

that the dubious method adopted by the assessee firm to reduce tax burden cannot be allowed in view of the judgment of Hon'ble Supreme Court in the case of Mac Dowell & Company Vs. CIT [154 ITR 148].

4. That on the facts and in the circumstances of the case, the CIT (A) ought to have upheld the order of the Assessing Officer.

5. It is therefore prayed that the order of the CIT (A) be set aside and that of the Assessing Officer be restored.

6. That the revenue craves leave to add, amend, alter or withdraw any grounds of appeal.”

3. In ITA No.358/Rjt/2012 for assessment year 2009-10, the Revenue has taken the following grounds of appeal:-

“1. The CIT (A) has erred in law and on facts in deleting the addition of Rs.29,53,516/- by charging interest on partners capital and addition of Rs.14,54,731/- towards remuneration to the partners.

2. The CIT (A) has erred in law and on facts in directing to allow the total deduction u/s.10B of the Act at Rs.38,01,492/- as against the allowable deduction worked out by the Assessing Officer at Rs.11,72,310/- after deducting the interest on partners capital and remuneration payable to the partners as per partnership deed.

3. The CIT (A) has erred in law and on facts in holding that it was not mandatory to pay interest and remuneration to partners even though there was a clear provision in partnership deed. The CIT (A) failed to appreciate that the dubious method adopted by the assessee firm to reduce tax burden cannot be allowed in view of the judgment of Hon'ble Supreme Court in the case of Mac Dowell & Company Vs. CIT [154 ITR 148].

4. That on the facts and in the circumstances of the case, the CIT (A) ought to have upheld the order of the Assessing Officer.

5. It is therefore prayed that the order of the CIT (A) be set aside and that of the Assessing Officer be restored.

6. That the revenue craves leave to add, amend, alter or withdraw any grounds of appeal.”

4. For the sake of convenience, facts are being extracted from records relating to assessment year 2006-07. Perusal of the assessment order shows that the assessee is a partnership firm. It claims to be a 100% Export-Oriented Undertaking and therefore entitled to exemption from tax in respect of profits and gains derived from the export of articles or things or computer software. The assessee is engaged in the business of manufacture and export of brass items. The assessee filed its return of income for Assessment Year 2006-07 on 31.12.2006 returning total income at Rs.28,91,892/- after claiming exemption for a sum of Rs.36,02,046/- u/s 10B of the Income-tax Act. Order of assessment was passed u/s 143(3) on 30.12.2008 assessing total income of the assessee for the Assessment Year 2006-07 at Rs.50,56,540/-. The assessment records were called for and examined by the Id. Commissioner of Income-tax u/s 263 of the Income-tax Act pursuant to which a revision order was passed by him on 28.03.2011 by which the order of assessment passed by the Assessing Officer on 30.12.2008 for the Assessment year 2006-07 was set aside with the following observations:-

“4. I have carefully considered the submission made by as the assessee but the same is not accepted. The supplementary deed furnished by the assessee is not found authentic and genuine. The xerox copy of deed submitted by the assessee bears no signature or seal of the notary. It was also ascertained that, during the assessment proceedings itself, the assessee was asked to produce the partnership deed for verifying the distribution of interest and remuneration among the partners. In reply, the AR of the assessee said that the firm had not made any supplementary deed for the distribution of interest and remuneration among the partners. Consequently, the firm was unable to produce the partnership deed at that time. It clearly appears that the supplementary deed is an afterthought, to avoid the proceedings where the question of non-payment of remuneration

and interest was arised. Therefore the supplementary deed produced by the assessee is rejected being bereft of merits.

5. Income from profits and gains of business or profession i.e. referred to in section 28 shall be computed in accordance with the provisions contained in section 30 to 43D. the Supreme Court in the case of *Mec dowell & Company Vs. CIT* (154 ITR 148) held that the tax planning should be legitimate and within the framework of law. Colorful devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting the dubious method.

6. I therefore hold that the assessment finalized by the AO u/s.143(3) is erroneous and prejudicial to the interest of revenue. Accordingly, the assessment is set aside with a direction to the AO to re-frame the assessment afresh after giving the assessee an opportunity of being heard. AO should also take steps to recover the demand raised, by the due date.”

5. Pursuant to the aforesaid directions given by the Id. Commissioner of Income-tax, the Assessing Officer has now passed a fresh order of assessment on 16.12.2011 u/s 143(3) read with section 263 of the Income-tax Act by which a sum of Rs.11,36,461/- and Rs.30,61,317/- being interest and remuneration respectively payable to the partners u/s 40(b) of the Income-tax Act has been reduced from the profits of the business eligible for exemption u/s 10B of the Income-tax Act.

6. Return of income for assessment year 2009-10 was filed by the assessee on 25.09.2009 returning total income at Rs.28,48,876/- as against which total income of the assessee has been assessed at Rs.54,78,060/- in the order of assessment passed u/s 143(3) of the Income-tax Act on 16.12.2011 after excluding the interest and remuneration payable to the partners u/s 40(b) of the Income-tax Act from the profits of the business eligible for exemption u/s 10B.

7. The aforesaid action of the Assessing Officer was challenged by the assessee before the Id. CIT(A). Though the Id CIT(A) has passed orders for both the assessment years separately on 13.03.2012, the operative portion of his order is not only identically worded but also carry the same paragraph numbers.

Paragraph 6 and 6.1 in the appellate orders passed by the Id. CIT(A) for both the assessment years read as under:-

“6. I have carefully considered the submission made by the appellant and the discussion made by the AO in the assessment order. The basic argument of the appellant is that it is not mandatory to allocate interest on partners’ capital and remuneration to partner u/s.40(b) merely on the fact that the partnership deed contained provisions of interest and remuneration. The payment of interest and remuneration to the partners is governed by mutual consent of the partners. If partners mutually decide not to pay interest and remuneration, in spite of having clause of the same in partnership deed, assessing authority is not justified in enforcing deduction of interest on capital and remuneration to the partners.

6.1 In the instance case, it is correct that the terms of partnership provided payment of interest @ 12% on capital of partners and remuneration to the working partners. However, the appellant did not make payment thereof to the partners not made any provision of liability in the books of account. On perusal of deed of partnership reveals that there was no any compulsion of the payment of interest or remuneration to the partners. The relevant clause in the deed indicate the flexibility by using words: “That the parties have decided that simple interest at the rate as may be mutually agreed by the partners from time to time or prescribed under section-40(b) of the Income Tax Act, may be paid to the partner on their capital invested, current, loan accounts and such interest may be paid even if in any particular year the partnership firm may have incurred losses”. From this clause, it is evident that partnership deed which authorized the partners to charge interest on their capitals 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 in writing in case they desired not to charge any interest or remuneration as such. This view also founds further supported by the decision of Jodhpur Bench of Tribunal in the case of *Tulsa Ram Kanhiyalal & Sons vs. ITO* (2008) 118 TTJ 536. In view of the above, I

opine that the AO could not have compelled the appellant to charge such interest or remuneration by invoking section 40(b) of the Act more particularly when it is not mandatory but discretionary of the assessee to have made such a claim. Therefore, ground of appeal taken by the appellant is allowed.”

8. Aggrieved by both the orders passed by the Id CIT(A), the Revenue is now in appeal before this Tribunal. In support of appeal, the Id. Departmental Representative relied upon the findings recorded by the Id. Commissioner of Income-tax in his order passed u/s 263 for the assessment year 2006-07 as also the findings recorded by the Assessing Officer in the assessment orders for both the years under appeal. He submitted that the issue under appeal was covered by the order passed by this Tribunal on 24.01.2013 in ITO v. Devine Impex, ITA No.279/Rjt/2012.

9. In reply, the Id Authorized Representative for the assessee supported the order passed by the Id CIT(A). He invited our attention to the partnership deed dated 28.11.2002 which was executed between four existing partners and two retiring partners. Referring to clauses 16 and 17 of the aforesaid partnership deed dated 28.11.2002, he submitted that interest on capital and remuneration was required to be paid to the partners in conformity with section 40(b) of the Income-tax Act. He further submitted that another partnership deed was executed on 14.09.2005 between two existing partners, namely, (1) Shri Vallabhbhai Shamjibhai Shiyani and (2) Shri Bharatkumar Gopaldas Faldu and two retiring partners, namely, (1) Shri Karsanbhai Shamjibhai Shiyani and (2) Shri Vallabhbhai Shamjibhai Shiyani. Inviting our attention to clauses 16 and 17 of the said partnership deed dated 14.09.2005, he submitted that interest on capital and remuneration was required to be paid to the partners in conformity with section 40(b) of the Income-tax Act. He also referred to a supplementary partnership deed executed on the same date, i.e., 14.09.2005 between existing two partners, namely, (1) Shri Vallabhbhai S. Shiyani and (2) Shri Bharatkumar G. Faldu as per which they mutually agreed not to pay any interest or any remuneration, bonus and/or commission for FY 2005-06 (AY 2006-07) to any of the partners. Relying upon the supplementary partnership deed executed on the same date on which the main

deed of partnership deed was executed, he submitted that payment of interest on capital and remuneration to partners was optional and therefore no payment of interest or remuneration was made to any of the partners. According to him, the profits were thus correctly worked out without excluding the element of interest and remuneration as both of them were not payable to the partners as per supplementary partnership deed. He contended that the Assessing Officer was bound to accept the aforesaid position as it was in conformity with the stipulation in supplementary partnership deed.

10. The Id Authorized Representative for the assessee took us through the provisions of section 10B and sub-sections (8) and (10) of section 80(IA) of the Income-tax Act for the proposition that none of the aforesaid provisions authorizes the Assessing Officer to work out interest on capital and remuneration payable to partners and exclude them from the profits of business eligible for relief u/s 10B.

11. As regards the reasons for not filing a copy of the supplementary partnership deed at the time of original assessment, the Id. Authorised Representative for the assessee submitted that there was no requirement in law to file such a supplementary partnership deed before the AO.

12. We have heard both the parties and carefully considered their submissions. Section 10B exempts from tax any profit and gain derived by a 100% Export-Oriented Undertaking from the export of articles or things or computer software subject to the fulfillment of conditions stipulated in section 10B of the Income-tax Act. The profits and gains eligible for exemption u/s 10B can neither be artificial nor inflated profits and gains but actual profits and gains. In other words, all outgoings including expenses eligible for deduction need to be considered while computing the profits and gains of the business. Payment of interest on capital and remuneration to partners is eligible for deduction u/s 37 of the Income-tax Act subject to the restrictions placed by section 40(b) of the Income-tax Act. According to section 37, any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the

purposes of the business or profession shall be allowed in computing the income chargeable under the head “profits and gains of business or profession”. Section 40(b) however places certain restrictions on the deductibility of amount of interest and remuneration payable to partners. The relevant clauses in the copies of partnership deeds filed before us do not violate the prescription of section 40(b) of the Income-tax Act. Therefore interest on capital and remuneration payable to partners are admissible for deduction u/s 37 and is therefore required to be taken into account for computing the profits eligible for exemption u/s 10B of the Income-tax Act.

13. Perusal of the partnership deed dated 28.11.2002 requires payment of interest on capital and remuneration to partners. There is similar stipulation in partnership deed dated 14.09.2005. It is interesting to observe that the partnership deed was executed on 14.09.2005 which is not only duly signed by the existing partners as well as retiring partners but also registered with Sub-Registrar, Jamnagar. The supplementary deed is also stated to have been executed on 14.09.2005 but it is not registered with Sub-Registrar, Jamnagar. Both the deeds, i.e., the partnership deed and the supplementary partnership deed, have reportedly been executed on 14.09.2005. Supplementary deed was not filed before the Assessing Officer at the time of original assessment proceedings. The supplementary partnership deed, if it was genuinely in existence at the time of original assessment proceedings, ought to have been filed before the AO not because it was required by law but because it was relied upon by the assessee in support of its claim that interest and remuneration was not payable to partners as per supplementary partnership deed. Besides, the supplementary deed contains a recital that both the partners have mutually agreed not to pay any interest or remuneration etc. for FY 2005-06. There is no similar supplementary deed for Assessment Year 2009-10. There is another deed of partnership dated 31.03.2006 which also provides for payment of interest on capital and remuneration to the partners. In fact, clause 17 of the aforesaid partnership deed provides that the remuneration shall be paid to the partners as per the details given in the said clause.

14. On careful perusal of the relevant partnership deeds, we are convinced that payment of interest on capital and remuneration to partners is not hit by section 40(b) of the Income-tax Act. The mere fact that the partners have chosen to forego interest on capital and remuneration payable to them does not ipso-facto mean that they are not admissible for deduction. The fact that the assessee has not debited such interest and remuneration payable to partners to its profit & loss account in spite of their admissibility to deduction makes its intention quite evident, namely, to inflate the profits eligible for exemption u/s 10B. The Assessing Officer has correctly worked out interest on capital and remuneration payable to partners and excluded them from the overall profits of business for working out the profits eligible for exemption u/s 10B of the Income-tax Act. The order of the Id. CIT(A) in this behalf is therefore reversed and that of the Assessing Officer restored. Both the appeals filed by the Revenue are allowed.

Order pronounced on 26.07.2013

Sd/-
(T. K. Sharma)
Judicial Member
Rajkot: 26.07.2013

Sd/-
(D. K. Srivastava)
Accountant Member

Bt

Copy of Order Forwarded to:-

1. Appellant – ACIT, Circle-2, Jamnagar
2. Respondent- Meridian Impex, Plot No.680, GIDC, Phase, II, Jamnagar
3. Concerned CIT, Jamnagar
4. CIT(A)-Jamnagar
5. DR, ITAT, Rajkot
6. Guard file.

True Copy

By order

Private Secretary, ITAT, Rajkot