REPORTABLE

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

\+ **ITA No. 955 of 2010**

Reserved On: 20th October, 2010
% **Pronounced On: 01st November, 2010**

KARAN RAGHAV EXPORT (P) LTD. . . . Appellant

through : Dr. S. Narayan, Sr. Advocate with Mr. Rajiv K. Garg and Mr. Ashish Garg, Advocates.

VERSUS

COMMISSIONER OF INCOME TAX . . .Respondent

through: Ms. Rashmi Chopra and Mr. Chandarmani Bharadwaj, Advocates.

CORAM :-
HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MR. JUSTICE SURESH KAIT

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. This appeal was admitted on the following substantial questions of law:

   1.) Whether the depreciation claimed on the factory building owned by the assessee but used in the business of the firm in which the assessee was a partner, rightly rejected by the Tribunal ignoring the settled law on the issue?

2.) Whether the claim for deduction of the insurance charges of ₹64,800 paid by the assessee against fire risk of the said factory building owned by the assessee but used in the business of the said firm in which the assessee was partner was rightly rejected by the Tribunal on the sole ground that only the interest paid on borrowals invested as capital in the partnership firm as capital is allowable as deduction?

2. The factual premise, which needs to be noted under which these questions have arisen for consideration, is in a narrow compass and runs as follows:

The appellant assessee is a private limited company. One of the assets owned by it is the factory building located at 225, Udyog Vihar, Phase-I, Gurgaon, Haryana. The partnership firm with the name, M/s. Gaurav International (hereinafter referred to as 'the firm') was formed in which the assessee became a partner. The firm is engaged in an export business. The assessee contributed its capital in the form of building and cash. Partnership Deed dated 02.04.2004 was written in this behalf. As per this Deed, the assessee agreed to provide its aforesaid factory premises at 225, Udyog Vihar, Phase-I, Gurgaon, Haryana (hereinafter referred to as 'factory building) for the use of partnership business.

3. We are concerned herewith the Assessment Year 2005-06. In this year, the assessee company received its share of profit of ₹12.38 lacs from the firm. It was also agreed between the partners that interest would be paid to the partners on the capital contributed by them to the firm in cash. Thus, the assessee company also received interest of ₹2.52 lacs on the cash capital contributed to the said firm. The share of profit earned from the partnership firm is exempted from tax under Section 10(2A) of the Income Tax Act (hereinafter referred to as 'the Act'). Thus, in the return of income, which was filed by the assessee, it showed interest income as well. In the return, the assessee also claimed deduction on account of depreciation on its factory building property as well as deduction on account of insurance premium paid in respect of the aforesaid factory building. These deductions were claimed against the interest income earned from the partnership firm.

4. The Assessing Officer (AO) rejected the claim of depreciation on the plea that the factory building was not used by the assessee for the purpose of its own business, but was used by the partnership firm. The claim with regard to the insurance charges was, however, allowed by the AO. In appeal, CITA (A) upheld the action of the AO insofar as it declined the claim of depreciation. He further opined that no expenditure was allowable against the exempt income. Therefore, the claim of insurance charges, which was allowed by the AO was also reversed by the CIT (A) and added to the income of the assessee.

5. The assessee assailed the order of the CIT (A) unsuccessfully inasmuch as the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') has dismissed the appeal of the assessee vide its impugned judgment dated 24.12.2009.

4. It is in this backdrop that the question has arisen as to whether the factory building which is owned by a partner and is allowed to be used by the partnership firm would be treated as the premises used by the partner himself. Dr. S. Narayan, learned Senior counsel, who appeared for the assessee submitted that the main submission of the appellant has totally been glossed over by the Tribunal. He pointed out that it was argued before the Tribunal that a partnership firm does not enjoy any separate legal entity in law. It is synonym with partners. Section 2(6B) of the Act clearly provides that "firm", "partner" and "partnership" will have to same meaning as in the Indian Partnership Act. The only proviso, which is added is that even a minor, who is admitted to the benefits of partnership will be treated as a "partner" for the purposes of Income Tax Act. Thus, when the partnership is the *alter ego* of its partners without having its own entity, the assets used by the firm is also be treated as the assets used by the partners themselves. On this analogy, he submitted that the asset which was admittedly used by the partnership firm had to be treated, in law having been used by the assessee company and therefore, conditions stipulated under Section 32 of the Act stood fulfilled. He referred to the following judgments in support of his

submission, again pointing out that these judgments were cited before the Tribunal, but were not considered by the Tribunal:

(i) ***Commissioner of Income Tax*** Vs. ***Ramnik Lal Kothari*** **[74 ITR 57]** wherein the Supreme Court explained the principle in the following words:

> "6. Where a person carries on business by himself or in partnership with others, profits and gains earned by him are income liable to be taxed Under Section 10 of the Indian Income-tax Act, 1922. Share in the profits of a partnership received by a partner is "profits and gains of business" carried on by him and is on that account liable to be computed Under Section 10, and it is a matter of no moment that the total profits of the partnership were computed in the manner provided by Section 10 of the Income-tax Act and allowances admissible to the partnership in the computation of the profits and gains were taken into account. Income of the partnership carrying on business is computed as business income. The share of the partner in the taxable profits of the registered firms liable to be included Under Section 23(5)(a)(ii) in his total income is still received as income from business carried on by him……."

(ii) ***Commissioner of Income Tax, Madras-II*** Vs. ***K.G. Sadagopan*** **[104 ITR 412]** in which identical issue of claiming depreciation in similar circumstances was allowed by the Madras High Court as under:

> "1……..At the instance of the assessee the following question has been referred:
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> > "Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the assessee was entitled to deduction on account of depreciation on assets owned by him and used for the profession of the firm of which he was a member ?"
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> 2. The depreciation is allowable under Section 32 of the Income-tax Act in respect of buildings, machinery, plant or furniture owned by the assessee and used for the purpose of business or profession. On the finding of the Income-tax Officer, the

assessee is the owner of the assets of the clinic and the nursing home. The only dispute was whether these assets were used for the purpose of the business or the profession of the assessee. This court has held in M. CT. Muthiah v. Commissioner of Income-tax 1974]97ITR516(Mad) following the decision in Commissioner of Income-tax v. Ramniklal Kothari, [1969]74ITR57(SC) that in the case of a partnership the business is not carried on by the partnership as such, but the business shall be deemed to be the business of the partners If that is so, certainly the assessee in this case had used the assets for the purpose of his business as he was a partner of the firm. The Appellate Assistant Commissioner and the Tribunal were, therefore, right in holding that the depreciation was allowable in the individual assessment of the assessee. We, accordingly, answer the reference in the affirmative and against the revenue."

(iii) ***Commissioner of Income Tax*** Vs. ***P. Janki Bai*** **[87 ITR 645]**, the decision rendered by the Andhra Pradesh High Court where, the Court has relied upon the judgment in the case of ***Ramni La Kothari (Supra)*** as under:

"5. In the light of these decisions and other decisions which took a similar view, Sri Rama Rao, standing counsel for the department, conceded that the depreciation on the building of the assessee used for the purpose of business of the firm, of which she was a partner could be allowed as a permissible deduction under the Indian Income-tax Act, 1922, but he submitted that the position under the Act of 1961 is different. Though the latter Act contains provisions similar to Sections 10(2)(vi) and 10(2)(xv) of the Indian Income-tax Act, 1922, there is a special provision, namely, Section 67, which deals with the method of computing a partner's share in the income of the firm. Under Section 67(3) it is provided that any " interest paid by a partner on capital borrowed by him for the purposes of investment in the firm shall, in computing his income chargeable under the head ' Profits and gains of business or profession in respect of his share in the income of the firm, be deducted from the share". He argued that the sub-section is exhaustive of the permissible deductions in computing a partner's share in the income of the firm, and except the interest paid by the partner on the capital borrowed by him, no other deduction is permissible. He submitted that the provisions in Sections 30 to 37 which provide for various

> deductions have no application to the case of a partner's share in the income of the firm. He relied on decisions which lay down that if there is a special provision and a general provision in an enactment, the special provision shall prevail : vide South India Corporation (P.) Ltd. v. Secretary, Board of Revenue, [1964]4SCR280 and Subhodchandra Popatlal v. Commissioner of Income-tax, and Excess Profits Tax. We do not consider that this principle has any application to the circumstances of this case. We do not find anything in the Act of 1961 which either expressly or impliedly precludes the application of Sections 30 - 37 to the case of a partner's share in the income from the firm. It is true, Section 67 refers to the method of computing a partner's share and Section 67(3) provides for deduction of interest paid by a partner on capital. The section, however, does not provide that any other deduction is not permissible. We do not find anything in the Act which will also imply that deductions under Sections 30 - 37 are not permissible in, the case of a partner's share in the income of the firm.
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> 6. On the other hand, a perusal of the legislative history of this section leads to a contrary conclusion. In the twelfth report of the Law Commission of India, which deals with revision of the Indian Income-tax Act of 1922, the, clause corresponding to Section 67(3) was Clause 69(3) which was as follows:
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> > " Any interest paid by a partner on capital borrowed for the purposes of investment as his capital in the firm shall, in computing his income charge--able under the head ' Profits and gains of business, profession or vocation' in respect of his share in the income of the firm, be deducted from the share, but no other deduction shall be allowed in respect of the said share."

5. The learned counsel also submitted that as per Section 37 of the Act, the assessee was entitled to expenses incurred in the course of business. Since business of the firm was carried out by the assessee as its partner and the property was used for the said business, the insurance amount paid in insured factory premises was an expense qua the said business and was, thus, allowable.

6. He also referred to the CBDT Circular No. 636 dated 31.08.1992, which contains explanatory notes on the provisions relating to direct taxes introduced by the Finance Act, 1992. Amendment to Section 10 by inserting sub-section (2A) was made by this Act and he highlighted that the purpose was to avoid double taxation, viz., first taxing partnership firm and thereafter taxing the share of profits in the hands of partners again. Therefore, his argument was that this provision had not made any difference.

7. Ms. Rashmi Chopra, learned counsel appearing for the Revenue, on the other hand, argued that the judgments cited by the appellant were of pre 1992 period, viz., before Section 10 was amended by introducing sub-section (2A) therein. Her submission was that this provision made make all the difference insofar as taxation is concerned. Sub-Section (2A) reads as under:

> "(2A) In the case of a person being a partner of a firm which is separately assessed as such, his share in the total income of the firm."

8. She, thus, argued that the position prior to this amendment was different, viz., the partner-assessee was also liable to pay the tax on the share of profits received by him even when the tax was paid by the partnership firm as well on the profits earned by it. It was in this context that the share of profits at the hands of partner was treated as profit from the partnership firm and the depreciation, etc. could be allowed if the assets belonging to a partner by the partnership firm. According to her, this situation is

altered after the amendment, as now it is only the partnership firm which bases the tax on its income when the share is received by a partner that is exempted from tax. Therefore, it is not treated as income in the hands of the partner. In the absence of the same as income, the question of allowing any deduction in the form of depreciation or insurance charges would not arise in view of provisions of Section 14A of the Act.

9. She further submitted that though the Tribunal has not discussed the cases cited by the appellant, there was a proper and complete discussion in this behalf by the CIT (A), who held that in view of Section 10(2A) of the Act, such decisions were not applicable. We hereby quote from the order of the CIT (A) as that forms the argument of Ms. Rashmi Chopra, learned counsel for the Revenue:

> "3.5 As mentioned above the appellant has earned interest of ₹2,52,000 from the partnership firm on the cash amount lying to its credit with the partnership firm. The appellant has claimed the deduction towards depreciation on this factory building in the P & L A/c wherein interest income u/s 28(v) is credited and offered for taxation. The computation of income under the head 'profit and gains of business or profession' is made in accordance with the provisions of section 29. The said section 29 provides that it is done in accordance with provision of section 30 to 43D. The depreciation is covered by section 32 and therefore, it is to be considered if the depreciation on the factory building which is claimed by the appellant has been with reference to the earning of income u/s 28 and more specifically u/s 28(v) of the Act? The said Section 28(v) reads as under:
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> > "any interest, salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from such firm;
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> > Provided that where any interest, salary, bonus, commission or remuneration, by whatever name called, or any part thereof has not been allowed to be deducted under clause (b) of section 40, the income under this clause shall be adjusted to the extent of the amount not so allowed to be deducted.

Thus, while computing the income chargeable under the head "business or profession" on account of the interest received by the appellant from the firm, only that expenditure which has been incurred for the purposes of earning such income can be allowed as deduction. Depreciation on factory building claimed by the appellant is not an expenditure incurred by the appellant for earning of the said income/interest because earning of interest and claim of depreciation operate in two different and un-related spheres. Moreover, for the purposes of claim of depreciation, it is essential that the assets shall be used for the purpose of the business or profession of that person. AS indicated in para 3.2 above, the business of the appellant company is not to give its assets to partnership firms and therefore, it cannot be said that by giving the assets of the appellant to the partnership firm, the appellant did use the said asset for the purpose of his business. Thus, the claim made by the appellant company on this account cannot be allowed.

3.6 The other component received by the appellant from the partnership firm is "share of profit" which is exempt u/s 10(2A) of the Act. As the said profit is exempted, provisions of Section 14A come into play. This section provides that no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act. Thus, no deduction is admissible to the assessee for any expenditure incurred in relation to the earning of the exempted income. If the appellant is of the view that it has earned its 'share of profit' by allowing the use of factory building to the partnership firm and accordingly depreciation is claimed, the said claim/benefit would be inconsistent with the provisions of Section 14A. On this account also, the appellant cannot be permitted to claim depreciation.

3.7.1 The case laws on which the appellant has relied are not applicable to the facts and the circumstances of the case. The provisions for taxability of the partnership firms were materially changed by the Finance Act, 1992 w.e.f 1.4.1993. The provisions of section 10(2A) and 28(v) were introduced simultaneously by the Finance Act, 1992. All the case laws of which the appellant has relied are for the cases/matters pertaining to the period prior to 1.4.1992 and therefore, the ratio laid down by these judgments is not applicable now. Thus, no weightage can be accorded to the ratio of these decisions in the present regimen.

3.7.2 Without prejudice to the above, the decision relied upon by the appellant in the case of Ramni Lal Kothari (supra) does not support the case of the appellant. The facts of the case were that the assessee was a partner in four firms. The issue was if he was entitled to deduct from his share of the profits from the firms amounts paid as

> salary and bonus to staff, expenses for maintenance and depreciation of motor cars and travelling expenses expended by him in earning the income from the firms. Under these facts and in view of the fact that the share of the partner is business income in his hands for the purpose of section 10(1) of the Indian Income-tax Act, 1922, (now corresponding section is 28), expenditure necessary for the purpose of earning that income and appropriate allowances are deductible therefrom in determining the taxable income of the partner. As mentioned above, now the share of profit from the partnership firm is exempt and not chargeable under the head "business" and therefore, the appellant cannot claim any deduction from it."

10. We are of the opinion that in the facts of this case, it is rightly held by the Authorities below that Section 10(2A) read with Section 28(v) of the Act, the position in law has changed and the judgments cited by the learned counsel for the appellant would be of no avail. We agree with the reasoning of CIT (A) and Tribunal. We have already reproduced above the discussion in CIT (A)'s order. The Tribunal has dealt with the issue as under:

> "3..... The computation of income under the head "profit and gains of business or profession" is made in accordance with the provisions of Section 29. Section 29 provides that deduction eligible u/s 30 to 43D is to be allowed while computing the business profits. The claim of depreciation on the building contributed by the assessee for the purpose of its business is to be considered u/s 32. Thus, whatever the assessee company has earned either in the form of share of profit or interest which is a business income of the assessee has to be computed after allowing deduction of expenditure permissible u/s 30 to 43D. Section 14A stipulates for disallowance of expenditure against the exempt income. However, if the expenditure is incurred in respect of the exempt income, such expenditure is to be reduced from the exempt income and the net exempt income is to be considered while computing the net profit. Section 14A declines such claim of expenditure which is incurred for earning exempt income, against the income liable to tax. In the instant case, the assessee has not claimed expenditure against the exempt income which is in the form of share of profit, but against the income liable to tax u/s 28(v), under the head "income from business and profession".

> 4. In the instant case, the assessee's claim for depreciation allowance is required to be examined in terms of Section 32 which stipulates that asset should be owned by the assessee and it should have been used for the purpose of business of the assessee. First condition with regard to ownership of factory building is established. However, uncontroverted fact is that this factory building was not used by the assessee company but by the partnership firm for the purpose of its business. Since the use of building was not by the assessee for the purpose of its business, we do not find any infirmity in the orders of lower authorities for declining the claim of depreciation in the hands of the assessee company in respect of factory building which was not put to use by the assessee but by the partnership firm to whom same was contributed as per the terms of partnership deed. Assessee's claim for insurance premium in respect of this building cannot also be allowed against interest income. Only interest expenditure incurred on the amount borrowed for the purpose of contributing funds in the form of capital in partnership firm can be allowed against the interest income received from partnership firm on the credit balance of capital. Because by payment of insurance premium on building owned by assessee, it has not earned interest income. Interest income is earned because of capital contributed in the partnership firm. Had the premium paid by partnership firm the same could be considered for allowing while computing business income of partnership firm. We are therefore in agreement with learned DR that the premium paid for the building cannot be allowed in the hands of the assessee against its interest income from the partnership firm on account of capital contributed by the assessee."

11. In a case like this, the partnership firm which has utilized the said factory premises could have asked for depreciation. This so held by this Court in the *case of* ***Additional Commissioner of Income-tax, Delhi-III*** Vs. ***Manjeet Engineering Industries*** **[154 ITR 509]**. Another judgment rendered by the Rajasthan High Court is to the same effect in the case of ***Commissioner of Income-tax*** Vs. ***Amber Corporation*** **[95 ITR 178]** wherein it is held that the firm and the partners would be entitled to depreciation.

12. We, thus, answer the questions in the affirmative and against the assessee and consequently, this appeal is dismissed.

(A.K. SIKRI)
JUDGE

(SURESH KAIT)
JUDGE

November 01, 2010
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