

आयकर अपीलीय अधिकरण, पुणे न्यायपीठ “एक-सदस्य” पुणे में
IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH “SMC”, PUNE

श्री डी. करुणाकरा राव , लेखा सदस्य
एवं श्री विकास अवस्थी, न्यायिक सदस्य के समक्ष

BEFORE SHRI D.KARUNAKARA RAO, AM
AND SHRI VIKAS AWASTHY, JM

आयकर अपील सं. / ITA No.1076/PUN/2017
निर्धारण वर्ष / Assessment Year : 2013-14

Ishwar Pulp & Paper Mill,
Gat No.104/2,
Post Umala, Jalgaon-425003
PAN : AAOFM2941G

.... अपीलार्थी/Appellant

Vs.

ITO, Ward-1(3),
Jalgaon

.... प्रत्यर्थी / Respondent

Assessee by : Shri Pramod Shingte
Revenue by : Shri Achal Sharma

सुनवाई की तारीख / Date of Hearing : 25.07.2018	घोषणा की तारीख / Date of Pronouncement: 31.08.2018
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आदेश / ORDER

PER D. KARUNAKARA RAO, AM :

This is the appeal filed by the assessee against the order of CIT(A)-2, Nashik, dated 07-02-2017 for the Assessment Year 2013-14.

2. Grounds raised by the assessee are extracted as under :

“1. The Ld.CIT(A) erred on facts and in law in upholding disallowance of interest paid to partners amounting to Rs.19,98,768/- u/s.40(b) of the Act. He specifically erred in law in reconstructing capital accounts of the partners on account of non-provision of depreciation in books of account.

2. The Ld.CIT(A) erred on facts and in law in upholding disallowance of interest paid to banks amounting to Rs.6,89,920/- u/s.36(1)(iii) of the Act on account of alleged diversion of funds to partners. He specifically erred in law in reconstructing capital accounts of the partners to arrive at the so called diversion of funds.

3. The Ld. CIT(A) erred on facts and in law in upholding disallowance of Rs.6,41,482/- being 10% of the expenses on account of Repairs & Maintenance, Carriage Inward, Factory Salary & Wages and Quality Rebate.

4. The Ld.CIT(A) erred on facts and in law in upholding disallowance of Rs.2,374/- being 5% of the expenses on account of Telephone Expenses.

5. The appellant craves leave to add, alter, delete or substitute all or any of the above grounds of appeal.”

3. Briefly stated relevant facts of the case are that the assessee is a firm engaged in the manufacturing of pulp and paper. Assessee filed the return/revised of income declaring brought forward losses at Rs.12,94,343/-. In the assessment, AO made various additions, the details of which are extracted here as under :

Total income as per return	Rs. Nil
<u>Addition/disallowances :</u>	
1. Out of interest to partners u/s.40(b)	19,85,768/-
2. Out of interest payment to bank Disallowed due to debit balance in two partners cases	Rs.6,89,920/-
3. Out of expenses in Mfg. A/c.	Rs.6,41,482/-
4. Out of expenses in P&L Account	Rs.1,89,258/-
5. Differences in Party's Account	Rs. 5,681/-

	Rs.35,12,109/-

Thus, the AO made the assessment on the total income of Rs.35,12,110/-. In the First Appellate proceedings, the CIT(A) confirmed most of the additions and the appeal of the assessee was partly allowed. With these brief facts, we proceed to adjudicate the ground-wise adjudication in the succeeding paragraphs.

4. Before us, at the outset, Ld.Counsel for the assessee did not press Ground No.4. Accordingly, the said ground is dismissed as 'not pressed'. Ground No.5 is general in nature and therefore, the same is dismissed as such. That leaves Ground Nos. 1 to 3 raised by the

assessee for adjudication. Ground-wise adjudication is given in the succeeding paragraphs.

5. Ground No.1 relates to disallowance of interest paid to the partners amounting to Rs.19,85,768/-. This part of the interest paid to the partners of the firm u/s.40(b) of the Act. The calculations leading to the said figure of Rs.19,85,768/- is given in Para No.5 of the order of CIT(A) and the said para is extracted here as under :

Sr. No.	Name of the Partner	Amount of Interest paid as per books of account	Amount of interest payable as per recasted capital a/c.	Amount of excess interest paid (3)-(4)
(1)	(2)	(3)	(4)	(5)
1	Shri Bhawanji Vishram Patel	2,88,660/-	0	2,88,660/-
2	Shri Chandulal Vishram Patel	6,16,449/-	2,00,295/-	4,16,154/-
3	Shri Deoram Vishram Patel	1,59,632/-	0	1,59,632/-
4	Shri Maganlal Vastaram Patel	2,43,145/-	0	2,43,145/-
5	Shri Narayanji Vastaram Patel	2,73,417/-	0	2,73,417/-
6	Shri Vasant Lauji Patel	2,40,479/-	45,226/-	1,05,253/-
7	Shri Vinod Keshvlal Patel	3,43,093/-	1,82,044/-	1,61,049/-
8	Shri Yashwant Vishram Patel	2,48,458/-	0	2,48,438/-
	Total	24,13,333/-	4,27,565/-	19,85,768/-

From the above table, it is evident that the assessee claimed the total expenditure u/s.40(b) of the Act amounting to Rs.24,13,333/-. AO allowed the sum of Rs.4,27,565/- and disallowed the balance of Rs.19,85,768/-. The core reason given by the AO in support of the said disallowance relates to the enhanced book profits by way of not disallowing the depreciation u/s.32 of the Act. Coming to the facts, AO noticed that the assessee did not claim the depreciation u/s.32 of the Act at the time of determining the book profits and the net profits. However, assessee claimed the same in the computation of income. On these facts, the AO reasoned by not claiming due depreciation of the

firm, the “book profits” stand inflated thereby more profits are available to the assessee firm for distribution among the partners of the firm. AO discussed this issue in Page 3 to 22 of his order. In these paragraphs, the AO extracted the submission/explanation of the assessee and various case laws (1) ACIT Vs. Sant Shoe Store 88 ITD 0524 (Chandigarh Tribunal) (SMC); (2) Swaraj Enterprises Vs. ITO 140 TTJ 0360 (Visakhapatnam Tribunal)/(10 taxmanncom 270) and (3) Deval Utensils Factory Vs. DCIT 98 TTJ 0501 (Pune Tribunal) and distinguished them as seen from the contents of Para No.7.4.1 to 7.4.3 of his order. He further relied heavily on the couple of decisions, i.e. (1) decision of Jaipur Bench of the Tribunal in the case of M.K. Enterprises Vs. ITO, dated 06-11-2015 and (2) judgment of Hon’ble Punjab & Haryana High Court in the case of Ashoka Oil Mills Vs. CIT – ITA No.484/2005, dated 01-09-2014. While the case of M.K. Enterprises (supra) relates to similar allegation of inflation of book profits by not debiting the depreciation, the case of Ashoka Oil Mills (supra) is on the allegation of inflation of book profits by not debiting the interest expenditure. In both these cases, as per the AO, the decisions was in favour of the Revenue. Further, the assessee also relied on the decision of Visakhapatnam Bench of the Tribunal in the case of Arthi Nursing Home Vs. ITO 119 TTJ 415 (Visakhapatnam) (SMC). Further, referring to the allowing of similar claim in the past, the AO mentioned in Para No.22 that there is no estoppels or *res judicata* in income-tax matters. Eventually, the AO decided this issue against the assessee as per the finding given in Para No.25 and the same is extracted as under :

“25. In the light of the above discussion, it is eminently clear that the assessee firm has not charged depreciation to the P & L account only with the intention to increase the capital balance of the partners’ so as to provide them higher amount of interest. As communicated to the assessee vide this office letter

dtd.15.02.2016, the re-casted capital account and thus arrived at excess interest paid to the partners amounting to Rs.19,85,768/- is disallowed and added to the total income of the assessee firm. Penalty proceedings u/s. 271(1)(c) are separately initiated.”

6. In the First Appellate proceedings, the assessee questioned the re-writing of the capital accounts of the partners account of the assessee as well as disallowance of interest amounting to Rs.19,85,768/- paid to the partners and relied on the written submissions made before the AO. On considering the same, in Para No.5.2 of the appellate order, the CIT(A) discussed the provisions of Explanation (3) to section 40(b) of the Act and concluded that the book profits means net profit as shown in the profit and loss account and computed in the manner laid down in Chapter IV-D. As per the CIT(A), depreciation is to be compulsorily considered while computing the said book profits/net profits whether assessee claims the same or not and relied on the contents of Explanation 5 to section 32 of the Act. He held that the same is applicable to the assessment year under consideration. Finally, he justified the recasting of the capital accounts of the partners and confirmed the disallowance made by the AO. Aggrieved with the same, the assessee is in appeal before us.

7. On this issue, Ld. Counsel for the assessee explained the above facts of the case and once again relied on the decisions (1) ACIT Vs. Sant Shoe Store 88 ITD 0524 (Chandigarh Tribunal) (SMC); (2) Swaraj Enterprises Vs. ITO 140 TTJ 0360 (Visakhapatnam Tribunal)/(10 taxmann.com 270) and (3) Deval Utensils Factory Vs. DCIT 98 TTJ 0501 (Pune Tribunal). Bringing our attention to the decision of Visakhapatnam SMC Bench of the Tribunal in the case of Swaraj Enterprises (supra), Ld. Counsel mentioned that the facts of the said

case are directly applicable to the present case but for the assessment years. This case deals with A.Y. 1999-2000 and others. Ld. Counsel also relied on the decision of Pune Bench of the Tribunal in the case of Deval Utensils Factory and DCIT (supra) and fairly submitted that the same relates to the manner of calculating the interest on the reducing balance on day-to-day basis and certainly not in the context of allowability of depreciation before working out the divisible book profits among the partners. Further, Ld. Counsel brought our attention to the judgment of Madras High Court in the case of Sri Venkateswara Phot Studio Vs. ACIT 256 CTR 95 (Mad) and mentioned the said judgment is delivered in the context of sub clause (iv) of clause (b) of section 40 of the Act. The conclusion of the said judgment reads that “when there is no specific reference to book profit as a basis on which interest has to be paid, unlike in the case of salary, the Revenue cannot insist on deduction of depreciation before crediting any interest on the capital of the assessee firm for the purpose of deduction u/s.40(b)(iv).” Ld. Counsel fairly submitted that clause (iv) deals with reference to “*any payment of interest to partners which is authorised by, and is in accordance with, the terms of partnership deed and related to any period falling after the date of such partnership deed.....*” Further, he submitted that Para No.15 of the partnership deed dated 30-03-2007 is relevant for the interest payable to the partners. Further, Ld. Counsel referred to page 6 to 12 of the paper book and submitted the same constitutes the copy of the partnership deed made on 01-04-2015 and the same mainly deals with the partners’ capital interest book profits, sec 40(b) of the Act etc.

8. On the other hand, Ld. DR for the Revenue relied heavily on the orders of the AO/CIT(A). Referring to clause 15 of the partnership deed, Ld. DR submitted that the allowability of depreciation is mandated by the income-tax provisions at the time of computation of book profits. Therefore, by virtue of this clause (15) assessee is under obligation to decide the quantum of profits as per Indian Partnership Act, 1932 or by any of distinct enactment in force for the time being, i.e. Income Tax Act, 1961 as amended by the Finance Act, 2001. He also submitted that there are number of binding decisions to suggest thrusting of depreciation on the assessee in matters of computation of the business profits. Ld. DR also relied on the amended provisions of Explanation (5) to section 32 of the Act directing the assessee to mandatorily claim the depreciation w.e.f. A.Y. 2002-03 and subsequent assessment years. Further, bringing our attention to the SMC decision of the Chandigarh Bench of the Tribunal in the case of Sant Shoe Stores (supra) and submitted that inflation of book profits by way of revaluation of building was held to be not allowable for the purpose of section 40(b)(iv) of the Act. Further, Ld. DR relied on the decision SMC of Visakhapatnam Bench of the Tribunal in the case of Arthi Nursing Home Vs. ITO (supra) and submitted that the decision is against the assessee. Further, he submitted that SMC made a reference to the other decision of Visakhapatnam Tribunal in the case of Swaraj Enterprises (supra). Relying on them, Ld. DR submitted that the “depreciation” needs to be charged to the profits before computing the allowable interest to the partners.

9. We heard both the parties on this issue of interpreting the meaning of the expression “book profits” qua the allowing of the

depreciation before quantifying the payment of interest to the partners raised in Ground No.1 of the appeal. We have also perused the orders of the Revenue and the decisions cited by both the sides. On facts, there is no dispute between the parties. However, the dispute is with regard to the interpretation of the expression “book profits” within the meaning of section 40(b) r.w. Explanation (3). On this issue, the decisions in the case of Arthi Nursing Home (supra), Swaraj Enterprises (supra), and Sri Venkateswara Photo Studio (supra) are directly relevant and others do not relate to the issue of depreciation and allowability of interest. While the Visakhapatnam Bench decisions are not agreeing on this issue with each other, the Madras High Court judgment in the case of Sri Venkateswara Photo Studio (supra) was not considered by the SMC Bench decisions although the same existed as on 12-06-2007, i.e. on the date of making an order in the case of Arthi Nursing Home (supra). This judgment of Madras High Court is filed for the first time before us asking for direction to the AO to allow payment of interest to the partners without claiming depreciation. The Madras High Court judgment in the case of Sri Venkateswara Photo Studio (supra) being dated 24-04-2012 was not considered at the time of making both the assessment order dated 29-03-2016 as well as First Appellate order dated 07-02-2017.

9.1 In the said judgment, the Hon’ble High Court discussed the provisions of Explanation (3) which defined the “book profits” and directed the Revenue not to reduce the gross profit to the extent of depreciation in the absence of any specific reference to the “book profits” in sub clause (vi) of section 40(b) of the Act. Reference to the book profits is relevant when it comes to said sub-clause (v) with

reference to other payments like remuneration. For the sake of reference, sub-clause (vi) is extracted here as under :

“any payment of interest to any partner which is authorised by, and is in accordance with, the terms of the partnership deed and relates to any period falling after the date of such partnership deed in so far as such amount exceeds the amount calculated at the rate of [twelve] per cent simple interest per annum; or.”

The above explanation (3) which defined “book profits” appeared to be relevant to the interest payment referred to in sub-clause (iv) of section 40(b) of the Act. This aspect is completely ignored in other decisions of the Tribunal which is relevant before deciding the ground in question.

9.2 Further, regarding the availability of another partnership deed dated 01-04-2015, we find there is a categorical reference to the manner of computation of interest payable to the partners on the capital balances as well as loans advanced to the firm. Clause (5) of the said partnership deed is relevant in this regard. The same was not discussed by both the authorities below while adjudicating the issue under consideration. Thus, the new partnership deed dated 01-04-2015 on one side and the Madras High Court judgment on the other constitutes significant information which is required to be considered by the CIT(A) afresh. For this purpose, Ground No.1 is allowed to be remanded to the file of CIT(A) for fresh adjudication. CIT(A) shall grant reasonable opportunity of being heard to the assessee in accordance with the set principles of natural justice. CIT(A) is directed to pass a speaking order considering the entire legal propositions existing on this issue and the provisions of section 40(b) with relevant sub-clause and Explanations. Assessee is also directed to furnish these documents

and the details necessary for adjudication of the issue before the CIT(A). Accordingly, the Ground No.1 is allowed for statistical purposes.

10. Ground No.2 relates to disallowance of interest paid to banks amounting to Rs.6,89,920/- u/s.36(1)(iii) of the Act on the ground that the interest bearing funds are diverted to the partners.

11. At the outset, on this issue, Ld. Counsel for the assessee brought our attention to the contents of Para No.26 of the assessment order and submitted that assessee paid interest of Rs.25,31,645/- on cash credit account opened with Jalgaon Janata Sahakari Bank Ltd. Consequent to the reconstruction of the capital balances of the partners, as discussed in the context of Ground No.1, in cases of two partners, i.e. (1) Shri Maganlal V. Patel and Shri Narayanji V. Patel, the interest bearing funds were found diverted to their accounts amounting to Rs.30 lakhs and Rs.28 lakhs respectively. The total diverted interest bearing funds from the cash credit account works out to Rs.58 lakhs. The relatable interest paid by the firm to the bank on this Rs.58 lakhs works out to Rs.6,89,920/-. In this regard, the AO relied on the judgment of Supreme Court in the case of CIT Vs. Meer Mohd. Ali 53 ITR 165 (SC) and held that withdrawing the funds from the cash credit account attracts the disallowance of relatable interest. CIT(A) confirmed the conclusions of the AO on this issue.

11.1 It is the submission of the assessee that the said amount constitutes share from the profits of the firm and therefore, it is the right to have these funds drawn from the firm whether they are interest bearing or otherwise. In that case, the said disallowance is uncalled for. Further, Ld. Counsel submitted that this issue becomes

consequential in nature to the outcome of the decision in Ground No.1. If the share of profits from the accumulated as well as current year profits of the firm becomes a right of the assessee. In that case, the withdrawals by the partners do not need re-computation so far as allowable interest is concerned. Therefore, it is the opinion of the Ld. Counsel that this issue should also re-visit to the file of CIT(A) for the coordinated decision on Ground Nos. 1 and 2.

12. We agree with the arguments of the Ld. Counsel on this issue and the same stands remanded to the file of CIT(A) with similar directions as given in Ground No.1 above.

13. Ground No.3 relates to disallowance of Rs.6,41,482/- being 10% of the expenses on account of repairs and maintenance, carriage inward, factory salary & wages and quality rebate etc.

14. Relevant facts on this issue are discussed in para No.27 of the assessment order and the same include that the assessee debited sum of Rs.85,65,831/- in the manufacturing account towards direct expenses. Out of the same, Rs.64,14,823/- was incurred on various accounts enlisted above were examined during the assessment proceedings. Considering the fact that most of these expenses are self-vouched and the correctness of expenditure was not verifiable, the AO called for detailed evidences in support of the claim. Assessee failed to do so. Relying on the judgment of Bombay High Court in the case of Ramanand Sagar Vs. DCIT 256 ITR 134, the AO held that the assessee failed to discharge the onus. It is the argument of the AO that when a deduction is claimed, assessee has to explain with evidences and genuineness of the expenditure. AO also relied on various other

decisions discussed in Para No.28 and held that assessee failed to prove the said expenditure was incurred wholly and exclusively for the purpose of business. Relevant lines from this paragraph is extracted are as under :

“28.....

.....In the case of the present assessee firm, it is stated that the assessee has maintained muster and salary, wages register is not sufficient particularly the same was not produced for verification. Further, it is stated that the same is lost for which FIR has been launched and copy of such complaint is enclosed is also totally false and misleading. No such enclosure is filed by the assessee firm. With regard to repairs to Plant and Machinery, it is stated that separate sheet alongwith copies of bills is attached is also false as nothing has been enclosed with this letter. The assessee has not proved that the above expenditure has been incurred by the assessee wholly and exclusively for the purpose of business. Considering all these facts and in absence of any documentary evidences, 10% out of the above expenses are disallowed and added to the total income of the assessee firm, which works out to Rs.6,41,482/-.”

Thus, the AO disallowed 10% of the above expenditure on adhoc basis works out to Rs.6,41,482/-.

15. In the First Appellate proceedings, the CIT(A) discussed this issue in Para No.7 of his order and extracted the submissions of the assessee in sub-para 7.1. Barring bald claims stating that the entire expenditure was incurred for business purposes and also stating that entire expenditure is genuine expenditure, the assessee did not furnish evidences as demanded by the AO. Accordingly, the CIT(A) dismissed the ground raised by the assessee in this regard and confirmed the addition made by the AO in Para No.7.2 and the same reads as under :

“7.2 I have carefully considered the facts of the case and rival contentions. On perusal of the same it has been noticed that the appellant has not rebutted the contentions of the AO and reasons mentioned by the AO for disallowing the expenses to the extent of 10%. The onus of proving the expenditure claimed is on the assessee and in view of the above facts the appellant has failed to discharge the onus. The AO is therefore justified in making the addition of Rs.6,41,482/- on account of disallowance of expenditure and hence the same is confirmed. Ground No.3 is dismissed.”

16. Before us, Ld. Counsel for the assessee submitted that the entire expenditure was incurred wholly and exclusively for the business purposes of the assessee. Referring to certain expenses like wages, carriage inward, repairs and maintenance etc., Ld. Counsel submitted that it is practically not possible to main third party vouchers capable of scrutiny of the authorities. Further, he submitted that when the income is earned and the goods are manufactured undisputedly, the expenditure mentioned in Para No.27 of the assessment order are necessary for the business purposes.

17. Ld. DR for the Revenue relied on the orders of the AO and CIT(A) and submitted that in matters of claims u/s.37(1) of the Act, the onus is heavily on the assessee and the assessee failed to do so in the present case. Therefore, Ld. DR prayed for confirming the conclusions of AO/CIT(A).

18. We heard both the both the parties on this issue and perused the orders of the Revenue as well as the paper book filed before us. We have also gone through the contents of pages 22 to 35 of the paper book and they relate to the above referred expenditure amounting to Rs.64,14,823/-. These documents constitute the ledger extracts from the books of account of the assessee. Further, we find from the orders of the Revenue that the AO merely disallowed 10% of the entire expenditure which indicates accepting the genuineness of the expenditure. AO merely doubted the quantum of expenditure without having any basis or evidence in his possession. It is not the case of the Revenue that the AO verified the claim of the expenditure and found they are false or otherwise. Further also, we find AO did not bring any

evidence to demonstrate 10% adopted by him has sustainable basis. Therefore, we are of the opinion that the percentage linked disallowance is not legally sustainable. On the other hand, assessee failed to produce the evidences and discharged the onus in demonstrating the correctness of the claim with evidences. Further, to plug the deficiencies from assessee's side, we are of the opinion that disallowance of some portion of it, i.e. a round-sum of Rs.5 lakhs should meet the ends of justice. Accordingly, AO is directed to restrict the disallowance to Rs.5 lakhs instead of Rs.6,41,482/- (10% of Rs.64,14,823/-. Accordingly, Ground No.3 is partly allowed.

19. In the result, the appeal of the assessee is partly allowed for statistical purposes.

Order pronounced on 31st day of August, 2018.

Sd/-

Sd/-

(VIKAS AWASTHY)

(D. KARUNAKARA RAO)

न्यायिक सदस्य / JUDICIAL MEMBER

लेखा सदस्य / ACCOUNTANT MEMBER

पुणे Pune; दिनांक Dated : 31st August, 2018
सतीश

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent
3. The CIT(A)-2, Nashik
4. The Pr.CIT-1, Nashik
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, "SMC Bench"
Pune;
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

Senior Private Secretary
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune