

IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH "A", HYDERABAD
(Through Virtual Hearing)

BEFORE SHRI A. MOHAN ALANKAMONY, ACCOUNTANT MEMBER
AND
SRI S.S. GODARA, JUDICIAL MEMBER

	ITA No.1706/Hyd/2017			
	A.Y. 2014-15			
ACIT, Circle-1, Karimnagar.	Vs.	Durga Granites, Karimnagar. PAN: AAGFD 8247 C		
(Appellant)		(Respondent)		
	Assessee by	Sri A. Srinivas		
	Revenue by	Sri Rohit Mujumdar, Sr. AR		
	Date of hearing:	02/12/2021		
	Date of pronouncement:	31/01/2022		

ORDER

PER A. MOHAN ALANKAMONY, A.M:

This appeal is filed by the Revenue against the order of the Ld. CIT(A)-2, Hyderabad in appeal No. 0346/2016-17, dated 30/06/2017 passed U/s. 143(3) r.w.s 250(6) of the Act for the A.Y. 2014-15.

2. The Revenue has raised three grounds in its appeal however, the cruxes of the issue are that

- (i) The Ld. CIT (A) has erred in deleting the addition made by the Ld. AO amounting to Rs. 3,25,50,207/- U/s. 68

of the Act being the unexplained partners investment in the assessee-firm.

- (ii) The Ld. CIT (A) has erred in deleting the addition made by the Ld. AO for Rs. 27 lakhs U/s. 40(b) of the Act towards claim of interest debited to the P & L Account of the assessee firm with respect to the unexplained investment of the partners of the firm.

3. The brief facts of the case are that the assessee is a firm engaged in the business as contractor filed his return of income for the relevant AY 2014-15 on 30/09/2014 admitting total income of Rs. 1,84,08,230/-. Subsequently, the case of the assessee was taken up for scrutiny and assessment was completed U/s. 143(3) of the Act vide order dated 9/11/2016 wherein the Ld. AO made addition of Rs.3,25,50,205/- U/s. 68 of the Act and Rs. 27,00,000 U/s. 40(b) of the Act.

4. During the course of scrutiny assessment proceedings, it was observed by the Ld. AO that the partners of the assessee company had introduced cash into the firm during the relevant assessment year on various dates in the form of capital as detailed herein below for which the source was not explained:

Sl No.	Name	Amount (Rs.)
1.	Sri N. Srirangarao	1,38,00,000

2.	Smt. N. Harita	20,00,000
3.	Sri V. Rajireddy	83,00,000
4.	Smt. V. Rama	30,00,000
	Total.....(A)	2,71,00,000

5. Similarly, the partners of the firm had also introduced cash into the firm by way of loan from partners the source of which could not be explained as detailed herein below:

Sl No.	Name	Amount (Rs.)
1.	Sri N. Srirangarao	51,97,796
2.	Smt N. Haritha	2,52,411
	Total.....(B)	54,50,207

6. Further, the assessee had debited interest at the rate of 12% on the amount introduced by the partners in the firm as detailed herein below:

Sl No.	Name	Amount (Rs.)
1.	Sri Srirangarao	12,92,000
2.	Smt Harita	1,70,000
3.	Sri Rajireddy	9,48,000
4.	Smt. V. Rama	2,90,000
	Total.....(C)	27,00,000

7. Since the source for the amount introduced in the firm as capital and loan was not properly explained the Ld.AO added the same in the hands of the assessee as unexplained credit U/s.68 of the Act. Further, since the interest credited to the partners account was in violation of

the provisions of section 40(b) of the Act, the Ld. AO disallowed the claim of expenditure towards such interest and added the same in the hands of the assessee. Accordingly, the Ld. AO made an aggregate addition of Rs.3,52,50,207/- viz., [(A) 2,71,00,000 + (B) 54,50,207 = 3,25,50,207 + (C) Rs. 27,00,000 = Rs. 3,52,50,207].

8. On appeal, the Ld. CIT (A) deleted the addition of Rs. 3,25,50,207/- by relying on the decision cited by the Ld. AR by observing as under:

"6.3. It is to be mentioned here that the AR relied on the decision of Hon'ble Telangana & Andhra Pradesh High Court in the case of CIT v. M.Venkateswara Rao & Others, dt: 27-08-2014 for the A.Y.1993-94. Relevant portion of the order is extracted as under:

"7. It is a matter of record that the respondent-firm comprises ten partners and each of them made contributions, be it in the form of cash or bank guarantees to be furnished to the Government. at the commencement of business. The returns submitted by the respondent-firm were processed. and the facts and figures furnished by it- were accepted. However, the matter was reopened at a later point of time. The Assessing Officer treated the capital raised by the firm in the form of contributions made by the partners as income. This conclusion was arrived at on the ground that source of income for the partners was not explained. Learned counsel for the appellant placed reliance upon the judgment of the Patna High Court in CIT v. Antipam Udyog (1983) 142 ITR 133 (Pat). The Tribunal rested its conclusions upon the judgment of the Bombay High Court in Narayandas Kedarnath v. CIT (1952) 22 ITR 18 (Born) and that of the Allahabad High Court in CIT v. Jaiswal Motor Finance (1983) 141 ITR 706 (All).

8. Section 68 of the Act no doubt directs that if an assessee fails to explain the nature and source of credit entered in the books of account of any previous year, the same can be treated as income. In this case, the amount, that is sought to be treated as income of the firm is the contribution made by the partners to the capital. In a way, the amount so contributed constitutes the very substratum for the business of the firm. It is difficult to treat the pooling of such capital, as credit. It is only when the entries are made during the course of business that can be subjected to scrutiny under section 68 of the Act.

9. Even otherwise, it is evident that the respondent explained the amount of Rs. 76.57.263 as the contribution from its partners. That

must result in a situation, where section 68 of the Act can no longer be pressed into service.

However, in the name of causing verification under section 68 of the Act. the Assessing Officer has proceeded to identify the source for the respective partners to make that contribution. Such an enquiry can, at the most be conducted against the individual partners. If the partner is an assessee, the concerned Assessing Officer can require him to explain the source of the money contributed by him to the firm. If, on the other hand, the partner is not an assessee, he can be required to file a return and explain the source. Undertaking of such an exercise. vis-a-vis the partnership firm itself, is impermissible in law. In the judgment relied upon by the appellant itself, the Patna High court held as under (page 137 of 142 ITR) :

"If there are cash credits in the books of a firm in the accounts of the individual partners and it is found as a fact that cash was received by the firm from its partners. then in the absence of any material to indicate that they are the profits of the firm, they cannot be assessed in the hands of the firm, though they may be assessed in the hands of the individual partners. Cash credits in the individual accounts of members of a joint family with third party cannot be assessed as the income of the family unless the Department discharges the burden of proof to the contrary. "

10. Therefore, the view taken by the Assessing Officer that the partnership firm must explain the source of income for the partners regarding the amount contributed by them towards capital of the firm cannot be sustained in law.

11. As regards the other amount, i. e., unexplained credit entries, the Tribunal took the view that the amount represented the security deposits made by the retail dealers, and the source thereof was properly explained. Nowhere in the order of assessment, the Assessing Officer recorded any finding to the effect that he verified the matter from the respective retail dealers and that such dealers have denied of making deposits. In the field of Arrack business, it is not uncommon that the retail dealers are required to keep security deposits with the supplier. At any rate, it is a pure question of fact. /I

As the issue involved is identical, the ratio laid down in the decision mentioned supra is hereby applied. Accordingly, the AD is directed to delete the addition of Rs.3,25,50,207 j- made in the hands of assessee firm. However, the AD can assess the same in the individual assessments of the partners, if they fail to satisfactorily explain the sources for the cash deposits made in their accounts. As a result, the grounds raised are allowed. "

9. Further, the Ld CIT deleted the addition made for Rs. 27,00,000/- towards interest credited in the partners' capital account by observing as follows:

"7. Next issue involved in this appeal is with regard to AD's action in disallowing interest amounts totalling to Rs.27,00,000/- paid by the assessee firm u/s, 40(b) of the Act. AO's observations are as under:

"Addition on account of interest paid on capital in the case of Sri N. Srirangarao:- As discussed above, the assessee firm had not substantiated the capital of Rs.2,13,00,000/-brought by the partners. However, the firm had claimed interest @ 12% on the capital. The capital account of Sri N.Srirangarao is gone through. The firm had credited an interest of Rs.12,92,000/- as interest @ 12% on the capital introduced. Since the assessee firm had not substantiated the capital brought, the said amount of Rs.12,92,000/- is added to the total income of the firm.

Addition on account of Interest paid on capital in the case of Smt. N.Haritha:- Likewise, the firm had credited total amount of Rs.1,10,000/-. Since the assessee firm had not substantiated the capital brought, the said amount i.e., Rs.1,70,000/- is added to the total income of the firm.

Addition on account of interest paid on capital in the case of Smt. N.Haritha:- Likewise, the firm had credited total amount of Rs.1,70,000/-. Since the assessee firm had not substantiated the capital brought, the said amount i.e., Rs.1,70,000/- is added to the total income of the firm.

Addition on account of interest paid on capital in the case of Sri V.Rajireddy:-

Likewise, the firm had credited total amount of Rs.9,48,000/- as interest paid on the capital introduced which is unexplained. Since the assessee firm had not substantiated the capital brought, the said amount i.e., Rs.9,48,000/- is added to the total income of the firm. "

10. Before us, the Ld. DR vehemently argued by stating that the source of investment made by the partners of the firm is not explained and since the amount is credited in the firm's book it should be treated as unexplained cash credit in the hands of the assessee firm. The Ld.

DR further argued stating that payment of interest in violation to section 40(b) of the Act cannot be allowed as deduction. Therefore the Ld. DR prayed that the Order of Ld.AO may be reinstated. The Ld.AR on the other hand relied on the Order of Ld.CIT(A) and argued in support of the same.

11. We have heard the rival submissions and carefully perused the materials on record. With respect to unexplained cash brought into the firm as partner's capital and loan from partners, neither the Ld. AR nor the assessee has established that the amount was accounted in the books of the respective partners of the firm. Hence, it is apparent that the amount of Rs. 2,71,00,000/- and the amount of Rs. 54,50,207/- is credited in the books of the assessee firm during the relevant assessment year without any corresponding entries in the books of the respective partners of the firm and there is no evidence to establish that the source of those funds are genuine and accounted. It is also obvious that the entire amount of Rs. 2,71,00,000/- and Rs. 54,50,207/- is appropriated and utilized by the assessee firm and not by the partners of the assessee firm. At this juncture, it is very relevant to examine the provisions of section 68 of the Act which is extracted herein below for reference:

11.1. The Provisions of section 68 stipulates as follows:

“Sec: S68. *Where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation*

about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year :

Provided *that where the assessee is a company (not being a company in which the public are substantially interested), and the sum so credited consists of share application money, share capital, share premium or any such amount by whatever name called, any explanation offered by such assessee-company shall be deemed to be not satisfactory, unless—*

(a) the person, being a resident in whose name such credit is recorded in the books of such company also offers an explanation about the nature and source of such sum so credited; and

(b) such explanation in the opinion of the Assessing Officer aforesaid has been found to be satisfactory:

Provided further *that nothing contained in the first proviso shall apply if the person, in whose name the sum referred to therein is recorded, is a venture capital fund or a venture capital company as referred to in clause (23FB) of [section 10](#).”*

12. From the above provisions of the Act and the facts of the relevant case before us it is crystal clear that the assessee firm is directly hit by the provisions of section 68 of the Act. Needless to mention that if the partners of the assessee-firm had introduced the cash in their respective books and thereafter transferred the same to the books of the assessee firm then probably the onus may be on the partners of the assessee firm to establish the source of the cash brought into their respective books and therefore addition may not be made in the hands of the assessee firm depending on the facts and circumstance of the case. However, in the case of the assessee it is apparent that the cash was never introduced in the books of the partners of the assessee firm, but it was merely introduced in the books of the assessee firm. Therefore, the onus is on the assessee firm to establish the genuineness of the cash introduced in its books. Since the assessee firm has failed

to establish the genuineness of the cash introduced in its books obviously the addition has to be made in the hands of the assessee firm as held by the Ld. AO. Therefore, we hereby set aside the order of the Ld. CIT (A) and confirm the order of the ld. AO on this issue. Further, neither the Ld. AR nor the assessee could establish that the amount debited in the P & L Account of the assessee firm as interest payable / paid to the partners of the assessee firm are not in violation of the provisions of section 40(b) of the Act. The Ld. CIT (A) has deleted the addition without making a clear finding on the issue. Therefore, we do not find any merit in the order of the Ld. CIT (A) on this issue also. Accordingly, we hereby set-aside the order of the Ld. CIT (A) on this issue and the order of the Ld. AO is hereby confirmed.

13. It is pertinent to mention that out above findings are based on the actual facts of the case which is not identical to the facts of the case cited by the Ld.AR and the Ld.CIT(A) and therefore the ratio stipulated in those decisions will not be applicable to the facts of this case before us.

14. In the result, appeal of the Revenue is allowed.

Pronounced in the open Court on the 31st January, 2022.

Sd/-
(S.S. GODARA)
JUDICIAL MEMBER

Sd/-
(A. MOHAN ALANKAMONY)
ACCOUNTANT MEMBER

Hyderabad, Dated: 31st January, 2022.

OKK

Copy to:-

- 1) Appellant: The Asst. Commissioner of Income Tax, Circle-1, Aayakar Bhavan, Karimnagar.
- 2) Respondent: M/s. Durga Granites, 2-10-1039/23, SRR Enclave, Jyothinagar, Karimnagar.
- 3) The CIT(A)-2, Hyderabad.
- 4) The Pr. CIT-2, Hyderabad.
- 5) The DR, ITAT, Hyderabad
- 6) Guard File