(1987) 03 AP CK 0037

In the Andhra Pradesh High Court

Case No : Reference Case No. 123 of 1980

Rahim Khatoon APPELLANT

Vs

Commissioner of Income Tax RESPONDENT

Date of Decision : 04-03-1987

Acts Referred:
Income Tax Act, 1961 — Section 263, 30, 31, 32, 33

Citation : (1987) 63 CTR 294 : (1987) 167 ITR 697

Hon'ble Judges : M.N. Rao, J;K. Ramaswamy, J

Bench : Division Bench

Advocate : Y. Ratanakar, for the Appellant; M. Suryanarayana Murthy and A.V. Krishna Koundinya, for the Respondent

Judgement

M.N. Rao, J.—At the instance of the assessee, the following two questions were referred by the Income Tax Appellate Tribunal to this court for its opinion, u/s 256(1) of the Income Tax Act, 1961 (Act No. 43 of 1961) (which will hereinafter be referred to as "the Act") :

"1. Whether, on the facts and in the circumstances of the case, the sum of Rs. 24,000 paid by the assessee to Hashmatunnisa Begum is allowable as a deduction from out of the assessee''s share income from the partnership firm, M/s. Kamal Enterprises ?

2. Whether, on the facts and in the circumstances of the case, there was any material before the Tribunal to come to the conclusion that the sum of Rs. 24,000 paid to Hashmatunnisa Begum was being adjusted towards the balance consideration of Rs. 2,00,000 due to Hashmatunnisa Begum ?"

2. The assessee is a partner of M/s. Kamal Enterprises and the extent of her share is 25%. The partnership firm has seven partners including the assessee. One of the Partners is a minor - she is the daughter of the assessee - and the extent of her interest in the partnership business in 25%. The partnership firm is running a cinema theatre, M/s. Kamal Talkies, taken on lease. The talkies

originally belonged to one Jainarayana Misra who sold it to one Hashmatunnisa Begum on September 1, 1966 subject to re-conveyance of the same in his favour or in favour of his nominees on payment of Rs. 4,00,000 before August 30, 1974. Jainarayana Misra executed a registered deed dated September 19, 1970, assigning the right to repurchase it is favour of Shri Gaffar Jaji Shukur and three others, who, in turn, entered into an agreement to assign their rights or interests in favour of M/s. Kamal Enterprises for a consideration of Rs. 1,25,000. A separate agreement was executed on January 8, 1971, between M/s. Hashmatunnisa Begum and the seven persons who subsequently became the partners of the partnership firm, known as "M/s. Kamal Enterprises", stipulating that out of the consideration of Rs. 4,00,000, half of it, namely Rs. 2,00,000, was to be paid immediately and the balance in five instalments. In terms of this agreement, Smt. Hashmatunnisa Begum should reconvey the theatre to the firm immediately on receipt of the last instalment. On the same day, i.e., January 8, 1971, a partnership deed was executed amongst the seven purchasers. The extent of the share of the assessee herein the partnership business is 25%, her minor daughter has a share of 25% and the other five partners, each 10% share.

3. In respect of the previous year relevant to the assessment year 1972-73, the individual income of the assessee and her minor daughter was subjected to tax by the Income Tax Officer. During the assessment proceedings, he allowed a deduction of Rs. 24,000, which was paid by way of interest by the assessee, Smt. Rahim Khatoon, to Smt. Hashmatunnisa Begum, the original owner of the theatre. The Income Tax Officer permitted deduction of this amount and that order of the Income Tax on February 8, 1977, in exercise of his power u/s 263 of the Act. The Commissioner was of the view that from the terms of the partnership deed dated January 8, 1971, the property was intended to be acquired by the firm. The books of account of the firm, M/s. Kamal Enterprises, disclosed that a total amount of Rs. 4,00,000 was due to Smt. Hashmatunnisa Begum and out of it only Rs. 2,00,000 was paid and in respect of the balance amount Smt. Hashmatunnisa Begum was shown as a creditor. From the agreement dated January 8, 1971, executed between the seven individuals who subsequently constituted the partnership firm, known an "M/s. Kamal Enterprises", and the partnership deed dated January 8, 1971, according to the Commissioner, it was clear that the firm was intended to be the owner of the property and not the partners individually. Since the privity of contract was between the owner, Hashmatunnisa Begum, and the firm represented by all the partners, it was not possible to treat the amount due to Hashmatunnisa Begum by the firm as capital borrowed by the assessee for investing the same in the firm. In that view, the Commissioner held that the Income Tax Officer erred in allowing the interest payment of Rs. 24,000 while assessing the share income of the assessee in respect of her share in the partnership business of M/s. Kamal Enterprises. Pursuant to the revisional order of the Commissioner, the Income Tax Officer passed a revised order disallowing the claim. The Income Tax Appellate Tribunal on appeal, held that section 67(3) of the Act was not

applicable. The entries in the books of account militated against the contention of the assessee as regards the applicability of section 67(3). The Tribunal also was of the view that "it may be true that Smt. Rahim Khatoon was paying the lease amount by way of cheques in favour of Smt. Hashmatunnisa Begum and the sum of Rs. 24,000 was being adjusted towards the balance of consideration of Rs. 2 lakhs due to Smt. Hashmatunnisa Begum. But it is too much to say that this represents the interest amount on the sum of Rs. 2 lakhs due by the firm to Smt. Hashmatunnisa Begum in the absence of any mention about that fact either in the partnership deed or in any of the documents which have been brought to our notice." As already stated, at the instance of the assessee the aforesaid two questions were referred to this court.

4. Section 67(3) of the Act deals with the method of computing a partner''s share in the income of the firm. Sub-section (3) enjoins that any interest paid by a partner on capital borrowed by him for the purpose of investment in the firm shall, in computing his income chargeable under the head "Profits and gains of business or profession" in respect of his share in the income of the firm, be deducted from the share. In the case of individuals who are partners of a firm, the analogous provision is found in section 36(1)(iii) of the Act. It is apparent that there was no borrowing of money by the assessee for the purpose of investing the same in the partnership business of M/s. Kamal Enterprises and, therefore, on the language of section 67(3), it is difficult to hold that the amount paid by way of interest on the principal amount of Rs. 2 lakhs is entitled to deduction. Sri Ratnakar, learned counsel for the assessee, in view of this factual situation, could not seriously contend about the applicability of section 67(3). Sri Ratnakar says that section 67(3) is not exhaustive; if an assessee can bring his or her claim within the ambit of any other provision in the Act, the claim should not be rejected. As a proposition of law, we think, this is unexceptional. The High Court of Delhi in Commissioner of Income Tax Vs. Sohan Lal Nayyar, has also taken the same view. Question No. 1, referred to us, is comprehensive in its sweep. It is not confined to the applicability of section 67(3) but it concerns with the aspect whether the sum of Rs. 24,000 paid by the assessee is allowable as a deduction from out of her share income in the partnership firm. Although before the Income Tax Appellate Tribunal no arguments appeared to have been advanced on the question of applicability of any other provision in the Act for claiming deduction, since it is a pure question of law, we have permitted the learned counsel for the assessee to raise the same before us.

5. The assessee undoubtedly paid Rs. 24,000 to Smt. Hashmatunnisa Begum towards interest. She did not borrow the amount of Rs. 2 lakhs. The sum of Rs. 2 lakhs due to Hashmatunnisa Begum is the unpaid purchase money and this is evident from the recitals in the agreement dated January 8, 1971, concluded between Smt. Hashmatunnisa Begum and the seven individuals, who subsequently constituted the partnership business, known as "M/s. Kamal Enterprises". The relevant clause in the agreement is as follows :

"That in consideration of the payment of Rs. 4,00,000 (Rupees four lakhs only) out of which a sum of Rs. 2,00,000 (Rupees two lakhs only) has been paid by the parties of the second part to the party of the first part by way of Cheque No. 74,153 dated January 8, 1971, drawn on the Syndicate Bank (Basheer Bagh Branch), Hyderabad, as earnest money, and the balance of Rs. 2,00,000 (Rupees two lakhs only) has been agreed to be paid by the parties of the second part to the party of the first part in five equal instalments within five years from the date of this agreement, the PARTY OF THE FIRST PART hereby agrees and undertakes to reconvey the property known as Kamal Talkies situated at Chaderghat, Hyderabad, full described in the schedule hereinafter to the parties of the second part as per the terms of this agreement. On receipt of the above payments, the party of the first part shall execute a registered sale deed in respect of the said property in favour of the parties of the second part."

6. For the assessee, it is contended that u/s 37(1) of the Act, the expenditure incurred by the assessee by way of payment of interest on the unpaid purchase money is a claimable deduction. Since the expenditure was incurred wholly and exclusively for the purpose of business, it did not fall within the ambit of sections 30 - 36 and it was neither capital expenditure nor personal expenditure. In support of this contention, reliance was placed on the ruling of the Supreme Court in BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY., . On the other hand, Sri M. Suryanarayana Murthy, learned counsel for the Revenue, contends that section 37(1) has no application. There is no stipulation anywhere in the documents placed before the Income Tax Appellate Tribunal obligating payment of interest on the instalments in respect of the unpaid purchase money. The liability was that of the firm, but not that of the individual partners and, therefore, the firm alone was entitled to claim allowance.

7. We are inclined to agree with the submission of the learned counsel for the assessee. As already noticed, the agreement for taking the theatre on lease was concluded between Hashmatunnisa Begum and the seven individuals who subsequently constituted themselves into a partnership firm known as "M/s. Kamal Enterprises". The liability under the aforesaid clause for payment of Rs. 2 lakhs in five instalments was that of the seven individuals jointly and severally. When the agreement was concluded between Hashmatunnisa Begum and the seven individuals, the partnership did not come into existence. The lease deed, executed on January 8, 1971, between Hashmatunnisa Begum and the seven partners also shows that the lessees are the seven individuals, but not the partnership firm. It is true, on the very same day the seven individuals formed themselves into a partnership known as "M/s. Kamal Enterprises". So far as the creditor, Smt. Hashmatunnisa Begum is concerned, her rights as a creditors are based on the lease deed and the agreement, but not on the partnership deed. The partnership deed is concerned only with the rights of the partners inter se. It is, therefore, difficult to accept the contention of the learned counsel for the Revenue that there was no liability for the individuals and that it was the

partnership firm which was liable to the owner, Smt. Hashmatunnisa Begum. This position may be tested from another point of view. In the event of failure on the part of the partners to pay the unpaid purchase money of Rs. 2 lakhs, Hashmatunnisa Begum could not have proceeded against the partnership firm. Her remedy was only to proceed against the seven individuals either jointly or severally. The facts of the case are somewhat parallel to BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY., , decided by the Supreme Court. As a result of amalgamation of two companies, certain amount had to be paid by one company to another and the unpaid money carried interest at the rate of 6%. In respect of the interest amount, the question that arose was whether it was allowable as a deduction u/s 10(2)(iii) or 10(2)(xv) of the Indian Income Tax Act, 1922, in computing its profits. It may be mentioned that section 10(2)(iii) of the 1922 Act is in pair material with section 36(1)(iii) of the present Act. Likewise, section 10(2)(xv) of the 1922 Act is in pari material with section 37(1) of the present Act. After holding that section 10(2)(iii) was not attracted since admittedly no amount was borrowed and, therefore, the interest paid did not qualify for deduction, the Supreme Court held, after referring to its earlier decision in State of Madras Vs. G.J. Coelho, , as follows (p. 61) :

"The test laid down by this court, therefore, was that expenditure made under a transaction which is so closely related to the business that it could be viewed as an integral part of the conduct of the business, may be regarded as revenue expenditure laid out wholly and exclusively for the purposes of the business.

The assessee-company had undoubtedly acquired the assets by pledging its credits. The assessee-company was formed for the purpose of taking over the business which the Scindias had acquired and for carrying on that business the assets with which the business was to be carried on were required. For obtaining those assets, the assessee-company rendered itself liable for a sum of Rs. 51,56,000 and agreed to pay that sum with interest at the rate stipulated. The transaction of acquisition of the assets was closely related to the commencement and carrying on of the business. Interest paid on the amount remaining due must in the normal course by regarded as expended for the purpose of the business, which was carried on in the year of account. There is no dispute that if interest was paid for the purpose of the business, it was laid out or expended wholly and exclusively for that purpose."

8. The aforesaid statement of law clearly applies to the facts on hand. The interest paid by the assessee, it cannot be seriously disputed, was for the purpose of the business. It was laid out or expended wholly and exclusively for the purpose of the business. In the even of the assessee''s failure to pay the interest, the original lessor, Hashmatunnisa Begum, would have definitely proceeded against the assessee and that would have certainly affected the business. The interest amount of Rs. 24,000 paid by the assessee to Smt. Hashmatunnisa Begum during the previous year relevant to the assessment year

1972-73 is, therefore, an allowable deduction u/s 37(1) of the Act.

9. For the foregoing reasons, we answer question No.1 in favour of the assessee and against the Revenue.

10. As regards question No. 2, we are of the view that on the facts of the case, it does not arise for decision. We, therefore, decline to answer that question.

11. There shall be no order as to costs.