

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: 'SMC' NEW DELHI**

Before Sh. N. K. Saini, Accountant Member

ITA No. 5634/Del/2016 : Asstt. Year : 2012-13

Shorewala Overseas, 9, Lancers Road, B.D. Estate, Timparpur, Delhi-110054	Vs	Income Tax Officer, Ward-47(1), New Delhi
(APPELLANT)		(RESPONDENT)
PAN No. ABLFS0193A		

S. A. No. 514/Del/2016

(In ITA No. 5634/Del/2016 Asst. Year: 2012-13)

Shorewala Overseas, 9, Lancers Road, B.D. Estate, Timparpur, Delhi-110054	Vs	Income Tax Officer, Ward-47(1), New Delhi
(APPELLANT)		(RESPONDENT)
PAN No. ABLFS0193A		

Assessee by : Sh. Repudaman Thakur, FCA

Revenue by : Sh. Bedobani Chaudhari, Sr. DR

Date of Hearing : 15.03.2017	Date of Pronouncement: 12.06.2017
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ORDER

This is an appeal by the assessee and is directed against the order dated 16.08.2016 of Id. CIT(A)-16, New Delhi. The assessee also moved an application for stay of the outstanding demand of Rs.4,81,630/-.

2. Following grounds have been raised in this appeal:

“On the facts and in the circumstances of the case and in law the action of the CIT(A) - 16, New Delhi, is arbitrary, fallacious and illegal on the following

grounds and, therefore, merits to be quashed with directions for appropriate relief to the assessee:-

- 1) That CIT (A) failed to appreciate that if the Assessing Officer made no addition regarding items for which reasons are recorded for CASS scrutiny selection, it means he had no "reasons to believe that income has escaped assessment" and the issue of the notice becomes invalid. If so, he has no jurisdiction to assess any other income.*
- 2) That CIT(A) erred in confirming an addition of Rs.9,38,616/- to the income of the firm, being made by Assessing Officer after charging interest on debit balance of partners' capital account by invoking the provision of Sec. 40(b)(iv) of the Income-tax Act.*
- 3) That CIT(A) erred in confirming an addition of Rs.9,38,616/- by not following and further failed to appreciate the provision of Sec.5 of the Income-tax Act, which takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax on 'hypothetical income'.*
- 4) That the CIT(A) erred in confirming a disallowance of Rs.1,92,455/-, which is 1/8th disallowance for Telephone expenses, Car Repair and Maintenance as well as Car Petrol expenses, being made by Assessing Officer arbitrarily and on mere suspicion.*
- 5) That CIT(A) erred in not dismissing the ground of initiating penalty proceedings u/s271(1)(c) of the Act.*

6) That the appellant crave leave to take additional ground or grounds of appeal or to alter or vary any or all the grounds of appeal before or at the time of hearing of the appeal.”

3. Ground No. 1 was not pressed, Ground No. 5 is pre-mature and Ground No. 6 is general in nature, so these grounds do not require any comment on my part.

4. Vide Ground Nos. 2 & 3, the grievance of the assessee relates to the confirmation of addition of Rs.9,38,616/- on account of interest on debit balance of the partners capital account by invoking of Section 40(b)(iv) of the Income Tax Act, 1961 (hereinafter referred to as the Act).

5. Facts of the case in brief are that the assessee filed its return of income on 28.09.2012 declaring an income of Rs.2,62,447/- which was processed u/s 143(1) of the Act. Later on, the case was selected for scrutiny. During the course of assessment proceedings, the AO noticed that the assessee had paid interest of Rs.14,53,887/- on the unsecured loans and the capital account of the partners revealed that the following partners had shown debit balance as on 31.03.2012:

<i>S. No.</i>	<i>Name of the partner</i>	<i>Balance as on 31.03.2012</i>
<i>1.</i>	<i>Shri Alok Kumar Shorewala</i>	<i>26,67,076</i>

2.	<i>Shri Anil Kumar Shorewala</i>	<i>21,93,282</i>
3.	<i>Shri Atul Kumar Shorewala</i>	<i>27,14,678</i>
4.	<i>Kalawati Devi</i>	<i>1,82,586</i>
5.	<i>Sangeeta Shorewala</i>	<i>64,182</i>
	<i>Total</i>	<i>78,21,804</i>

6. The AO further observed that the partners had made huge withdrawals by way of various individuals, firms and for various expenditure which resulted in negative balance and that the partners had withdrawn the funds of the assessee firm meant for working capital. The AO also pointed out that clause no. 7 of the partnership deed filed by the assessee revealed as under:

“That the parties will be entitled to a simple interest at the rate of 18% or at such other rate as may be mutually agreed upon or prescribed u/s 40(b) of the Income Tax Act, 1961 on the credit balance of the capital, current loan account of partners. If there is any debit balance in the account of any partner, interest at the same rate shall be payable by him.”

7. The AO charged the interest @ 12% as prescribed u/s 40(b) of the Act on the debit balance of the partners capital and considered the same as income of the assessee. Accordingly, he made the addition of Rs.9,38,616/-.

8. Being aggrieved the assessee carried the matter to the Id. CIT(A) who sustained the addition made by the AO by observing

that it had not been denied by the assessee that the clause no. 7 exist in the partnership deed and that if the said clause was not to be given effect the same could have been deleted by amending the partnership deed.

9. Now the assessee is in appeal. The Id. Counsel for the assessee reiterated the submissions made before the authorities below and further submitted that before application of Section 40(b) of the Act, two requirements must be satisfied:

- i) the income must be the income of the firm
- ii) out of the said income, the payment must be made to a partner and if the payment is not out of the income of the firm, there is no question of disallowance.

It was further submitted that there was positive balance of Rs.8,10,310/- in the capital account of the partners which had not been considered by the AO. It was also submitted that the provisions contained u/s 40(b) of the Act nowhere provides to charge interest on debit balance of partners capital account as income of the firm, where no interest was actually charged and provided in books of the firm. The reliance was placed on the following case laws:

- *Swaraj Enterprises Vs ITO (2011) 132 ITD 488 (Visakhapatnam-ITAT)*

- *Karnavati Dyestff Industries Vs ITO in ITA No. 2263/Adh./2010*
- *ACIT Vs M/s Lakhani Shoes Co. Pvt. Ltd. (2012) (ID2)-GJX-1054-TJAI*
- *DCIT Vs M/s Ashok Kumar, Amit Kumar & Shipra Estates (P) Ltd. (2013)-(ID2)-GJX-3393-TDEL*

10. It was further submitted that as per the provisions of Section 5 of the Act, the taxability is attracted even when income has accrued but it is the real income and not any hypothetical income and if the income does not result at all, there cannot be a tax, even though in book keeping and entries are made about a hypothetical income. The reliance was placed on the following case laws:

- *E. D. Sassoon & Co. Ltd. Vs CIT (1954) 26 ITR 27*
- *DIT Vs Ericsson Communications Ltd. (2015) 378 ITR 395 (Del.)*
- *CIT Vs Shoorji Vallabhdas and Co. (1962) 46 ITR 144 (SC)*
- *CIT Vs Chamanlal Mangaldas and Co. (1960) 39 ITR 8 (Sc)*

11. In his rival submissions the ld. DR strongly supported the orders of the authorities below and reiterated the observations made in their respective orders.

12. I have considered the submissions of both the parties and carefully gone through the material available on the record. In the present case, it is noticed that the partners of the assessee firm in the partnership deed (copy of which is placed at page nos. 299 to 301 of the assessee's paper book) agreed vide clause no. 7 that the parties will be entitled to a simple interest @ 18% or at such other rate as may be mutually agreed upon or prescribed u/s 40(b) of the Act on the credit balance of the capital, current loan account of partners and if, there is any debit balance in the account of any partner, interest at the same rate shall be payable by him.

13. From the above provisions, it is crystal clear that the partners were required to pay interest on the debit balance at the same rate which was applicable on their credit balance. In the present case, it is not in dispute that there was debit balance in the account of the partners, however, the said debit balance has been considered by the AO on the last date of the year. In my opinion, the interest is to be charged on day to day basis and not on the balance at the end of the year. In the present case, since there is clear provision in the partnership deed for charging the

interest on the debit balance of the partners and the assessee is also paying interest on the credit balance to the partners. I, therefore, do not see any infirmity in the impugned order passed by the Id. CIT(A). However, the AO is required to work out the interest to be charged on the debit balance on day to day basis and not at the end of the year, for this limited purpose, the issue is restored back to the file of the AO.

14. The next issue vide Ground No. 4 relates to the confirmation of disallowance of Rs.1,92,455/- made by the AO out of the telephone expenses, car repairs & maintenance as well as care car petrol expenses.

15. The facts related to this issue in brief are that the AO during the course of assessment proceedings noticed that the assessee had debited following expenses in the profits and loss account:

<i>i) Telephone Expenses</i>	<i>Rs. 5,65,569/-</i>
<i>ii) Travelling</i>	<i>Rs. 2,67,884/-</i>
<i>iii) Car Depreciation</i>	<i>Rs. 8,33,715/-</i>
<i>iv) Car Repair & Maintenance</i>	<i>Rs. 4,21,002/-</i>
<i>v) Car Petrol Expenses</i>	<i>Rs. 5,53,070/-</i>

He further observed that the above said expenditure may include some element attributable towards the

personal use by the partners and it was not proved that the whole of the expenditure was incurred wholly and exclusively for the purpose of business. He disallowed 1/8th of the total expenditure and made the addition of Rs.3,30,155/-.

16. Being aggrieved the assessee carried the matter to the Id. CIT(A) and submitted that the AO had not pointed out any instance of personal use.

17. The Id. CIT(A) after considering the submissions of the assessee observed that the depreciation on car is a statutory allowance which is not affected by the extent or type of usages. Therefore, there shall not be any disallowance out of car depreciation. Similarly, the expenses on travelling had been claimed to be only for business purposes and the AO had not pointed out any instance of personal use. Accordingly, disallowance made by the AO on account of car depreciation and travelling expenses was deleted. As regards to the disallowance out of telephone, car repair & maintenance and car petrol, the Id. CIT(A) observed that the assessee had not maintained any log-book for running of cars and there were no separate telephone and vehicles for personal use. He,

therefore, opined that the disallowance of 1/8th of the expenditure from telephone, car repairs & maintenance and car petrol made by the AO was fully justified.

18. Now the assessee is in appeal. The ld. Counsel for the assessee reiterated the submissions made before the authorities below and further submitted that the assessee's substantial part of the business was of export and its clients were in US & Hong Kong, its factory is located at Kundali, Distt. Sonapat, Haryana. Hence, it was obvious that the expenses on phones would be definitely categorized as genuine. It was further submitted that the expenses on running of car do not fall within the ambit of Section 38(2) of the Act and it was not the case of the revenue that the assessee firm committed any illegality in the cloak of its legal separate character. It was further submitted that the AO had completely failed in bringing out any specific instance of expenditure being used for non-business purposes and without bringing any material on record the disallowance of 1/8th of expenditure made by the AO was justified. The reliance was placed on the following case laws:

- *CIT Vs M/s Muthoot Financiers (2015) 371 ITR 408 (Del.)*

- *CIT, West Bengal Vs A. W. Fijjies and Co. & Ors. (1953) 24 ITR 405 (SC)*
- *CIT Vs Dalmia Cement (P.) Ltd. (2002) 254 ITR 377 (Del.)*
- *DCIT Vs Haryana Oxygen Ltd. (2001) 76 ITD 32 (Del. – Trib.)*

19. In his rival submissions the ld. DR strongly supported the orders of the authorities below and reiterated the observations made by them in their respective orders.

20. I have considered the submissions of both the parties and carefully gone through the material available on the record. In the present case, the assessee admitted before the ld. CIT(A) that no separate telephone or vehicles were there for the personal use and that no log-book was maintained for running of the cars, in such circumstances, the personal use by the partners and the employees cannot be ruled out in such type of cases. However, the disallowance made by the AO and sustained by the ld. CIT(A) appears to be on higher side. I, therefore, considering the totality of the facts and to meet the ends of justice, deem it appropriate to reduce the disallowance to the extent of 10% of expenses incurred on telephone, car

repairs & maintenance and car petrol instead of 1/8th made by the AO and sustained by the ld. CIT(A).

21. As regards to the Stay Application filed by the assessee is concerned, the same becomes infructuous. Since, the appeal has been disposed off in former part of this order.

22. In the result, the appeal of the assessee is partly allowed and the Stay Application is dismissed.

(Order Pronounced in the open Court on 12/06/2017)

Sd/-
(N. K. Saini)
ACCOUNTANT MEMBER

Dated: 12/06/2017

Subodh

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR