* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Judgment reserved on November 13, 2014
Judgment delivered on February 03, 2015

\+ ITA 336/2002
COMMISSIONER OF INCOME TAX, DELHI-VIII, NEW DELHI ..... Appellant
Through: Mr.Rohit Madan,Sr.Standing Counsel with Mr.Akash Vajpai, Advocate

versus

M/S. MUTHOOT FINANCIERS, NEW DELHI ..... Respondent
Through: Mr.Rajat Navei, Advocate with Mr.Kushagra Pandit, Advocate

\+ ITA 338/2002
COMMISSIONER OF INCOME TAX, DELHI VIII ..... Appellant
Through: Mr.Rohit Madan,Sr.Standing Counsel with Mr.Akash Vajpai, Advocate

versus

M/S. MUTHOOT FINANCIERS, NEW DELHI ..... Respondent
Through: Mr.Rajat Navei, Advocate with Mr.Kushagra Pandit, Advocate

\+ ITA 341/2002
COMMISSIONER OF INCOME TAX ..... Appellant
Through: Mr.Rohit Madan,Sr.Standing Counsel with Mr.Akash Vajpai, Advocate

versus

M/S. MUTHOOT M. GEORGE BANKERS ..... Respondent
Through: Mr.Rajat Navei, Advocate

with Mr.Kushagra Pandit, Advocate

\+ ITA 345/2002

COMMISSIONER OF INCOME TAX, DELHI VIII

..... Appellant

Through: Mr.Rohit Madan,Sr.Standing Counsel with Mr.Akash Vajpai, Advocate

Versus

M/S. MUTHOOT BANKERS, NEW DELHI

..... Respondent

Through: Mr.Rajat Navei, Advocate with Mr.Kushagra Pandit, Advocate

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE V.KAMESWAR RAO

V.KAMESWAR RAO, J.

1. This batch of appeals under Section 260-A of the Income Tax Act, 1961 ('Act', in short) even though pertains to the different assessees, involve a singular substantial question of law are being decided by this common order.

2. The substantial question of law as framed in these appeals is as under:

"Whether the Income Tax Appellate Tribunal was correct in law and on fact in holding that penalty under Section 271-D of the Income Tax Act,1961 could be levied on the assessee?

3. The facts in all these appeals are not disputed. They are common in the sense that the respondent assessee in all these appeals are

partnership firms involved in the business of banking and registered under the Kerala Money Lending Act. The assessees had filed return of income and it appears that the return of the income was processed accepting the returned income. Thereafter, notice under Section 148 of the Act was issued to the respondent-assessees. During the course of the assessment proceedings, it was found that the firm had accepted payments from the partners, during the relevant year corresponding to the Assessment Years, in cash. The details of the total amounts paid to the individual firm by the partners in all the aforesaid four appeals are as under:

Appeal No.	**Amount of advance made by the partners**	**Assessment Year**	**Amount of Penalty**
ITA No. 336/2002	Rs. 2,08,45,000/-	1996-97	Rs.2,08,45,000/-
ITA No. 338/2002	Rs.2,29,34,000/-	1998-99	Rs.2,29,34,000/-
ITA No. 341/2002	Rs.52,600,000/-	1998-99	Rs.5,90,00,000/-
ITA No. 345/2002	Rs.66,530,000/-	1998-99	Rs.66,530,000/-

4. It was the case of the assessees before the Assessing Officer (as noted from ITA No. 341/2002) that in the case of a partnership firm, there is no difference between the firm and the partners. As a partner of the firm, he is a part of the firm itself. Section 269-SS of the Act has no application in a transaction between the partner and the firm. The Assessing Officer, in his order, was of the view that the partners and the firm being two distinct and separate entities/persons are also in the

mischief of Section 269-SS of the Act. According to him, the assessees had maintained three accounts; (1) capital account, (2) current account, (3) loan account. As per the partnership deed of the firm, Rs. 10,000/- was contributed equally by all the partners. It was his conclusion that the transactions under reference were not part of the current account or the capital account. He held that interest was given to the partners on the amount advanced, which conclusively proved that transactions are between different persons whereby the firm has accepted and repaid loans in cash, and accordingly, initiated the proceedings under Section 271-D and 271-E of the Act and thereby imposed penalty under Section 271-D of the Act.

5. In appeals, the Commissioner of Income Tax (Appeals) upheld the order of the Assessing Officer imposing penalty under Section 271-D of the Act. The relevant observation of Commissioner of Income Tax (Appeals) in ITA 336/2002 is as under:-

> *"40. The Bombay ITAT had held that both the Assessing Officer and the CIT(A) have held and correctly that there was absolutely no reason for making or receiving cash payments in the present case. In case the transactions were with partners or members of their family or the sister concerns, it was all the more necessary that such transactions ought to*

have been entered into in cash but by crossed account payee cheques or drafts. In this connection, counsel referred to s.273B and submitted that the explanation offered by the assessee shows a reasonable cause for the failure of the assessee to comply with the provisions of s.269-SS and 269-T. This argument is not acceptable. The circumstances clearly indicate that in transactions of this type between persons who are connected, it is all the more necessary that such transactions are to be made only in conformity with the provisions of s.269-SS/269-T. It would be difficult to accept the contention of the assessee that the nature of the assessee's business was such where cash transactions are inevitable. The assessee is engaged in the business of building/road construction. The nature and type of the business, is not such, which may necessitate sudden or immediate or unforeseen requirement of cash. Moreover, it has not been substantiated with the aid of cash book and other books of account that on the dates on which the questioned transaction took place the assessee, in the case of cash receipts and also in the case of cash payments, was in dire need of money. Taking the totality of the relevant facts and circumstances there was no reasonable cause for the failure of the assessee to comply with the provisions of s.269-SS and 269-T.

41. In the present case, I find that the appellant has no where made out a case that there was a reasonable cause for taking cash payment from its partners in the discharge of his business. The appellant was aware as early as for assessment year 1989-90 in the case of his sister concern M/s. Muthoot M. George Bankers that penalty u/s 271D was leviable in the case of cash loans taken from sister concern. The appellant has a ground of money lending concerns which are making cash transactions amongst each other. Even in appeal before me, the issue of penalty u/s 271-D in the cases of several other sister concerns is pending. The appellant cannot claim, after a passage of several years that he was unaware of the provisions of Section 269-SS read with Section 271-D. This is specially relevant as the appellant has benefit of expert legal advisors and it is presumed that his legal advisor would do the necessary due diligence to ensure that there was no violation of the provisions of Income-tax Act. There is also not a single instance of violation of Section 269-SS. The appellant has borrowed crores of rupees from its partners. There can be no "reasonable cause" with respect to the systematic violation of Section 269-SS. I, therefore, uphold the penalty imposed u/s 271-D of the I.T. Act in view of the IT Act."

6. On further appeals, the Income Tax Appellate Tribunal (Tribunal, in short), was of the view that the effect that advanced made to the firm by one of its partners cannot be regarded as a loan advanced to the firm. It was also the conclusion that there was no dispute that the amount taken is capital of the firm and amount being not a loan, it cannot be said that the advance made is said to have violated the terms of the Statute. The following is the conclusion of the Tribunal in ITA 336/2002:-

> *"5. We have heard the parties and taken ourselves through the record. The undisputed fact is that Mr.George is a partner in the firm. It is also not in dispute that money has been brought into the firm by Mr.George. The other undisputed fact is that source of money which has been brought into the firm is not disputed by the revenue. The legal precedent cited by the ld. AR are all to the effect that the advance made to the firm by one of its partners cannot be regarded as a loan advanced to firm. The prohibition u/s 269-SS is not the loan or to the advances made to the firm. In view of the settled legal position, the amount brought by the partner to the firm cannot be said to be a loan. It is also not in dispute that the amount taken is capital of the firm in view of the language of the Section 269-SS. We do feel that the amount brought by the partner to the firm in these circumstances, be it in cash cannot be said to have violated the terms of*

statute."

7. Mr.Rohit Madan, learned counsel appearing for the appellant-revenue would contend that the Tribunal was wrong in allowing the appeal of the respondent-assessee by construing the payments made by one of its partner, cannot be regarded as loan advanced to the firm. According to him, the firm and its partners are separate legal entities for the purpose of the Act and the amount advanced is a loan and further the amount being over Rs. 20000/- could not have been given in cash. He relied upon the judgment of this Court in the case of ***Commissioner of Income Tax Vs. Nagpur Golden Transport Co., [1998] 233 ITR 389 (Delhi)*** and ***Soundarya Textiles Vs. Assistant Commissioner of Income Tax, [2014] 362 ITR 488 (Ker)*** in support of his contentions.

8. On the other hand, Mr.Rajat Navei, Advocate appearing for the respondent-assessees in these appeals would contend that the amount advanced being from a partner to the firm cannot be regarded as a loan but, is a capital of the firm and the transaction cannot be taken as an independent transaction as the partnership firm has no separate legal entity nor is there a separate identification between the firm and the partner. He would state that as such, there is no violation of Section 269-SS of the Act. In this regard, he relied upon the following judgments:

1. *(1977) 1 SCC 431, Commissioner of Income Tax, Madras Vs. R.M.Chidambaram Pillai & Ors.*
2. *(2013) 354 ITR 9 (Mad), Commissioner of Income Tax Vs. V.Sivakumar.*
3. *(2008) 304 ITR 172 (Raj), Commissioner of Income Tax Vs. Lokhpat Film Exchange (Cinema).*
4. *(2005) 277 ITR 420 (P&H), Commissioner of Income Tax Vs. Saini Medical Store.*
5. *(2009) 315 ITR 163 (P&H), Commissioner of Income Tax Vs. Sunil Kumar Goel.*

9. Having heard the learned counsel for the parties, we are of the view that the answer to the issue which arises for our consideration has its contours in realm of the Partnership Law as well as the Act. In fact, the status of partners qua the firm has been summed up by the Supreme Court in the case of *R.M.Chidambaram Pillai (supra)*, wherein the interplay between provisions of the two enactments was examined. The Supreme Court was of the view that a firm is not a legal person even though it has some attributes of the personality. According to the Court, partnership is a certain relation between persons, the product of agreement to share the profits of a business. 'Firm' is a collective noun, a compendious expression to designate an entity, not a person. In Income Tax Law, a firm is a unit of assessment by special provisions but is not a full person; which leads to the next step that since a contract of

employment requires two distinct persons viz. the employer and the employee, there cannot be a contract of service, in strict law, between a firm and one of its partners. So that any agreement for remuneration of a partner for taking part in the conduct of the business must be regarded as portion of the profits being made over as a reward for the human capital brought in. The Supreme Court, further relying upon its own judgment reported as ***Commissioner of Income Tax, Bihar vs. Ramniklal Kothari [1969] 74 ITR 57 SC,*** wherein it had concluded that business of the firm was a business of the partner and the profits of the firm, were the profits of the partners and the expenditure incurred by partners in earning such shares was admissible for deduction in arriving at the total income under Section 10(1) of the Act. The Supreme Court quoted from the commentary of well-known author namely A.C.Sampath Iyengar, 6th Edn. 1973-pp. 1063-1064 (Vol. II), gave the following summary as under:

> *"Any interest, salary, bonus, commission or remuneration paid by a firm to any of its partners cannot be deducted by the firm as an expenditure in its profit-computation. The reason is this: The partners in a firm are ultimately entitled to the entire profits of the firm, according to their shares in the business. Therefore, the entirety of such profits should be brought to charge and*

no portion be exempted by giving' the same away to a partner as his salary, bonus, commission, remuneration or interest. A partner is bound to find the necessary finances for the partnership and hence any interest on capital supplied by the partner is not deductible. A partner's rendering services to the firm stands on the same footing as his providing capital; only instead of in money, in kind. Further, no remuneration is permissible to a partner for his rendering services to the firm, since the carrying on of the business of the partnership is a' primary duty which, all the partners, or some of the partners acting for all, are required to do by the law relating to partnership.

The matter may be looked at another way too. In law, a partner cannot be employed by his firm, for a man cannot be his own employer. A contract can only be bilateral and the same person cannot be a party on both sides, particularly in a contract of personal employment. A supposition that a partner is employed by the firm would involve that the employee must be looked upon as occupying the position of one of his own employers, which is legally impossible. Consequently, when an arrangement is made by which a partner works and receives sums as wages for services rendered, the agreement should in truth be regarded 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. Hence, all the aforesaid payments are non-deductible."

10. The aforesaid conclusion of the Supreme Court was referred to by the Madras High Court in *V.Sivakumar's* case *(supra),* wherein the assessee was a partner in four firms and the proprietor in Reliance Realtors and in the Assessment Year 2005-06, the assessee had taken loan from the four firms which were found to be in cash. The Assessing Officer initiated penalty proceedings under Section 271D of the Act and imposed penalty of Rs. 18 lakhs. The Commissioner of Income Tax (Appeals) dismissed the appeal. On a further appeal before the Tribunal, the Tribunal remitted the matter to the Assessing Officer to give a definite finding whether the transaction was between the firm and partner. The Assessing Officer passed a fresh order that the assessee individual was a partner in four firms from where funds had been advanced to the assessee and imposed a penalty of Rs. 18 lakhs. The Commissioner of Income Tax (Appeals) allowed the appeal holding that the transactions between the partner and the firm do not partake the character of a loan or deposit and therefore, there is no applicability of the provisions of Section 269-SS of the Act. The further appeal preferred by the revenue was dismissed by the Tribunal which resulted in

the revenue filing an appeal before the High Court. The High Court dismissed the appeal filed by the revenue, upholding the conclusion of the Tribunal that there is no separate legal entity for the partnership firm and the partner is entitled to use the funds of the firm.

11. We further note that even the Rajasthan High Court in the case of ***Commissioner of Income Tax Vs. Lokhpat Film Exchange (Cinema), (2008) 304 ITR 172 (Raj)***, relying upon the decision of the Supreme Court in *R.M.Chidambaram Pillai (supra),* dealing with identical facts, wherein, the firm during the relevant Assessment Year, received deposits from its partners. The Assessing Officer, considering it be a intra-party transactions of deposit, otherwise, than by way of a cheque or by bank draft, considered the payment and repayment in violation of Section 269-SS and 269-T of the Act, imposed penalty, for receiving deposits in cash and payment in cash. The Court after consideration, has held that the partnership firm being not a juristic person, the inter-se transaction between the firm and the partners are not governed by the provisions of Section 269-SS and 269-T of the Act.

12. At the same time, we note that the Supreme Court in the case of ***Commissioner of Income Tax, West Bengal Vs. A.W.Fijjies and Co. and Ors. [1953] 24 ITR 405(SC)***, held that the partners of the firm are distinct as a civil entities while the firm as such is a separate and distinct

unit for the purpose of assessment.

13. The question raised is whether in a transaction between the firm and the partner the provision of Section 269SS would be attracted and if we hold that Section 269SS was attracted and therefore violated, whether the respondent assessee would be entitled to benefit of Section 273B of the Act. The position that emerges is that there are three different High Courts, which have held that Section 269SS would not be violative when money is exchanged inter-se between the partners and partnership firm in spite of the fact that the partnership firm and individual partners are separate assessees. We appreciate and understand that the opposite view is possible. Keeping in view that three different High Courts have taken a consistent view on the facts, which are similar to the facts in the present case, which includes the judgment of the Madras High Court as late as in the year 2013, we respectfully follow the same line of reasoning given by the Madras High Court in the case of ***V.Sivakumar*** (supra).

14. Having said that, it is clear that any interest, salary, bonus, commission or remuneration paid by a firm to any of its partners should be regarded as a mode of adjusting the amount that must have been taken to have been contributed to the partnership assets by a partner, who can really contribute in kind as well as in money. Applying this principle,

we are of the view that the transaction effected in these cases cannot partake the colour of loan or deposit and as such, Section 269-SS nor Section 271-D of the Act would come into play.

15. We further find, it is an undisputed fact that the money was brought by the partners of the assessee-firms. The source of money has also not been doubted by the appellant revenue. The transaction was bona fide and not aimed to avoid any tax liability. Creditworthiness of the partners and genuineness of the transactions coupled with the relationship between the "two persons" and two different legal interpretations put forward could constitute a reasonable cause in a given case for not invoking Section 271-D and 271-E of the Act. Section 273B of the Act would come to the aid and help of the respondent-assessee. In this regard, we refer to the judgment of the Punjab and Haryana High Court in the case of *Saini Medical Store (supra)*, as under:

> *"6.1 As pointed out earlier, there is no doubt about the genuineness of the transactions which have been fully accepted in the assessment made for the year under consideration. Even if, there is any ignorance, which resulted in the infraction of law, the default is technical or venial which did not prejudice the interests of the Revenue as no tax avoidance or tax evasion was involved. To my mind, bona fide belief coupled with the genuineness of the transactions would constitute reasonable cause under*

Section 273B for not invoking the provisions of Section 271E of the Act, The impugned order of penalty is cancelled."

13. The findings of the Commissioner of Income Tax (Appeals) have been confirmed in appeal by the Tribunal.

14. Therefore, the findings recorded by the Commissioner of Income Tax (Appeals) and the Tribunal that the assessee had shown reasonable cause for the failure to comply with the provisions of Section 269T of the Act is a finding of fact based on appreciation of material on record. It does not give rise to any question of law much less substantial question of law.".

16. Even, in the case of *Sunil Kumar Goel (supra),* it was observed:-

"The Income Tax Appellate Tribunal was right in recording its conclusion that a "reasonable cause" had been shown by the respondent-assessee. The Income Tax Appellate Tribunal relied on the fact that the respondent-assessee had produced his cash books, depicting loans taken by him unilaterally before the Revenue. Another fact taken into consideration was that no prejudice was caused to the Revenue in the instant action of the respondent-assessee inasmuch as the respondent-assessee did not attempt by the impugned act to avoid any tax liability. Furthermore, there is no dispute about the fact that the instant cash transactions of the respondent-assessee were with the sister concern and that these transactions were

between the family and due to business exigency. A family transaction, between two independent assessees, based on an act of casualness, specially in a case where the disclosure thereof is contained in the compilation of accounts and which has no tax effect, in our view establishes "reasonable cause" under Section 273B of the Act. Since the respondent-assessee had satisfactorily established "reasonable cause" under Section 273B of the Act he must be deemed to have established sufficient cause for not invoking the penal provisions (sections 271D and 271E of the Act) against him".

17. Insofar as the judgments relied by the learned counsel for the appellant-revenue, are concerned, we first refer to the judgment in the decision of this Court in *Nagpur Golden Transport Company (supra).* At the outset, we note that the said case was not with regard to the violation of Section 269-SS or the penalty imposed under Section 271-D of the Act. Even on facts, it is seen that assessee firm in that case namely Nagpur Golden Transport Company has paid interest to the firm Laxmi Chand Jiwan Dass. The controversy arose because the partner in the firm Laxmi Chand Jiwan Dass was the same as in the assessee firm i.e. Nagpur Golden Transport Company. The Income Tax Officer formed the opinion that the payment of interest by one firm to the other was the payment to the partners of the firm inasmuch as the partners in the two

firms were common, attracting the applicability of Section 40(B) which has an overriding effect on the provisions of Section 36 of the Act. It was in the aforesaid context, this Court had held that under the scheme of the Act, the firm and its partners are treated as separate legal entity so far as the provisions of tax laws are concerned, moreso, by framing an order of the assessment, the firm and its partners are treated as two separate legal entitles. The said judgment is therefore, not applicable to the facts here. Similarly, the judgment relied by Mr. Rohit Madan in *K.Kelukutti (supra).* The question in that case was whether partners constituting a partnership firm carrying on one business constitute thereafter another partnership firm carrying on a separate and distinct business, are two distinct partnership firms, in whose hand, the turnover of the two businesses falls to be respectively assessed or is there in law only a single partnership firm liable to assessment on the turnover of both businesses. Suffice to state, the question which fell for consideration of the Supreme Court being not identical to the one which falls for our consideration in these appeals, we do not think, the same would be of any help to Mr. Rohit Madan.

18. In view of the submissions made, we are of the view that the present appeals filed by the revenue are devoid of any merit. We answer the substantial question of law against the revenue and in favour of the

respondent-assessees.

19. The appeals are accordingly dismissed. No costs.

(V.KAMESWAR RAO)
JUDGE

(SANJIV KHANNA)
JUDGE

FEBRAURY 03, 2015
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