

Laxmi Ice Factory Vs. Cit

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Court : Allahabad

Decided On : Sep-30-2004

Reported in : [2005]143TAXMAN314(All)

Appeal No. : IT Reference No. 179 of 1985 30 September 2004

Appellant : Laxmi Ice Factory

Respondent : Cit

Advocate for Pet/Ap. : Vikram Gulati, *for the Assessee* A.N. MahaJan, *for the Revenue*

Judgement :

R.K. Agrawal, J.

The Income Tax Appellate Tribunal, Allahabad has referred the following question of law under section 256(2) of the Income Tax Act, 1961, hereinafter referred to as the Act, for opinion to this court:

'Whether on the facts and circumstances of the case and having regard to the terms and conditions of the original partnership deed and also in view of the provisions of section 13(c) of the Partnership Act was it not open to partners to change its course, when they realized that the interest on the debit balance of one of the partners was being charged erroneously, and the findings recorded by the

Appellate Assistant Commissioner and confirmed by the Tribunal that the agreement dated 20-2-1985 was afterthought and not relevant are based on relevant consideration and liable to be sustained?'

2. Briefly stated the facts giving rise to the present Reference are as follows:

The present reference relates to assessment years 1976-77 and 1977-78, The applicant is the firm consisting of three persons, namely, Smt. Lilawati Narang, Shri V.P. Narang and Sri R.K. Narang. During the course of the assessment proceedings for the assessment year 1976-77 the Income Tax Officer raised the following query vide letter dated 23-11-1978:

'Smt. Lilawati Narang was owing to the firm an amount of Rs. 1,21,654 as on 1-12-1975 and has further allowed to withdraw Rs. 18,782 especially when the firm was returning losses and had to pay interest to th creditors for investment purposes. Please state as to why proportionah interest may not be disallowed as not incidental to business.'

The applicant vide letter dated 24-11-1978 replied as follows:

'Smt. Lilawati Narang has a debit balance ever since the firm was constituted by her after inheriting the factory from her husband Late Sri Kesar Ram Narang and the drawing made by her are for the usual and normal drawings and no investment by her out of the withdrawals and the amount borrowed by the firm was for the purpose of business only and not for investment by her individually. Therefore, there is no question for disallowing proportionately interest.'

3. The Income Tax Officer vide order dated 22-11-1978 made addition of Rs. 27,687 with the following remarks:

'Interest from Srimati Lilawati Narang, last year the firm charged interest on debit balance of Smt. Lilawati @ 20% which has not been charged this year. As per letter dated 23-11-1978 the assessee was required to explain as to why the interest was not charged from her, as it was charged in the previous year. The assessee's reply is on file and is very vague and unconvincing.'

4. In respect of assessment year 1977-78 the Income Tax Officer once again enquired from the applicant as to why no interest has been charged on the debit balance in the account of Smt. Lilawati Narang. In its reply the applicant submitted that in view of the agreement dated 20-2-1975 the charging of interest was discontinued as the partners have felt that it was unfair of Smt. Lilawati Narang to be charged interest on the debit balance. The Income Tax Officer, however, included a sum of Rs. 18,888 in the total income of the applicant with the following remarks:

'This argument put forth by the assessee has no force. Interest paid to the partner on the capital employed by the partners is a revenue expenditure like other expenses. It is disallowed and added back to the income of the firm as per specific provisions of the Income Tax Act. It is nowhere provided in the Act that interest realized from the partner will be deducted from the firm's income. It may further be pointed out that the agreement which is alleged to have been executed on 20-2-1975 is nothing but an afterthought. Had there been any agreement the same would have certainly been produced during the earlier assessment year i.e., 1976-77 when explanation for not charging interest was asked for. The explanation adduced that time was altogether different from what has been given now. From the perusal of the so called agreement it would be seen that the stamp papers date back to 10-10-1971 (about 4 years prior to the execution of the agreement one of the three paper was purchased by some person S/o Sant Lal, whose identity was not even known to the firm. The stamp paper should have been purchased in the name of the firm or at least in the name of partners. In the circumstances, no reliance can be placed on the agreement form. Under these circumstances, the interest @ 12% amounting to Rs. 18,888 which should have been charged on the debit balance of the sleeping partner Smt. Lilawati is charged and added to the income of the firm.'

5. The applicant being aggrieved by the orders of the Income Tax Officer for the both the assessment years preferred separate appeals before the Appellate Assistant Commissioner. In the appeal filed by the applicant for the assessment year 1976-77 the applicant also filed an application for bringing on record the additional evidence, i.e., agreement dated 20-2-1975. Upon objection being raised

by the assessing authority, the Appellate Assistant Commissioner rejected the application for filing additional evidence. In both the appeals the Appellate Assistant Commissioner upheld action of the assessing officer. She has found that the agreement alleged to be executed on 20-2-1975 was not genuine. Further such interest was charged on the debit balance in the past and further two partners were also paid interest on the credit balance in their respective accounts.

6. Feeling aggrieved by the order passed by the Appellate Assistant Commissioner the appellant filed separate appeals before the Tribunal. The Tribunal has upheld the orders passed by the assessing authority.

7. We have heard Sri Vikram Gulati, learned counsel for the applicant and Sri A.N. Mahajan, learned standing counsel for the revenue.

8. Learned counsel for the applicant submitted that Smt. Lilawati Narang had inherited the debit balance in the partnership firm on the death of her husband and such firm was running into loss. The partners had rightly agreed not to charge any interest on the debit balance. He further submitted that the agreement dated 20-2-1975 was a genuine document and had been entered into between the partners and, therefore, the appellate authority was wrong in holding it otherwise. He further submitted that there was no occasion to file a copy of the agreement during the assessment proceedings for the assessment year 1976-77. No such query was made by the assessing authority. Only by passing of the assessment order the applicant came to know that the addition is being made on the ground of non-charging of interest on the debit balance and was taken by surprise. He relied upon the following decisions:

1. Mrs. Monie Ardeshir Baria & Mrs. Piloo F Antia, Executrices of the Estate of Ardeshir D. Baria v. CED : [1977]106ITR203(Bom) .

2. CIT v. R.M. Chidambaram. Pillai : [1977]10ITR292(SC) .

3. C. V. Mulk v. CAIT : [1979]120ITR670(Ker) .

9. Sri A.N. Mahajan, submitted that the finding recorded by the Tribunal that the agreement dated 20-2-1975 was not genuine is based on appreciation of evidence

and materials on record and moreover the aforesaid finding recorded by the authorities was not specifically challenged by the applicant before the Tribunal. He, thus, submitted that the Income Tax Officer was justified in bringing to tax the amount of interest on the debit balance though not charged by the applicant firm.

10. Having heard learned counsel for the parties we find that for the assessment year 1976-77 specific query was made by the assessing officer as to why proportionate interest be not disallowed as not incidental to business as Smt. Lilawati Narang was having debit balance specially when the firm was returning losses and had to pay interest to the creditors for investment purposes. In that year the applicant had not charged any interest from Smt. Lilawati Narang. In the explanation which was put forward by the applicant was that no interest was charged since the expenses and withdrawal made by her being normal. In the assessment year 1977-78 when the Income Tax Officer put a specific query why the interest had not charged from her, the applicant for the first time came up with the agreement dated 20-2-1975. The Income Tax Officer in the order for the assessment year 1977-78 has held that the agreement dated 20-2-1975 is nothing but an afterthought on the grounds that had there been any agreement, the same would have certainly been produced during the earlier assessment year 1976-77 when the explanation for non-charging interest was asked for. He was further of the view that from a perusal of the so called agreement it would be seen that the stamp papers bears date of 10-10-1971, i.e., almost four years prior to the execution of the agreement, one of the three papers was purchased by some person S/o Sant Lal, whose identity was not even known to the firm. According to the Income Tax Officer the stamp papers should have been purchased in the name of the firm or at least in the name of the partners and, therefore, no reliance could be placed on the agreement. The aforesaid findings has been upheld by the Appellate Assistant Commissioner in the appeal for the assessment year 1977-78. In the memo of appeal filed by the applicant before the Tribunal, copy of which is on record of the paper book, we do not find that any such plea like challenge to the finding regarding genuineness of the agreement dated 20-2-1975 was raised. In the absence of any challenge regarding the finding about the genuineness of the agreement dated 20-2-1975 the Tribunal was justified in not going into that issue. Further having regard to the findings recorded by the Income Tax Officer and the

Appellate Assistant Commissioner we do not find that the said findings suffer from any legal infirmity. So far as the question of the applicability of section 13(c) of the Indian Partnership Act is concerned, we find that it only provides that if the partner is entitled to interest on the deposit made by him such interest shall be payable only out of the profits. It does not refer to charging of interest on debit balance of the partners. The case of Mrs. Monie Ardeshir Baria (supra) related to the matter of the Estate Duty Act which has no bearing to the present case. Likewise in the case of R.M Chidambaram Pillai (supra) the Apex Court considered the case as to whether the salary paid to the partner by a firm which grows and sells tea is exempted under the provisions of Indian Income Tax Rules, 1922 which has no bearing to the present case. Same is the position with the case of C.V Mulk (supra).

11. In view of the foregoing discussions, we answer the question referred to us in the negative i.e., in favour of the revenue and against the assessee. However, there shall be no order as to costs.