

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "B", NEW DELHI
BEFORE SHRI S.V. MEHROTRA, ACCOUNTANT MEMBER
AND SHRI RAJPAL YADAV, JUDICIAL MEMBER**

**ITA No.2959/Del/2012
Assessment Year : 2009-10**

FCML Projects, A-217, Okhla Indl. Area, Phase-1, New Delhi. PAN : AAAFF 1343 H	Vs.	ACIT, Circle- 28(1), New Delhi.
(Appellant)		(Respondent)

**ITA No.2522/Del/2013
Assessment Year : 2010-11**

FCML Projects, A-217, Okhla Indl. Area, Phase-1, New Delhi. PAN : AAAFF 1343 H	Vs.	ACIT, Circle- 28(1), New Delhi.
(Appellant)		(Respondent)

Appellant by : Shri Pradeep Dinodia, CA &
Shri R. K. Kapoor, CA

Respondent by : Shri Anil Kumar Sharma, Sr.DR

Date of hearing : 20-12-2016
Date of pronouncement : 23-12-2016

ORDER

PER S.V. MEHROTRA, A.M :

Both the captioned appeals, preferred by the same assessee, were heard together and are being disposed of by this consolidated order for the sake of convenience.

ITA No.2959/Del/2012 (A.Y. 2009-10) :

2. This appeal, filed by the assessee, against the order dated 23.04.2012 passed by the Commissioner of Income Tax (Appeals)-XXV, New Delhi, u/s 143(3) of the Income Tax Act, 1961 (in short "the Act") relates to assessment year 2009-10.

3. Brief facts of the case are that assessee, in the relevant assessment year, was engaged in the business of dealer/retailer in home/hospitality accessories such as Sanitary Goods, Bathroom Hardware, Tissues paper, Soap, Detergents, Glasswares, Cutlery, Crockery, Decoration items such as Photo frames and also in Mattresses, Carpets and electronics items such as LCT TVs, hair dryer etc.. The assessee filed its return of income declaring total income at Rs.5,60,35,817/-. The Assessing Officer noticed that the assessee had paid interest on partners capital @ 12% on the balance outstanding in their capital account. He noted that the partners capital included amount of Rs.5 crores, which was credited in equal proportion to all the three partners of the firm on account of goodwill by way of a book entry. He observed that the actual money was never introduced in the books of account and by passing a book entry the assessee had claimed that capital had increased by Rs.5 crores and paid interest of Rs.60 lakhs on the enhanced partners capital. He required the assessee to explain as to how the

interest of Rs.60 lakhs was allowable as per the provisions of section 36(1)(iii) r.w.s. 40(b)(iv) of the Act. The Assessing Officer, relying on the decision of the Hon'ble Supreme Court in the case of *Munjal Sales Corporation vs. CIT*, (2008) 298 ITR 298 (SC), observed that section 40 was a corollary to section 30 to 38 and, therefore, section 40 was not a standalone section, therefore, the limitation of deduction of interest of section 40(b)(iv) will come into play only if the expenditure of interest was allowable u/s 36(1)(iii) of the Act. Ld. CIT(A) confirmed the Assessing Officer's action.

4. Ld. counsel for the assessee reiterated the submissions made before ld. CIT(A) and pointed out that the assessee firm is in the business for last 100 years and, as such, the assessee firm had generated/credited a goodwill, which had been credited in the capital accounts of the partners of the firm as the capital of the partners. He, further, submitted that the interest on goodwill allowed by the firm has been treated as business income in the hands of the partners as per section 28(v) of the Act and the same had been offered as income in the individual income-tax returns of the partners. Ld. counsel submitted that the whole exercise is tax neutral because the rate of taxation is same, both in the hands of the assessee firm as well as partners.

Ld. CIT(A) confirmed the Assessing Officer's action observing in para 4.6

as under :-

“4.6 I have considered the order of the AO and the submissions of the assessee and I do not find any merit in the submission of the assessee that the interest payment is allowable u/s 40(b) on the goodwill as the interest payment is allowable only when the same is payable for the borrowed capital and the capital is borrowed for the purpose of business as provided u/s 36(1)(iii). In the present case, assessee has claimed to have created a goodwill which has been credited in the capital accounts of the partners and the assessee firm is claiming the payment of interest as an expenditure or deduction u/s 40(b) but the same is not allowable as no money or capital has been borrowed for the purpose of business. The payment of interest as a deduction may be allowed only when the capital is borrowed for the purpose of business as provided u/s 36(1)(iii). It is also seen that the creation of goodwill claimed by the assessee is only a notional asset and the same cannot be treated at par with the borrowed capital and as such the AO is justified to disallow the payment of interest as no money or capital has been borrowed for the purpose of business. After considering all the facts and circumstances of the case, I am of the view that there is no merit in the submission of the assessee and the AO has rightly made the disallowance/addition of the interest payment and accordingly, the addition made by the AO is confirmed.”

5. Ld. DR relied on the order of the CIT(A).

6. We have considered the rival submissions of both the parties and perused the record of the case. The facts are not disputed. The only point for consideration is whether assessee is entitled to interest paid to the partners on the amount credited on capitalization of goodwill. The submission of ld. counsel is that the interest paid is within the limit as prescribed u/s 40(b)(iv) and is in terms of the partnership deed, therefore, no disallowance could be made. Ld. counsel also submitted that the assessee's claim is allowable u/s 37 and not u/s 36(1)(iii). Section 40 deals with

certain expenses enumerated therein, which are not deductible. The scheme of the Act in regard to computation of business income is like this. Section 28 deals with various kinds of income which are chargeable to income-tax under the head 'profits and gains of business or profession'. Section 28(v) reads as under :-

“S.28 The following income shall be chargeable to income-tax under the head ‘Profits and gains of business or profession’,—

(i)

.....

(v) any interest, salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from such firm :

***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 ;]”*

7. Section 29 lays down the mode of computation of business income and as per this the income referred to in section 28 is to be computed having regard to the provisions contained in sections 30 to 43D. Section 30 onwards deals with various deductions allowable to assessee from the business income.

8. Now, coming to section 40, we find that this section starts with non-obstante clause and mandates that even if anything contrary is contained in section 30 to 38 still the items enumerated u/s 40 would not be allowable as

deduction. It implies that even if deduction is allowable under the provisions of sections 30 to 38 on account of certain exceptions still for allowance of various items enumerated u/s 40 conditions laid down therein have to be fulfilled. Section 40 is primarily an extension of sections 30 to 38 and cannot be invoked *de-hors* the consideration of provisions of sections 30 to 38. As a matter of fact, it is complete scheme of the computation of business income which is to be taken into consideration while computing the total income under the head 'business'. We find that the Hon'ble Supreme Court in the case of Munjal Sales Corporation (supra) has observed as under :-

"Before the enactment of the Finance Act, 1992, broadly speaking, payment of interest by the firm to any partner of the firm constituted business disallowance per se. After the Finance Act, 1992, section 40(b)(iv) of the 1961 Act places limitations on the deductions under sections 30 to 38. Prior to the Finance Act, 1992, payment of interest to the partner was an item of business disallowance. However, after the Finance Act, 1992, the said section 40(b) puts limitations on the deductions under sections 30 to 38 from which it follows that section 40 is not a standalone section. Section 40, before and after the Finance Act, 1992, has remained the same in the sense that it begins with a non obstante clause. It starts with the words "Notwithstanding anything to the contrary in sections 30 to 38" which shows that even if an expenditure or allowance comes within the purview of sections 30 to 38 of the 1961 Act, the assessee could lose the benefit of deduction if the case falls under section 40. In other words, every assessee including a firm has to establish, in the first instance, its right to claim deduction under one of the sections between sections 30 to 38 and in the case of the firm if it claims special deduction it has also to prove that it is not disentitled to claim deduction by reason of applicability of section 40(b)(iv). Therefore, in the present case, the assessee was required to establish in the first instance that it was entitled to claim deduction under section 36(1)(iii) and that it was not disentitled to claim such deduction on account of applicability of section 40(b)(iv). It is important to note that sections 36(1) refers to other deductions whereas section 40 comes under the heading "Amounts not deductible". Therefore, sections 30 to 38 are other deductions whereas section 40 is a limitation on that deduction. It is

important to note that sections 28 to 43C essentially deal with business income. Sections 30 to 38 deal with deductions. Sections 40A and 43B deal with business disallowances. Keeping in mind the said scheme the position is that sections 30 to 38 are deductions which are limited by section 40. Therefore, even if an assessee is entitled to deduction under section 36(1)(iii), the assessee (firm) will not be entitled to claim deduction for interest payment exceeding 18/12 per cent. per se. This is because section 40(b)(iv) puts a limitation on the amount of deduction under section 36(1)(iii).

It is vehemently urged on behalf of the assessee that the partner's capital is not a loan or borrowing in the hands of a firm. According to the assessee, section 40(b)(iv) applies to partner's capital whereas section 36(1)(iii) applies to loan/borrowing. Conceptually, the position may be correct but we are concerned with the scheme of Chapter IV-D. After the enactment of the Finance Act, 1992, section 40(b)(iv) was brought to the statute book not only to avoid double taxation but also to bring on par different assesseees in the matter of assessment. Therefore, the assessee-firm, in the present case, was required to prove that it was entitled to claim deduction for payment of interest on capital borrowed under section 36(1)(iii) and that it was not disentitled under section 40(b)(iv). There is one more way of answering the above contention. Section 36(1)(iii) and section 40(b)(iv) both deal with payment of interest by the firm for which deduction could be claimed, therefore, keeping in mind the scheme of Chapter IV-D every assessee who claims deduction under sections 30 to 38 is also required to establish that it is not disentitled under section 40. It is in this respect that we have stated that the object of section 40 is to put a limitation on the amount of deduction which the assessee is entitled to under sections 30 to 38. In our view, section 40 is a corollary to sections 30 to 38 and, therefore, section 40 is not a standalone section.”

9. Therefore, the Assessing Officer has rightly pointed out that section 40 is corollary to sections 30 to 38 and, therefore, section 40 is not a standalone section. Therefore, the limitation of deduction of interest u/s 40(b)(iv) will come into play only after expenditure of interest is allowable u/s 36(1)(iii) of the Act. The contention of Id. counsel is that the expenditure claimed by assessee is allowable u/s 37. Let us examine this plea of the assessee. Admittedly, there was no infusion of funds in the

capital account and only on the basis of book entry the goodwill was credited in the capital accounts of partners. Therefore, payment of interest to partners could not be held to be wholly and exclusively for business purposes because it was primarily further addition to goodwill account. We, therefore, do not find any merit in the submissions of the Id. counsel for the assessee. The next plea advanced by the Id. counsel is that the whole exercise is tax neutral and, therefore, the assessee's claim should have been allowed. We are not inclined to accept this plea of the Id. counsel of the assessee because merely that an exercise is tax neutral does not justify an inadmissible claim of an assessee. In the light of aforesaid discussion, the assessee's appeal is dismissed.

10. In the result, the appeal of the assessee in ITA No.2959/Del/2012 for assessment year 2009-10 is dismissed.

ITA No.2522/Del/2013 (A.Y. 2010-11) :

11. This appeal, filed by the assessee, against the order dated 09.04.2013 passed by the Commissioner of Income Tax (Appeals)-XXV, New Delhi, u/s 143(3) of the Act relates to assessment year 2010-11.

12. Since the facts are identical to assessment year 2009-10 and, therefore, following the same parity of reasoning given therein, we dismiss

the assessee's appeal in ITA No.2522/Del/2013 for assessment year 2010-11.

13. Resultantly, both the captioned appeals of the assessee are dismissed.

Order pronounced in the open court on this 23rd day of December, 2016.

Sd/-
(RAJPAL YADAV)
JUDICIAL MEMBER

Sd/-
(S.V. MEHROTRA)
ACCOUNTANT MEMBER

Dated : 23-12-2016.

Sujeet

Copy of order to: -

- 1) The Appellant;
- 2) The Respondent;
- 3) The CIT;
- 4) The CIT(A)-, New Delhi;
- 5) The DR, I.T.A.T., New Delhi;

By Order

//True Copy//

Assistant Registrar
ITAT, New Delhi