

IN THE INCOME TAX APPELLATE TRIBUNAL
RAJKOT BENCH, RAJKOT

**Before: Shri Waseem Ahmed, Accountant Member
And Shri Siddhartha Nautiyal, Judicial Member**

**ITA No. 75/Rjt/2022
Assessment Year 2017-18**

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| M/s. Jagjit Builders and Developers, Rajkot PAN: AADFJ9480A (Appellant) | Vs | The Pr. CIT, Rajkot-1 (Respondent) |
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**Assessee by: Shri Mehul Ranpura, A.R.
Revenue by: Shri Sanjeev Jain, CIT-D.R.**

Date of hearing : 30-06-2022
Date of pronouncement : 27-07-2022

आदेश/ORDER

PER BENCH:-

This assessee's appeal for A.Y. 2017-18, arises from order of the Principal Commissioner of Income Tax (PCIT), Rajkot-1 dated 04-02-2022, in DIN & Order No. ITBA/REV/F/REV5/2021-22/1039395629(1), in proceedings under section 263 of the Income Tax Act, 1961; in short "the Act".

2. The assessee has raised the following grounds of appeal:-

“1. The grounds of appeal mentioned hereunder are without prejudice to one another.

2. The order passed by Pr. Commissioner of Income-tax, Rajkot-1 [hereinafter referred as to the "PCIT"] is bad in law, invalid and requires to be quashed, the same may kindly be quashed.

3. The ld. PCIT erred in law and on facts in arriving at a conclusion to the effect that the assessment order passed by the A.O. was erroneous as well as prejudicial to the interest of the revenue on the ground that such order was passed without verifying mandatory requirement of payment of interest on capital of partner as per clause of partnership deed. Therefore, the order passed by PCIT is required to be quashed and may kindly be quashed.

4. The learned Pr. CIT erred on facts as also in law in setting aside the assessment order dated 29-11-2019 passed u/s. 143(3) of the I.T. Act, directing the A.O. to pass a fresh assessment order. The order passed u/s. 263 of the Act by the learned Pr. CIT is totally unjustified on facts as also in law therefore the same may kindly be quashed.

5. Your Honour's appellant craves leave to add, to amend, alter, or withdraw any or more grounds of appeal on or before the hearing of appeal.”

3. The brief facts of the case are that the assessee is a partnership firm consisting of five partners. The return of income for assessment year 2017-18 was filed on 09-10-2017 declaring total income of ₹ 1,81,75,900/-. The assessment was completed under section 143(3) of the Act on 29-11-2019 at the same income as declared by the assessee firm in its return of income. On examination of records, Principal CIT observed that the assessee firm had claimed deduction under Chapter-VIA under section 80IB(10) of the Act. During the course of assessment proceedings, the assessee firm had

submitted its latest partnership deed which was effective from 18-12-2006. On perusal of the same, as per clause 5 of the partnership deed, each partner is entitled for interest on his/her capital @12% as per section 40(b) of the Act or with mutual understanding, the partners may fix rate of interest at a lower rate. However, during the year, it is noticed that assessee firm is claiming deduction under Chapter-VIA under section 80IB(10) of the Act and claimed deduction amounting to ₹ 35,53,468/-. Therefore, assessee firm is taking advantage of exempt income by not claiming interest on partner's capital as the interest on capital is taxable in the hands of the partners. Therefore, assessee firm has not given any interest on capital as per the terms of partnership deed by claiming higher exempt income. It is further noticed that the assessee firm had not paid interest to the partners in contravention of the express conditions of the partnership deed. Hence, assessee firm had inflated profits eligible for deduction under section 80IB(10) of the Act by not debiting the interest payable to partners as per partnership deed. The eligible interest in the hands of partners on their capital as per the partnership deed was worked out at ₹ 14,04,074/- and accordingly, the assessee firm had inflated its profits from eligible business under section 80IB(10) of the Act to the above extent with the view to claim higher deduction under section 80IB(10) of the Act. Accordingly, Principal CIT held that the assessment order passed u/s 143(3) of the Act is erroneous and prejudicial to the interests of the revenue. While passing the order, Principal CIT made the following observations:

“4. I have gone through the records and the submission made by the assessee during the proceedings. The assessee has submitted that in the firms case in reply to show cause notice calculating the interest

4. Before us, the counsel for the assessee submitted that this issue has been discussed by the assessing officer during the course of assessment proceedings. He drew our attention to pages 9-10 of the paper book (show cause notice issued by the assessing officer dated 24-11-2019) wherein at paragraph 3 of the said notice, the AO had made a specific enquiry on this point. He further drew our attention to reply of the assessee dated 29-11-2019 at pages 11 to 14 of the paper book. Accordingly, the counsel for the assessee submitted that this issue had been specifically raised by the assessing officer during the course of assessment proceedings and the assessee had duly responded by filing submission dated 29-11-2019, which was considered by the AO while passing the assessment order. Further, the counsel for the assessee submitted that Clause-5 of partnership deed specifically provides that the partners shall be entitled to increase or reduce the interest on capital contributed by partners and thus, though the partnership deed contains a provision for interest to partners, it is open for the partners to increase or decrease the same or even not to pay interest at all, as per mutual agreement. In the assessee's case, it was decided that no interest shall be paid and accordingly, neither interest has been paid during the impugned year, nor the same has been debited to the profit loss account. The counsel for the assessee placed reliance on the case of **Tulsa Ram Kanhiyalal & Sons[2008] 25SOT402 (Jodhpur)**, where ITAT held that since partnership deed revealed that parties on mutual consent could add, amend, vary or alter any of terms of partnership, Assessing Officer could not have compelled assessee to charge such interest or remuneration by invoking section 40(b), more particularly when it was not mandatory but discretionary

for assessee to have make such a claim. In response, the Ld. DR relied on the observations made by the Principal CIT in the 263 Order.

5. We have heard the rival contentions and perused the material on record. We note from the records that it is an undisputed fact that this specific issue was raised by the assessing officer vide show cause notice dated 24-11-2019 and in response to which the assessee had filed detailed reply on 29-11-2019. Therefore, it cannot be said that this issue had escaped notice of the assessing officer during the course of assessment proceedings that the AO did not give a thoughtful consideration to this matter. Further, we note that in the case of **Tulsa Ram Kanhiyalal & Sons [2008] 25 SOT 402 (Jodhpur)** the ITAT has made the following relevant observations on this issue:

It was correct that the terms of partnership deed provided for payment of interest at the rate of 12 per cent on capital of partners as well as remuneration to the working partners. The assessee, however, did not make payment thereof to the partners nor made any provision of such liability in its books of account. A perusal of deed of partnership revealed that the parties on mutual consent could add, amend, vary or alter any of the terms of partnership. This was found to be so spelled out in clause No. 11 of partnership deed dated 4-4-1988 and adopted in the supplementary deed as well. From that clause it was evident that the various clauses of partnership deed which authorized the partners to charge interest on their capital and remuneration to the working partners could be varied or amended either verbally or

even by conduct. It was not necessary for the parties to have reduced such terms to writing in case they desired not to charge any interest or remuneration as such. From the conduct of parties it was evident that they had acted in terms of clause No. 11 of the partnership deed. The Assessing Officer, therefore, could not have compelled the assessee to charge such interest or remuneration by invoking section 40(b)(v), more particularly when it was not mandatory but discretionary for the assessee to have made such a claim.

5.1 We note that in the case of **Myhome Developers v. ACIT [2021] 129 taxmann.com 120 (Gujarat)**, assessee was a partnership firm engaged in activity of developing housing projects. The assessment in case of assessee was sought to be reopened on ground that assessee had claimed excessive deductions under section 80-IB(10), without providing interest on capital and remunerations to partners for respective years under consideration, which had escaped assessment. The assessee contended that, both interest and remuneration stipulations were incorporated in partnership deed earlier which contained clause as to payment of interest and remuneration, however, same was not at all paid to partners. Further, though clauses of partnership deed provided for interest on partner's capital and remuneration, same was subject to their mutual agreement. Thus, it was noted that mere incorporation of clauses in partnership deed for interest on partner's capital and remuneration, did not signify that, interest and remuneration was to be paid to partners mandatorily. The record indicated that assessee had not provided any remuneration interest on capital payable to partners. Accordingly, the Gujarat High Court held that the impugned reopening

noticed issued against assessee was unjustified and same was to be set aside. While passing the order, the Gujarat High Court observed as under:

18. We have examined the clauses of the partnership deeds as referred to above. Though the clauses of the partnership deed provided for interest on partner's capital and remuneration, the same is subject to their mutual agreement. In other words, the clauses contained are only enabling provision not mandatory in nature so as to lead to an inference that, the assessee had to pay interest on capital and remuneration to its partners. Even after 1-4-2009, interest on capital as well as the remuneration were not to be paid to the partners. We do not find any material on record to indicate that, the writ applicant has actually received any interest on capital and remuneration from the partnership firm. Record further indicates that, for the assessment year 2010-11, deduction under section 80IB(10) was claimed without paying any interest on capital and remuneration to partners and such claim was not disturbed by the assessing officer. In this view of the matter, the conclusion arrived at by the assessing officer that, the assessee has claimed deduction without providing interest on capital and remuneration to partners as per the clause 6 and 7 of the deed, has escaped assessment on account of failure on the part of the assessee in filing of the return of income disclosing fully and truly all material facts are contrary to law and without jurisdiction.

5.2 Therefore, in view of the above judicial precedents, including the one rendered by the jurisdictional Gujarat High Court, we are of the considered

view that the twin conditions that the order is erroneous and is also prejudicial to interest of revenue are not satisfied in the instant facts. The issue on the claim of excessive deduction under Chapter-VIA under section 80IB(10) of the Act was specifically raised during the course of assessment proceedings and the assessee had filed detailed reply in response thereto during assessment proceedings. Further, as evident from the above judicial precedents, the view taken by the AO is a legally possible view. Therefore, we find no infirmity in the assessment order. Accordingly, we are of the view that Principal CIT has erred in holding that the order passed by the assessing officer is erroneous and prejudicial to the interest of revenue.

6. In the result, the appeal of the assessee is allowed.

Order pronounced in the open court on 27-07-2022

Sd/-
(WASEEM AHMED)
ACCOUNTANT MEMBER
Ahmedabad : Dated 27/07/2022

Sd/-
(SIDHHARTHA NAUTIYAL)
JUDICIAL MEMBER

आदेश की प्रतिलिपि अग्रेषित / Copy of Order Forwarded to:-

1. Assessee
2. Revenue
3. Concerned CIT
4. CIT (A)
5. DR, ITAT, Ahmedabad
6. Guard file.

By order,

Assistant Registrar,
Income Tax Appellate Tribunal,
Rajkot