Sri Ram Mahadeo Prasad vs Commr. Of Income-Tax, United ... on 8 May, 1953

Equivalent citations: AIR1953ALL779, [1953]24ITR176(ALL), AIR 1953 ALLAHABAD 779

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Bench: V. Bhargava

JUDGMENT

Malik, C.J.

1. This is a reference under Section 66 (1), Income-tax Act, made at the instance of the assessee. The assessee is a registered firm which carries on business, owns house property, has income from dividends and other sources. During the relevant assessment year, the assessee claimed certain deductions as hotel charges incurred by the partners while on tour connected with business. The partners of the assessee firm had also lent money to the firm for purposes of carrying on its business and had from time to time borrowed money from it. There was a Khata in the name of each partner which showed the amount of interest paid by the firm to the partner on the amount borrowed from him and also interest received from the partner on any amount borrowed by him. The total amount paid to the partners as interest OD amounts borrowed from them was Rs. 19,712/-, while the amount received from the partners as interest on monies borrowed by them was Rs. 7,931/-. The assessee had in his return deducted from its income the sum of Rs. 19,712/- paid as interest to the partners. The Income-tax Officer disallowed the hotel charges paid by the partners, as also the whole item of Rs. 19,712/-which he added back to the income. The Appellate Assistant Commissioner and the appellate Tribunal directed a sum of Rs. 13,412/- only to be added back to the return.

2. On the application of the assessee, the following two questions have been referred to us for our decision:

> "1. Whether the hotel charges of the proprietors in respect of a tour undertaken for the purposes of procuring business for the firm are allowable expenditure under Section 10 (2) (xv) of the Income-tax Act?
>
> 2. Whether the excess interest received from the partners of the firm on the amounts overdrawn by them after adjustment against the payments of interest made to them by the firm is taxable income in the hands of the firm?"

3. As regards the first question it is already covered by our decision in -- 'Ramkishan Sunderlal v. Commr. of Income-tax, U P.', (1951) 19 ITR 324 at p. 330 (All) (A). We see no reason to reconsider our view and answer the question in the negative.

4. As regards the second question, the assessee was a partnership firm of which the five partners were, (1) Jagannath Mahadeo Prasad (2) Kamta Prasad (3) Har Prasad (4) Chunnilal Sohanlal and (5) Gangadin Kedar-nath. It appears that the first four partners had invested money in the partnership firm on which the firm was paying interest to them. The amount of interest paid by the firm to Jagannath Mahdeo Prasad being Rs. 12,166/-, to Kamta Prasad Rs. 601/-, to Har Prasad Rs. 3,423/- and to Chunnilal Sohanlal Rs. 3,522/-, the total amount thus paid as interest to the partners on the capital borrowed from or invested by them came to Rs. 19,712/-. It appears from the accounts that the partners withdrew or borrowed money from the firm on which they were charged interest by the firm. The amount of interest thus paid by Jagannath Mahadeo Prasad was Rs. 5.699/-Kamta Prasad Rs. 1,439/- and Gangadin Kedarnath Rs. 793/-. The total amount of interest received by the firm from the partners for money borrowed by them from the firm was Rs. 7,931/-.

5. The Income-tax Officer added back the whole amount of Rs. 19,712/- paid by the firm to the partners for money borrowed from them without deducting the sum of Rs. 7,931/-, the interest received by the firm from the partners, The assessee filed an appeal and the Appellate Assistant Commissioner amended the order by deducting the amounts of Rs. 5,699/- and Rs. 601./- only, thus holding that a sum of only Rs. 13412/- (Rs. 19,712/- minus Rs. 6300/-) should have been added back to the return made by the firm. The Tribunal upheld the Appellate Assistant Commissioner's order.

6. The Appellate Assistant Commissioner and the Tribunal dealt with the amount received from and paid to each partner separately. For example, Jagannath Mahadeo Prasad had received Rs. 12,166/- as interest on money lent by him to the partnership, while he had paid Rs. 5,699/- as interest on amount borrowed by him from the partnership. The amount paid to him as interest was adjusted against the amount received from him so that only the difference between Rs. 12,166/- and Rs. 5,699 /- was directed to be added back. Kamta Prasad had lent money to the partnership for which he had been paid Rs. 610/- as interest. He had, however borrowed more than what he had lent to the partnership and had, therefore, to pay Rs. 1,439/- as interest to the. partnership. The amount of Rs. 601/- was allowed by the Assistant Commissioner and the Tribunal to be deducted out of Rs. 1,439/-.

7. As regards sums of money which were borrowed from partners and on which the assessee firm paid interest to the partners, the provisions of Section 10 (2) (iii) and 10 (4) (b), Income-tax Act, make it perfectly clear that the amounts could not be deducted in computing profits or gain's of the partnership. The relevant portion of Section 10 (2) (iii) is as follows:

> "(2) Such profits or gains shall be computed after making the following allowances, namely:
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> (iii) in respect of capital borrowed for the purposes of the business, profession or vocation the amount of the interest paid:

> Provided that no allowance shall be made ..... in the case of a firm, for any interest paid to a partner of the firm;"
>
> Again Section 10 (4) (b) provides that:
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> "..... nothing in clause (xv) of Sub-section (2) shall be deemed to authorise (b) any allowance in respect of any payment by way of interest, salary, commission or remuneration made by a firm to any partner of the firm;"

It is thus clear that the assessee was not entitled to claim that the interest paid by it to its partners for money borrowed from them should be treated as expenditure and should be allowed to be deducted at the time of computation of profits. There is, however, nothing in the Income-tax Act which excludes from the computation of the income of the partnership any amount paid as interest by a partner for money borrowed by him from the partnership.

8. Our attention has been drawn to a deci-sion of the Madras High Court in -- 'Venkadari Somappa v. Venkataswami Chetty', AIR 1941 Mad 672 (B) and reliance has been placed on behalf of the assessee on the observations in that judgment that, when the income of a partnership is assessed to tax under the Income-tax Act, what is really assessed is nothing less than the income of individual partners and that a partner is entitled to apply under Section 48 for the refund of the tax upon his share if his total income for the year is below the taxable minimum. These observations, however, relate to an entirely different set of circumstances. In that case the question was whether the appellant was an agriculturist entitled to claim the benefit of an Act passed for the benefit of agriculturists and a person was not deemed to be an agriculturist if he had been assessed to Income-tax under Proviso (A) to Section 3 of Act 4 of 1938. The appellant in that case was a partner in a ginning factory and was entitled to one-fourth share of the profits. The factory Was assessed to Income-tax for its profits in the year 1937-38. The point raised was whether the appellant could be said to have been assessed to Income-tax as the factory of which he was a partner had been assessea to Income-tax.

9. The case of -- 'Arunachalam Chettiar v, Commr. of Income-tax, Madras', AIR 1936 P C 133 (C) was also relied upon. That was a case in which the question arose whether a partner could undertake the liability to pay the losses incurred by another partner and claim to set it off against his profits from other business. Another point in the case was whether the losses incurred by the other partner could be treated as bad debt in the year in question. While dealing with these points their Lordships of the Judicial Committee said:

> "From section 24 (2) of the Indian Income-tax Act it would seem that the Indian legislature thought it necessary to anticipate any possible apprehension that a partnership, by being registered as a registered firm within the meaning of section 26 of the Act, might be treated as a separate assessee in so absolute a sense as to prevent a partner's share of loss being set off against his individual profits or gains. In their Lordships' opinion whether a firm is registered or unregistered, partnership does not obstruct or defeat the right of a partner to an adjustment on account of his share of

> loss in the firm, whether the Set off be against other profits under the same head of income within the meaning of Section 6 of the Act or under a different head (in which case only need recourse be had to Section 24 (1)."

We do not see how these observations help the assessee. In neither of the two cases has it been held that it is not possible for a partner to borrow from or lend money to a partnership.

As a matter of fact Section 13, Partnership Act (4 of 1932), provides that:

> "Subject to contract between the partners.....
>
> (d) a partner making, for the purposes of the business, any payment or advance beyond the amount of capital he has agreed to subscribe, is entitled to interest thereon at the rate of six per cent, per annum."

A partner, therefore, is entitled to charge interest under the Partnership Act at such rate as may be agreed upon between the partners and in the absence of an agreement six per cent per annum for all sums advanced by him beyond the amount of capital he had agreed to subscribe. The provisions of the I. T. Act quoted above make it clear that the assessee firm is not entitled to claim a deduction for any interest paid by jt to its partners. If the partner has borrowed money from the partnership, it only means that he has divested to his own personal use a part of the capital which might have been invested for business purposes and has agreed to compensate the partnership by paying interest for it. There appears to be no reason why the interest paid by the partner should not be treated as profits made by the partnership.

10. In the case before us the Appellate Assistant Commissioner and the Tribunal treated the case of a partner, who had lent money to the partnership and had also borrowed money from it. as a case of double entry and treated the balance alone as the amount either borrowed by him from or lent by him to the partnership, as the case might be, and after having made this adjustment they disallowed all interest paid by the partnership to such a partner by reason of the provisions of Sections 10 (2) (iii) and 10 (4) (b) quoted above, while in the case of a partner.

who had borrowed more than he had lent, the excess amount paid as interest was treated as profits.

11. The Appellate Assistant Commissioner and the Tribunal thus treated the assessee most fairly and, our answer to the second question be in the affirmative. The assessee must pay the costs of this reference which we assess at Rs. 300/-.