

Santosh Kumar Agrawal Vs. Assistant Commissioner of

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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Jul-13-2000

Reported in : (2001)78ITD394(Mum.)

Judge : R Easwar

Appellant : Santosh Kumar Agrawal

Respondent : Assistant Commissioner of

Judgement :

1. These appeals by the assessee relate to the assessment years 1993-94 and 1994-95 and the only question in the appeals is whether the assessee is entitled to the deduction of the interest paid in respect of the amounts borrowed for the capital invested in the firm in which he is a partner, against the income by way of remuneration received by him from the firm.

2. From the assessment year 1993-94, a new scheme of taxation of the firm and partners was introduced and briefly stated, according to the new scheme, the firm itself was taxed at the maximum marginal rate and the partners were taxed in respect of their share income. However, the interest and remuneration paid by the firm to its partners which were allowed as a deduction in computing the firm's taxable income were assessed in the hands of the partners who were in receipt of the same.

Section 28(v) which was also introduced w.e.f the assessment year 1993-94 provided that any remuneration due or received by a partner of a firm from the firm shall be chargeable to income-tax under the head 'profits & gains of business or profession'. When the Statute has, by fiction, provided that the remuneration received by the partner from the firm is to be assessed under the head 'business', any interest paid by the partner for the purpose of earning the remuneration must also be deducted. A fiction must be extended to its logical conclusion and one's mind shall not boggle down when it comes to the extension of the fiction to all its logical consequences. The objection raised by the revenue authorities is that the interest is not paid for the purpose of earning the remuneration. The answer to this objection is that strictly speaking, there cannot be a contract of service in law between a firm and its partners. The firm is not a legal person even though it is recognised as a unit of assessment for the purpose of Act. Any payment of salary to a partner is only a mode of sharing the profits. The salary paid to a partner retains the same character of the income of the firm. These principles have been laid down by the Supreme Court in the case of CIT v. R. M. Chidambaram Pillai [1977] 106 ITR 292. It has been held in this decision, that the salary of a partner is only an alias for the return by way of profits for the human capital-sweat, skill and toil - which the partner has brought in for the common benefit. The immediate reason for payment of salary may be the service contract, but the causa causans is the partnership. The Supreme Court held that when an arrangement is made by which a partner works and receives amounts as wages for services rendered, the agreement should in truth be recorded as a mode of adjusting the amount, that must be taken to have been contributed to the partnership's assets by a partner, who has made what is really a contribution in kind, instead of contribution in money. On this reasoning, the Supreme Court held that what has been paid as salary by the firm to a partner is really the share or profits paid to him. It would appear that the Legislature has recognised this principle by enacting a fiction in section 28(v), If really the remuneration has to be treated as a return of the share of profits by the firm to the partner, it follows that the partner should be entitled to all the deductions which he was hitherto entitled while computing his share of profits in the firm including the deduction in respect of interest paid on monies borrowed for investment in the firm as capital under section 67(3). Section

36(1)(iii) enacts the same principle. The assessee in the present case is therefore, entitled to the deduction of the interest paid on monies borrowed for investment in the firm in which he is a partner, against the amount received by him from the firm as remuneration and assessed under the head business. I direct accordingly and allow the appeals.

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