

facts of the case are such that we are of the view that the Tribunal was justified in holding that the extended limitation provided in Section 153 (1) (b) of the Act was applicable and the referred question is answered in affirmative, in favour of the Revenue. No costs.

S.C.K.

*Before G. C. Mital and S. S. Sodhi, JJ.*

COMMISSIONER OF INCOME TAX, HARYANA, ROHTAK,  
—*Petitioner.*

*versus*

M/S PRECISION STEEL AND ENGG. WORKS, FARIDABAD.—  
—*Respondent.*

*Income Tax Reference No. 4 of 1986*

May 4, 1989.

*Income Tax Act (XLIII of 1961)—S. 40(b), Explanation (1)—Partners making deposits with firm—Receiving interest on such deposits—Partners also paying interest on withdrawals from the firm—Interest paid exceeding interest received—Addition of interest paid to the income of assessee firm—Validity of such addition—Circulars issued by the Central Board of Direct Taxes—Value of such circular.*

*Held*, that only the net amount paid by the firm to its partners after adjusting the interest paid by the partners to the firm, can be disallowed under S. 40(b) of the Income Tax Act, 1961 since in this case the partners had paid more interest to the firm, the interest paid by the firm to the partners was rightly not disallowed by the Tribunal and the Tribunal was right in deleting the addition.

(Para 5)

*Held*, that the circulars issued by the Board are not binding on courts because if assessee wants to challenge its correctness, it is open to him to do so. But at the same time, the circular issued by the Board are binding on the department and the department cannot be allowed to raise argument opposed to the decision of the Board. In this case, we have to give effect to the circular, as it favours the assessee and would bind the department.

(Para 4)

Commissioner of Income Tax, Haryana, Rohtak v. M/s Precision Steel and Engg. Works, Faridabad (G. C. Mital, J.)

*Reference under Section 256(1) of the Income-tax Act, 1961 by the Income Tax Appellate Tribunal (Delhi Bench) New Delhi, to the Hon'ble High Court of Punjab and Haryana for opinion of the following questions of law arising out of the Tribunal's order dated 26th March, 1984 in R.A. No. 768/Del/84 in ITA No. 1867/Del/83, Assessment Year 1981-82:*

*“Whether on the facts and in the circumstances of the case, the Tribunal was right in law in deleting the addition of Rs. 1,08,287 as interest paid to partners under section 40(b) of the Income-tax Act, 1961”?*

Ashok Bhan, Sr. Advocate with Ajay Mittal, Advocate, for the Applicant.

Amita Gupta, Advocate, for the Respondent.

#### JUDGMENT

Gokal Chand Mital, J.

(1) The assessee is a registered firm. During the accounting year relevant to the assessment year 1981-82, it got interest amounting to Rs. 1,62,410 from the partners on the withdrawals made by them in the current account. The partners had made deposits with the firm and on those deposits during that period they were paid interest amounting to Rs. 1,08,287. During assessment, the Income Tax Officer added back interest of Rs. 1,08,287 as under Section 40(b) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act'), deduction of interest paid to the partners could not be allowed. The assessee obtained some relief from the Commissioner of Income Tax (Appeals). On further appeal to the Income Tax Appellate Tribunal (for short 'the Tribunal'), Delhi, the assessee got the entire relief in regard to the interest of Rs. 1,08,287 paid to the partners, in view of certain decisions referred in the order. In this background, the following question has been referred for opinion of this Court :

*“Whether on the facts and in the circumstances of the case, the Tribunal was right in law in deducting the addition of Rs. 1,08,287 as interest paid to partners u/s 40(b) of the Income-Tax Act, 1961 ?”*

(2) Section 40(b) as it stood during the assessment year in question was as follows :

“40. Notwithstanding anything to the contrary in sections 30 to 39, the following amounts shall not be deducted in computing the income chargeable under the head ‘Profits and gains of business or profession :

9(a) x x x x x x x x x x x

(b) in the case of any firm, any payment of interest, salary, bonus commission or remuneration made by the firm to any partner of the firm.”

The aforesaid provision came up for consideration before the four High Courts in the following cases and on similar facts it was held that only the net amount paid by the firm to its partners, after adjusting the interest paid by the partners to the firm, can be disallowed under Section 40(b) of the Act and not whole of it.

(i) *C.I.T. v. Kailash Motor* (1).

(ii) *C.I.T. v. T. V. Ramanaiah and Sons* (2).

(iii) *C.I.T. v. Kothari and Co.* (3).

(iv) *C.I.T. v. Moti Lal Ramjiwan and Company* (4).

However, a contrary view has been taken by the Madras High Court in *C.I.T. Tamil Nadu v. O.M.S.S. Sankaralinga Nadar and Co.* (5).

(3) By the Taxation Laws (Amendment) Act, 1984, three explanations were inserted to Section 40(b) of the Act, which came into force with effect from 1st April, 1985 and Explanation (1) which is relevant for our purposes is as follows :

“*Explanation 1* : Where interest is paid by a firm to any partner of the firm who has also paid interest to the

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(1) 134 I.T.R. 312 (All).

(2) 157 I.T.R. 300 (AP)

(3) 165 I.T.R. 594 (Karnatka)

(4) 171 I.T.R. 294 (Rajasthan)

(5) 147 I.T.R. 332.

Commissioner of Income Tax, Haryana, Rohtak v. M/s Precision Steel and Engg. Works, Faridabad (G. C. Mital, J.)

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firm, the amount of interest to be disallowed under this clause shall be limited to the amount by which the payment of interest by the firm to the partner exceeds the payment of interest by the partners to the firm.”

This explanation is in tune with the decision rendered by the four High Courts, referred to on behalf of the assessee. After insertion of the explanation, question cropped up before the Central Board of Director Taxes as to whether the explanation would be applicable prospectively or was merely of a clarificatory nature and would also be applicable for earlier years in cases which may be pending in Courts. The Central Board of Direct Taxes took a decision favouring the assessee, which is printed in 149 I.T.R. (Statutes 127). The relevant para of the Board's decision, which may concern the decision of this case is as follows :—

“(2) A number amendments have been made to bring out the legislative intention more clearly so that further controversy and litigation regarding the true intent and purport of these provisions is avoided. To illustrate :

(a) It has been clarified that in cases where a firm pays interest to a partner as well as receives interest from him, only the net amount paid by the firm to the partner will be disallowed under section 40(b) of the Income-tax Act in computing the income of the firm.”

*Explanation* (1) which came into effect from 1st April, 1985 needed no clarification and the net amount, if any, paid to partners, could be disallowed but if the result was that the amount paid by the partners to the firm was more than the amount paid by the firm to the partners, then the amount of interest paid by the firm to the partners could not be disallowed. When this provisions was so clear with effect from 1st April, 1985, there was no question of issuing clarification by the Central Board unless it was considered that the explanation was of clarificatory nature and would apply to the assessment years even before the explanation (1) came into force. The High Courts of Andhra Pradesh, Karnataka and Rajasthan in the aforesaid judgments have taken the view that the decision of the Board is of clarificatory nature and the amendment would be

applicable to the assessment years prior to 1st April, 1985. However, the Madras High Court in *O.M.S.S. Sankaralinga Nadar and Co's case (supra)*, took a different view. On this matter, we have held in I.T. Ref. No. 43 of 1981 (*Hindustan Steel Forging Rajpura v. C.I.T. Patiala*) (6), that the aforesaid decision of the Board is of clarificatory nature and what was hidden was made apparent. There we were considering the effect of Explanation 2.

(4) The circulars issued by the Board are not binding on Courts because if assessee wants to challenge its correctness, it is open to him to do so. But at the same time, the Supreme Court has held in numerous cases that the circulars issued by the Board are binding on the department, and the department cannot be allowed to raise argument opposed to the decision of the Board. In this case, we have to give effect to the circular referred to above, as it favours the assessee and would bind the department.

(5) In view of our earlier decision and the decision of the three High Courts in favour of the assessee on the circular point, we agree with the judgments referred to on behalf of the assessee and dissent from the decision rendered by the Madras High Court, and hold that only the net amount paid by the firm to its partners after adjusting the interest paid by the partners to the firm, can be disallowed under section 40(b) of the Act. Since in this case the partners had paid more interest to the firm, the interest paid by the firm to the partners was rightly not disallowed by the Tribunal and the Tribunal was right in deleting the addition and we answer the referred question in favour of the assessee, in the affirmative, with no order as to costs.

S.C.K.

Before : G. C. Mital and S. S. Sodhi, JJ.  
GANESH FACTORY, RAJPURA,—Appellant.  
versus

COMMISSIONER OF INCOME TAX, PATIALA,—Respondent.

*Income Tax Reference No. 12 of 1981*

May 18, 1989.

*Income Tax Act (XLIII of 1961) Ss. 40(b), 40A(2)—Partnership concern paying salary to its partners—Firm claiming deductions as*

(6) I.T.R. No. 43 of 1981 decided on 2nd March, 1980.