

Apsara Cinema Vs. Assistant Commissioner of

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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Sep-04-1992

Reported in : (1993)44ITD253(Delhi)

Judge : V Gandhi, R Mehta

Appellant : Apsara Cinema

Respondent : Assistant Commissioner of

Judgement :

1. This appeal by the assessee firm for the assessment year 1984-85 is directed against order of CIT(A) upholding disallowance of Rs. 49,545 under Section 40(b) of IT Act on account of interest paid to the partners after rejecting assessee's contention that Rs. 21,425 as interest charged from partner Dr, Anil Prasad be deducted and only net amount be considered.

2. Briefly stated facts are that assessee firm in the relevant period had 12 partners. 11 partners had credit balance whereas the 12th partner Dr. Anil Prasad had a debit balance in their accounts with the firm. The firm paid interest aggregating to Rs. 49,544 on credit balance of the partners. On debit balance of Dr. Anil Prasad, the firm charged interest of Rs. 21,425. The assessee before the assessing officer claimed that only net amount be disallowed under Section 40(b) of IT Act. In other words, the claim was that sum of Rs. 21,425 be deducted from Rs. 49,545 and only the net amount be treated as interest paid to partners. This contention was rejected by the assessing officer as he was of the view that the entire amount of

interest paid was to be disallowed in terms of Section 40(b) of IT Act. In support of above view ITO relied upon the decision of Allahabad High Court in the case of Sri Ram Mahadeo Prasad v. CIT [1953] 24 ITR 176 and another decision of Hon'ble Madhya Pradesh High Court in Chhotalal Keshavram v. CIT [1978] 115 ITR 347.

3. The assessee challenged the addition in appeal before CIT(A) and relied upon decisions given by CIT(A) in the case of the assessee for the assessment years 1979-80 and 1983-84. Reference was further made to decision of Allahabad High Court in the case of CIT v. Kailash Motors [1982] 134 ITR 312. The Circular of CBDT No. 882 dated 13-11-1979 was also relied upon.

4. Learned CIT(A) noted that firm paid interest to 11 partners and received interest from the 12th partner. Thus interest was not paid and received from the same partner. In CIT(A)'s view decision of Kailash Motors' case (supra) and circular of CBDT were applicable only in a case where the firm pays and receives interest from the same partner.

In such a situation only the net amount of interest is to be taken into consideration but the position in the present case is different and amount received from one partner could not be deducted from the interest paid to other partners. CIT(A) accordingly upheld the disallowance. Assessee has brought the issue in appeal before the Appellate Tribunal.

5. We have heard the parties. Learned counsel for the assessee reiterated the submissions advanced on behalf of the assessee before the CIT(A). He further drew our attention to provision of Section 40(b) of IT Act and submitted that expression "by the firm to any partner of the firm" meant net amount of interest paid by the firm to the partners. There was, therefore, no justification for not deducting interest received from a partner while applying provision of Section 40(b) of IT Act. During the course of hearing decision of Hon'ble Supreme Court in the case of Keshavji Ravji & Co. v. CIT [1990] 183 ITR 1 was considered. According to the learned counsel for the assessee, the said decision supported his view as "substance" distinguished from 'form' of transaction is to be considered as per the ratio of above decision. In the present case the receipt and payment of interest by partners was a single transaction split into two. The net effect is to be

seen. Thus directive of Hon'ble Supreme Court supported the claim of the assessee. The aforesaid submissions were opposed by the learned Departmental Representative. She submitted that decision of Hon'ble High Court was complete answer to the claim of the assessee. She read out certain portion of the decision to support the order of CIT(A).

6. To dispose of the appeal we first consider ratio of decision of Supreme Court in the case of KeshavjiRavji & Co. (supra). In the said case partners were maintaining two accounts and firm paid and received interest on the debit and credit balances of partners. The assessing officer did not set off interest received from the partners on their borrowings while disallowing the amount of interest paid to the partners under Section 40(b) of IT Act. The order of assessing officer was confirmed on appeal by the AAC and Appellate Tribunal. The Hon'ble High Court also decided the issue against the assessee. Before the Supreme Court, five contentions were raised which are noted at page 8 of the report. While dealing with the first contention relating to adjustment of outgoings for ascertaining real income of firm their Lordships observed as under:-- There are, indeed, strong and compelling considerations against the adoption of the test suggested by Sri Ramachandran. Limiting of the ambit of Section 40(b) on the supposed 'real income' test would, perhaps, lead to positions and results, the dimensions and implications of which are not, to say the least, fully explored. The test suggested by Sri Ramachandran might, on its own extended logic, validate a set-off of the interest paid to one partner against interest received from another and, likewise, 'interest' received from one partner on some other dealings between him and the firm against interest paid to another partner on his or her capital contribution. The test of 'real income' as one on which the operation of Section 40(b) could be sought to be limited is not a reliable one. Indeed, the following observations of this court on the concept of 'real income' in State Bank of Travancore v. CIT [1986] 158 ITR 102 at page 155, though made in a different context, are apposite: ...The concept of real income is certainly applicable in judging whether there has been income or not but, in every case, it must be applied with care and within well recognised limits.

We were invited to abandon legal fundamentalism. With a problem like the present one, it is better to adhere to the basic fundamentals of the law with clarity and consistency than to be carried away by common cliches. The concept of real income certainly is a well-accepted one and must be applied in appropriate cases but with circumspection and must not be called in aid to defeat the fundamental principles of the law of income-tax as developed.' This contention of Sri Ramachandran rests on generalisations which incur the criticism of being too broad and have certain limitations of their own.

Though the Court was dealing with a slightly different situation as in that case interest was paid and received from the same partner, the set off of interest received from partner against interest paid to another partner was not accepted. This is clear from the above extracted passage. The concept of real income was also held to be not applicable in the field of operation of Section 40(b). The Court, however, for the reasons given at pages 12 to 17 accepted the claim of the assessee that interest, if any, paid to the partner by the firm in excess of what is received from the partner could alone be disallowed under Section 40(b) of the IT Act. We, therefore, do not find anything in the ruling supporting the view canvassed on behalf of the assessee. It is, however, true that the situation before us is slightly different from the situation in the case before the Hon'ble Supreme Court.

7. In the present case there is no dispute regarding amount of interest charged by the firm from the partners. The dispute relates to deduction of interest received by the firm from one partner. The provision of Section 40(b) requires that any payment of interest by a partnership firm to a partner shall not be deducted in computing the income of partnership firm. For the purpose of finding out the amount paid by way of interest, it is necessary for the assessing officer to find out the amount of interest paid by the partnership to the partner and see if the same partner paid any interest to the partnership firm and ascertain the amount of interest effectively paid by the partnership to the partner. There is no provision in the Act which permitted an adjustment of amount of interest received from a partner against interest paid to other partners. The transaction relating to payment of interest by the partner to the firm is a commercial or business transaction

resulting in earning profits to the firm which like other profits is to be apportioned and allocated to the partners as their share income. Such payment of interest to the firm cannot fall within the expression "payment of interest by the firm to any partner of the firm". The receipt of interest by the firm from a partner is a transaction distinct and separate from payment of interest by the firm to another partner. Each of the partners and the firm indisputably are different and distinct entities for the purpose of IT Act. The transaction between the partner and the firm cannot be linked with the transaction between the firm and some other partner. A debit balance of one partner cannot be mixed with credit balance of some other partner nor the interest paid adjusted against interest received by other partner as if it was a single transaction. The doctrine of real income has no application to the present case as elaborately discussed in the case of Keshauji Ravji & Co. (supra). The Circular of CBDT relied upon by the assessee is applicable only in a case where interest is paid and received from the same partner which is not the situation here. On the other hand, decisions relied upon by the assessing officer fully support the view taken by the revenue. In the case of Sugar Dealers v. CIT [1980] 122 ITR 826 (All.) deduction of amount of interest received from 4th partner against interest paid by the firm to 3 other partners was held to be a mistake apparent from record rectifiable under Section 154 read with Section 40(b) of IT Act. This shows that legal position is more than clear. For the aforesaid reasons, we hold that sum of Rs. 21,425 has rightly not been deducted while computing amount disallowable under Section 40(b) of IT Act. Accordingly, we uphold order of CIT(A).

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