

IN THE INCOME TAX APPELLATE TRIBUNAL
“SMC-A” BANGALORE BENCH

BEFORE SHRI N.V VASUDEVAN, VICE-PRESIDENT

ITA No.1605/Bang/2019
Assessment Year : 2016-17

Shri. Suresh Sreeram, 763, 5 th Main Road, Vijayanagar, Bangalore – 560 040. PAN : AXXPS 8850 J	Vs.	The Income Tax Officer, Ward–3(2)(2), Bangalore.
Appellant		Respondent

Assessee by	:	Shri. Narendra Sharma, Advocate
Revenue by	:	Shri. Ganesh R. Ghale, Jr. Standing Counsel

Date of hearing	:	25.01.2021
Date of Pronouncement	:	28.01.2021

ORDER

This is an appeal by the assessee against the order dated 21.05.2019 of CIT(A), Bengaluru, relating to Assessment Year 2016-17.

2. The only issue that arises for consideration in this appeal is as to whether the Revenue authorities were justified in disallowing a sum of Rs.23,23,496/- which was claimed as interest expenditure in relation to business of the assessee.

3. The assessee is an individual. The assessee filed his Income tax return for the AY 2016-17 on 21.12.2016, declaring Total Income of Rs 8,01,860/-. The assessee is a partner in the firm M/s Rama Hi-Power Tech and all income from the partnership firm including interest on capital, remuneration, commission, etc are includible as income under the head 'Profits & Gains

from business or profession' u/s.28(vi) of the Income Tax Act, 1961(Act). As per clause 4 of the partnership deed dt. 17.11.2002 of M/s Rama Hi-Power Tech, all the partners are entitled to interest on capital to the extent of 12% p.a. for the capital invested in the firm. It is the plea of the assessee that the partners have agreed that they would claim interest on capital only when profits are earned by the firm. The assessee has made substantial investments in the partnership firm and the net investment outstanding as on 31.03.2016 is Rs. 2,24,06,476 (after deducting losses incurred in previous years). There is no dispute between the assessing officer and the assessee that these borrowed funds were invested for the purpose of the partnership business as capital contribution. The assessee claimed deduction of interest of Rs.23,23,496 on funds borrowed for the purpose of investment as capital in the business of the partnership firm.

4. The computation of income under the head PGBP of the assessee was a Rs.4,06,633 and the same was as follows:

Sl.No	Income under head PGBP	Amount (in Rs.)
1	Profit earned from Vehicle hire charges	6,86,847
2	Income from consultancy services	8,36,200
3	Commission Income	12,07,082
4	Interest on Partner capital from M/s Rama Hi-Power Tech	NIL
	TOTAL	27,30,129
	Less: Interest on borrowed funds	(23,23,496)
	Net income taxable under head PGBP	4,06,633

5. The assessee was engaged in other business in his personal capacity viz., i.e. Vehicle hiring business, Commission Income and Consultancy

services. The income from these businesses were set off against loss from the business of “Income and salary from the partnership firm” of Rs.23,23,496. Though the computation of income as given above does not reflect this position, the correct position is that is a claim for set off of loss under the same head of income i.e., intra head adjustment which is permitted u/s.70 of the Act.

6. The Assessing Officer however held that no income has accrued to the assessee from the partnership business during the financial year 2015-16. The expenses do not have any nexus with the other source of income under the head PGBP i.e., vehicle hire, consultancy or commissioner expense. Hence, the interest expense was proposed to be disallowed u/s 37 of the Income tax Act as the expenses were 'not laid out wholly and exclusively for the purpose of business or profession'. The assessing officer also held that no interest was received from M/s Rama Hi-power Tech, the partnership business, in which the capital was invested and that the interest expense therefore cannot be allowed as deduction. The CIT(A) confirmed the order of the AO and he also held that the interest expense would be expenditure incurred for the purpose of earning income from the partnership firm in the form of share income and therefore the expenditure would be not allowable in terms of Sec.14A of the Act. This reasoning of the CIT(A) is incorrect because admittedly the firm incurred loss and the assessee did not receive any exempt income in the form of share of profits from the firm.

7. Aggrieved by the order of the CIT(A) the assessee is in appeal before the Tribunal. We have heard the rival submissions. The learned AR reiterated submissions made before AO and the learned DR relied on the order of the CIT(A).

8. We have carefully considered the rival submissions. It is an undisputed fact that in AY 2016-17 the partnership firm incurred heavy losses from its business and was not in a position to pay any interest on capital for the investment. Due to the poor financial condition of the partnership firm, the partners of the firm mutually decided to delay the withdrawal of interest on capital from the partnership and withdraw the same only when the partnership firm starts making profits. Though the partners were entitled to interest on capital @12% p.a. from the partnership firm as per the agreed partnership deed, the partners on mutual consent postponed this withdrawal of funds keeping in mind the financial losses being made by the partnership firm. The necessary Income Tax Returns & Balance sheet of Partnership firm was also filed before the AO. However, since the funds were borrowed from external sources, interest was payable by the assessee to its unsecured lenders. The partner claimed the deduction which it was entitled u/s 36(1)(iii) and 37 with income earned from other sources of income under the same head i.e. Vehicle hire, Commission Income and Consultancy income. This resulted in a loss arising from one source under the head business which was set-off with another source of income under the head of PGBP in terms of section 70.

9. Interest, salary, bonus, commission or remuneration received or receivable from the firm by the partners shall be assessable in the hands of the partners as income from business or profession under section 28 of the Act. The partner shall be entitled to all expenditure which is incurred to earn such income or for purposes of the said business. Other deductions as admissible in law can also be claimed by the partner against such income. Under the old provisions, section 67(3) entitled a partner to claim deduction in respect of any interest paid by a partner on capital borrowed by him for the purposes of investment in the firm from the share income. The Supreme Court in *CIT vs. Ramniklal Kothari (1969) 74 ITR 57 (SC)* held the share of the partner as business income in his hands and being business income expenditure necessary for the purpose of

earning that income and appropriate allowances are deductible there from in determining the taxable income of the partner. The Court held that the amount paid as salary and bonus to staff, expenditure for maintenance and depreciation of motor cars and travelling expenses expended by him in earning the income from firm are deductible from the income. The Delhi High Court in *CIT vs. Sohan Lal Nayar (1974) 95 ITR 90 (Del)* held that section 67(3) is not exhaustive and any deduction otherwise allowable under section 37(1) will have to be allowed even if it does not fall within the ambit of section 67(3) of the Act. Salary paid to a manager by a partner for looking after his interest in the firm stands allowed by the Madras High Court in *CIT vs. S. Meyyappan (1969) 73 ITR 20 (Mad)*. Therefore absence of earning any interest income on capital from the firm is no bar to claim the interest paid on borrowings for the purpose of contributing capital to the firm by the assessee as deductible expenditure. In such an event there would be loss under the head "PGBP" sub-head "interest, salary from the partnership firm" and the assessee is entitled to set off the said loss against other income under the same head "PGBP". We are also of the view that the reasoning of the CIT(A) that the interest expense would be expenditure incurred for the purpose of earning income from the partnership firm in the form of share income and therefore the expenditure would be not allowable in terms of Sec.14A of the Act. This reasoning of the CIT(A) is incorrect because admittedly the firm incurred loss and the assessee did not receive any exempt income in the form of share of profits from the firm.

10. For the reasons given above, we direct the AO to allow the claim of the assessee and allow the appeal.

11. In the result, appeal by the Assessee is allowed.

Pronounced in the open court on the date mentioned on the caption page.

Sd/-
(N.V VASUDEVAN)
Vice President

Bangalore,
Dated : 28.01.2021
/NS/*

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar
ITAT, Bangalore.