

Important judgements and Updates

Update No 24/ 2021

Dipak Ratnabhai Patel R/SCA NO. 20609 of 2018 Gujarat High Court In favour of Assessee

Issues discussed and addressed:

Issue No 1 Interest and Remuneration to Partner Mere incorporation of interest on partners capital and remuneration does not necessarily mean or should be construed as mandatory. There has to be some material on record to indicate that the writ-applicant had actually received any 'interest on capital' or 'remuneration' from the partnership firm. Where no such income has been earned by the writ-applicant, the question of taxing the same does not arise at all

Facts of the case with respect to issue No 1:

The writ-applicant is a partner in a partnership firm running in the name of M/s. Vijya Laxmi Exports. The Revenue Audit Party raised an audit objection in the case of Vijya Laxmi Exports that the partnership deed of M/s. Vijya Laxmi Exports contains a clause to provide interest and remuneration to its partners as per the provision of Section 40(b) of the Act 1961. It was the case of the department that the firm did not make any provision for the said interest and remuneration to be provided to the partners in accordance with the provisions of the partnership deed during the Assessment Year 11-12

Held by the Authorities with respect to Issue No 1:

Mere incorporation of interest on partners capital and remuneration does not necessarily mean or should be construed as mandatory. There has to be some material on record to indicate that the writ-applicant had actually received any 'interest on capital' or 'remuneration' from the partnership firm. Where no such income has been earned by the writ-applicant, the question of taxing the same does not arise at all.

Judgments Relied upon by the Authorities with respect to Issue No 1:

CIT v. Alidhara Taxspin Engineers [Tax Appeal No. 265, dated 2-5-2017],

Mac Industries ITA No. 1036 (AHD) of 2016 Ahmedabad ITAT In favour of Assessee

Issues discussed and addressed:

Issue No 1 Interest and Remuneration to Partners The interest income earned by the assessee-firm from the fixed deposit receipts should not be ignored for the purpose of working-out the book profit to ascertain the ceiling of the partners' remuneration

Facts of the case with respect to issue No 1:

The assessee was engaged in the manufacturing of aromatic chemicals. During the course of assessment proceedings it was noticed by the assessing officer that the total income of the assessee included dividend

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income of Rs. 377/-, interest on deposit of Rs. 4,51,820/, interest on income tax refund of Rs. 28,322/- and interest on recurring deposit account of Rs. 42,602/-, which were covered under the head "Income from other sources". The assessing officer noted that these incomes were not directly related to business income of the assessee but derived from other sources, therefore these amounts, aggregating to Rs. 5,23,121/-, were required to be deducted from the net profit to compute book profit. Thus, the book profit was to be derived to Rs. 7,89,025/- from which admissible remuneration as per u/s. 40(b)(v) of the Act would be at Rs. 3,68,110/-. However, assessing officer noticed that the remuneration paid to partner was Rs. 5,92,357/-. So, there was an excess payment of remuneration amounting to Rs. 2,24,247/- (Rs.5,92,357 - Rs. 3,68,110).

Held by the Authorities with respect to Issue No 1:

For the purpose of section 40(b)(v) read with *Explanation* there cannot be separate method of accounting for ascertaining net profit and/or book profit. Therefore, the interest income earned by the assessee-firm from the fixed deposit receipts should not be ignored for the purpose of working-out the book profit to ascertain the ceiling of the partners' remuneration. For the purpose of ascertaining such ceiling of the partners' remuneration on the basis of book profit, the profit shall be in the profit and loss account and is not to be classified in the different heads of income under section 40 of the Act. The interest income, therefore, cannot be excluded for the purposes of determining the allowable deduction of remuneration paid to the partners under section 40B of the Act

Judgments Relied upon by the Authorities with respect to Issue No 1:

- a. CIT v. J.J. Industries [2013] 358 ITR 531/216 Taxman 162/35 taxmann.com 103 (Guj.),
- b. Md. Serajuddin & Bros. v. CIT [2012] 24 taxmann.com 46/210 Taxman 84

Suresh Sreeram ITA No. 1605/Bang/2019 Bangalore ITAT In favour of Assessee

Issues discussed and addressed:

Issue No 1 Interest and Remuneration to Partners 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.

Facts of the case with respect to issue No 1:

The assessee was a partner in a firm. The assessee has made substantial investments in the partnership firm. There was no dispute between the AO and the assessee that borrowed funds were invested for the purpose of the partnership business as capital contribution. The assessee claimed deduction of interest on funds borrowed for the purpose of investment as capital in the business of the partnership firm. The partnership

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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 partner claimed the deduction which it was entitled under section 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.

Held by the Authorities with respect to Issue No 1:

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" subhead "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".

Judgments Relied upon by the Authorities with respect to Issue No 1:

- a. CIT v. Ramniklal Kothari (1969) 74 ITR 57 (SC)
- b. CIT v. Sohan Lal Nayar (1974) 95 ITR 90 (Del)
- c. CIT v. S. Meyyappan (1969) 73 ITR 20 (Mad)

Vangapandu Prem Kumar I.T.A. No. 269/Viz/2019 Visakhapatnam ITAT In favour of Assessee

Issues discussed and addressed:

Issue No 1 Section 68 Even if books of accounts are maintained but if the alleged cash deposits in bank account are out side the books of accounts then addition u/s 68 is not justified.

Facts of the case with respect to issue No 1:

AO doubted cash deposits in assessee's bank account and made addition on amount concerned under section 68. Assessee's case was that deposits were made in bank account, and not in the books of account. Bank account statement or pass books were not the books of account, hence, AO was not permitted to make addition under section 68.

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Held by the Authorities with respect to Issue No 1:

As per section 68, sum found credited in books of account maintained by assessee, for which no explanation is offered by assessee required to be brought to tax. Though assessee had maintained books of account, cash deposits made in bank account were not found credited in books of account. The entire transactions were made outside the books of account. In the absence of any finding with regard to cash deposits recorded in the books of account of assessee, addition made by AO under section 68 in respect of cash deposits made in bank account was unsustainable.