt it simultaneously made a corresponding debit entry in the capital account of its partners maintained in its books of account. The subsequent making of this "havala entry" did not in any way alter the original position of the creation of the credits in favour of the said creditors. It was emphasised that at the later point of time the partners were at liberty to withdraw the sum of Rs. 3,94,823 from their capital account and to advance it to the said creditors, who, in their turn, would have advanced the said amount to the assessee-firm. Such is exactly the effect of the debit to the partners' capital account and continuing the original credit in favour of the said creditors, subject to such payments one way or the other as may have been made in the interval after writing off the said debt due by the Karachi firm as a bad debt. " The effect of making these entries was that the credits in favour of the said creditors which was originally the corresponding debit to the Karachi firm was, on its being written off as bad debt, substituted by corresponding debit to the capital account of the partners and the original transaction of creating the credits in favour of the said creditors continued ; but only the consideration supporting it changed. It was also taken note of that the original transaction was a business transaction because it was by itself for the purposes of the assessee's business and, in any event, because the obligation to pay interest to the said creditors was created to earn interest from the corresponding debit to the Karachi firm. On this view of the matter, the contention of the revenue that since in giving credit to the Karachi creditors no money came in the till of the assessee-firm, the credit was not given for the purposes of the business of the assessee-firm, was repelled.

4. We fail to understand as to how the assessee can derive any advantage from this decision. That case proceeded on an entirely different set of facts. In the present case, the capital had not been borrowed by the assessee and was not utilised by it in its own business. The capital was borrowed by the sister concern and was utilised by it in its business. The assessee merely took over the liability to pay that loan by making transfer entries. That would not make these loans capital borrowed by the assessee for its own business and, therefore, the Appellate Tribunal was right in holding that the claim for deduction of interest was not allowable u/s 36(1)(iii) of the Act.

5. We, therefore, answer the question in the negative, in favour of the department and against the assessee. The department is entitled to its costs, which we assess at Rs. 200 and counsel's fee in like figure.