

आयकर अपीलीय अधिकरण, जयपुर न्यायपीठ, जयपुर
IN THE INCOME TAX APPELLATE TRIBUNAL,
JAIPUR BENCHES (SMC), JAIPUR

श्री विजय पाल राव, न्यायिक सदस्य के समक्ष
BEFORE: SHRI VIJAY PAL RAO, JUDICIAL MEMBER

आयकर अपील सं./ITA No. 527/JP/2015
निर्धारण वर्ष/Assessment Year : 2006-07

M/s Karni Maa International 64, Ayuwan Singh, Nagar, Maharani, Farm, Durgapura, Jaipur.	बनाम Vs.	Income Tax Officer, Ward 6(2), Jaipur.
स्थायी लेखा सं./जीआईआर सं./PAN/GIR No.: AAHFK 6082 F		
अपीलार्थी / Appellant		प्रत्यर्थी / Respondent

निर्धारिती की ओर से / Assessee by : Shri Manish Agarwal (C.A.)
राजस्व की ओर से / Revenue by : Smt. Poonum Rai (DCIT)

सुनवाई की तारीख / Date of Hearing : 22/12/2017
उदघोषणा की तारीख / Date of Pronouncement : 08/03/2018

आदेश / ORDER

PER: VIJAY PAL RAO, J.M.

This appeal by the assessee is directed against the order dated 27.04.2015 of Id. CIT(A), Jaipur for the assessment year 2006-07. The assessee has raised the following grounds:-

- "1. on the facts and the circumstances of the case the Ld. CIT(A) has grossly erred in passing the impugned order u/s 144 of the Income Tax Act, 1961 without providing adequate opportunity to the assessee, hence the order so passed deserves to be quashed.*
- 2. on the facts and the circumstances of the case the Ld. CIT(A) has grossly erred in making addition of Rs. 45,724/- on account of*

disallowance u/s 40A(3) without considering the submission made and evidence adduced during the remand proceedings, thus addition so made deserves to be deleted.

3. on the facts and the circumstances of the case the Ld. CIT(A) has grossly erred in upholding the disallowance of Rs. 1,24,514/- made by Ld. AO on account of remuneration to partners without considering the supplementary deed submitted as addition evidence during the proceedings, thus disallowance so upheld deserves to be deleted.

4. on the facts and the circumstances of the case the Ld. CIT(A) has grossly erred in upholding the capital addition of Rs. 13,20,500/- made by Ld. AO on account of unexplained income without considering the submission made and evidence adduced, thus addition so sustained deserves to be deleted.

4.1 That the Ld. CIT(A) has further erred in ignoring the fact that verification of all the persons from whom loan was taken for introduction of fresh capital was submitted which itself explains the source of investment, thus addition so sustained deserves to be deleted.

5. That the appellant craves the right to add, delete, amend or abandon any of the grounds of this appeal either before or at the time of hearing of appeal."

2. Ground No. 1, at the time hearing, the learned counsel for the assessee has stated at bar that the assessee does not press ground no. 1 and the same may be dismissed as not pressed. The Ld. DR has raised no objection if ground no. 1 of the assessee's appeal is dismissed as not pressed. Accordingly the ground no. 1 of the assessee's appeal is dismissed being not pressed.

3. Ground no. 2 is regarding disallowance made u/s 40A(3) of the Act. The assessee is a partnership firm created vide partnership deed dated

17.10.2005. The assessee is in the business of trading and job work of readymade garments and this is the first year of business of the assessee. The AO made disallowance of Rs. 4,93,238/- by applying the net profit of the assessee of the earlier year. On appeal the assessee produced books of accounts as well as other relevant material/details before the Id. CIT(A) as additional evidence U/r 46A of the Income Tax rules. The Id. CIT(A) forwarded the additional evidence to the AO for verification and called for a remand report. The AO in the remand report as pointed that two payments of Rs. 24,094/- & 21,630/- have been made in cash, for purchases in violation of the provisions of Section 40A(3) of the Act. Accordingly, the Id. CIT(A) has directed the AO to made an addition of Rs. 45,724/- u/s 40A(3) by holding that the payments made by the assessee in cash to M/s S.K. Grafts and M/s Vardhaman Creations were in violation of provisions of Section 40A(3) of the Act.

4. Before the Tribunal, Id. AR of the assessee has submitted that the Id. CIT(A) has failed to confront this issue and no explanation was called from the assessee on this issue. Thus, Id. CIT(A) has made the addition without providing an opportunity of hearing. Nevertheless, he has submitted that the payments were made under exigency after the normal banking hours. Further the aforesaid two parties had desired payment from assessee urgently without providing proper time to assessee to make

payment through proper banking channel. Thus, the Id. AR of the assessee has submitted that the payments were made in cash due to aforesaid unavoidable exceptional circumstances and therefore, the provisions of Section 40A(3) of the Act are not applicable in the case. He has thus submitted that the case of the assessee falls in the exceptional circumstances provided under Rule 6DD of the Income Tax Rule, 1962.

5. On the other hand, Id. DR has submitted that it is clear a case of violation of the provisions of Section 40A(3) r.w.r 6DD of the Income Tax Rules. He has relied upon the order of the Id. CIT(A).

6. I have considered the rival submissions as well as relevant material on record. The payment in questions were made for purchases of Garments/material and therefore, it is not a payment in urgent or compelling circumstances. The decisions for purchases are made after well thought out process and therefore, not in an urgent situation of payment. Further, it is not the case of the assessee that the other parties are not having the bank accounts. Therefore, the case of the assessee does not fall in the exceptions provided under Rule 6DD of the Income Tax Rules. The order of the Id. CIT(A) qua this issue is upheld.

7. Ground No. 3 disallowance of interest and remuneration to partners. During the year under consideration the assessee firm paid Rs. 60,853/- to the partners as remuneration and also paid interest of Rs. 63,660/-. The

AO made disallowance of both the amounts totaling amounting to Rs. 1,24,514/- by holding that these payments could not be verified for want of partnership deed. The assessee produce the partnership deed dated 17.10.2005 as well as the copy of supplementary partnership deed dated 02.01.2006 before the Id. CIT(A) in support of the claim of payment of remuneration and interest to the partners. Since, these partnership deeds were submitted as additional evidence U/r 46A accordingly the Id. CIT(A) called for a remand report from the AO. After considering the remand report the Id. CIT(A) has noted that there is no provisions of payment of remuneration in the original partnership deed dated 17.10.2005 and further the supplementary deed dated 02.01.2006 cannot be verified from independent source therefore, he has confirmed the disallowance of remuneration paid to the partners. As regards payment of interest the Id. CIT(A) has observed that the entire interest is not allowable but restricted only which is relatable to capital of Rs. 1,47,000/- because the balance capital was not accepted and addition was made in the hand of the partnership firm therefore, the claim of interest was restricted by the Id. CIT(A).

8. Before us, Id. AR of the assessee has submitted that the AO disallowed remuneration to the partner for want of partnership deed which was submitted as additional evidence along with supplementary

partnership deed dated 02.01.2006. He has referred to the supplementary partnership deed dated 02.01.2006 and submitted that vide clause 3 thereof, the remuneration payable to the partners is fixed in terms of the provisions contained therein. Thus, Id. AR has submitted that once the assessee has produced the supplementary partnership deed which contains the provisions for payment of remuneration to the partners then the disallowance made by the authorities below is not justified.

9. On the other hand, Id. DR has relied upon the order of the Id. CIT(A) and submitted that the genuineness of the supplementary partnership deed could not be verified from independent source and therefore, it is an afterthought deed prepared by the assessee which was not produced before the Assessing Officer.

10. I have considered the rival submissions as well as relevant material on record. There is no dispute that the assessee produced the partnership deed as well as supplementary partnership deed before the Id. CIT(A). As regards the payment of remuneration to the partners it is a decision to be taken by the partners of the partnership firm by making a provision in the partnership deed. Once, the partners have taken a decision to make the provisions in the partnership deed for payment of remuneration to the partners then the taxing authority cannot question such provisions in the partnership deed. Accordingly, the partnership firm is governed and bound

by the terms and conditions of the partnership deed and therefore, the assessee has rightly paid the salary to the partners in terms of the supplementary partnership deed which is allowable deduction. Even otherwise in case of partnership firm the income has to be either taxed in the hand of the firm or in the hand of the partners to the extent of salary or interest paid to the partners. If the partners have decided to include the income in their personal hand on account of interest and salary and the said payment is in accordance with terms of the partnership deed then the disallowance is not justified. As regards the disallowance of interest the Id. CIT(A) has restricted the interest claim only to the extent of the capital introduced by the partners which was accepted therefore, the issue is dependent on the outcome of the addition made by the AO/Id. CIT(A) u/s 68 on account of capital contribution by the partners.

11. Ground Nos. 4 and 4.1 are regarding addition u/s 68 on account of capital contribution of the partners. During the assessment proceeding the AO questioned the source of capital contribution total amounting to Rs. 14,67,500/-. Since, the assessee could not submit its explanation during the course of assessment proceedings therefore, the AO treated this entire amount as assessee's unexplained income and made addition accordingly. On appeal, before the Id. CIT(A) the assessee produce complete details along with the relevant evidences in support of the source of money in the

hands of the partners. The assessee explained that the capital of Rs. 6,93,500/- was contributed by partner Shri Jairaj Singh out of his past savings and own funds as well as unsecured loan taken from relatives. The balance amount of Rs.7,74,000/-was contributed by the partner Shri Jairaj Singh. The Id. CIT(A) accepted only an amount of Rs. 1,47,000/- as genuine on the ground that only 7 persons were holding PAN from whom the partners claimed to have taken loan. Accordingly the remaining amount of Rs. 13,20,500/- was sustained by the Id. CIT(A).

12. Before the Tribunal, Id. AR of the assessee has submitted that this is the first year of business of the assessee firm and therefore, the source of capital cannot be held as unexplained in the hands of assessee firm. He has further submitted that the assessee has produced ample evidences to support the source of funds in the hand of the partners who have contributed to the capital of the partnership firm. When the partners have introduced the amount as their capital contribution then the said amount cannot be held as unexplained cash credit in the hand of partnership firm. In support of his contention he has relied upon the following decisions:-

- CIT vs. Kewal Krishan & Partners 18DTR 121.
- CIT vs. Pandian Distributors 259ITR 428.
- India Rice Mills v. CIT 218 ITR 508,511.
- CIT vs. Electro Polychem Ltd. 294ITR 661.

- Abhudaya Pharmaceuticals v. CIT 32 Taxmann.com 68.

The Id. AR further submitted that the assessee is not obliged to establish the source of income in as much as this is the first year of operation of assessee's business. Even otherwise the assessee has satisfactorily explained the availability of funds in the hands of the partners accordingly, he has pleaded that the addition sustained by the Id. CIT(A) be deleted.

13. On the other hand, Id. DR has submitted that the assessee has not produced anything before the AO and only before the Id. CIT(A) the assessee claimed that the partners are having the source of capital contribution though it was claimed that the partners have taken loans from numbers of persons who were not even having the PAN or assessed to income. He has relied upon the order of the Id. CIT(A).

14. I have considered the rival submissions as well as relevant material on record. There is no dispute that the assessee firm was created vide partnership deed dated 17.10.2005 and therefore, this is first year of the business of the assessee's firm. Even only for less than 6 months period the assessee has carried out the business activity during the year under consideration. Accordingly, capital contribution made by the partners prior to the commencement of the business cannot be treated as the income of the assessee partnership firm. The Hon'ble jurisdiction High Court in case

of CIT vs. Kewal Krishan & Partners (supra) while dealing with an identical issue has held in para 7 and 8 as under:-

"7. It is not in dispute that the members of the AOP S/Shri Ali Mohd. Deposited Rs. 5,00,000/-, Amarnath deposited Rs. 3,00,000/- and Kewal Krishan deposited Rs. 50,000/- as capital contribution on the first day of commencement of the business by the firm i.e. 01.04.1989. All the partners have confirmed that they had introduced those amount as their capital contribution. Obviously, it was for the partners to explain the source of the deposits and if they failed to discharged the onus then, such deposits could be added in the hands of the partners only and not in the hands of the assessee firm. In any case, such capital contributions entered into the books of the accounts of the assessee firm prior to the commencement of the business cannot be treated to be the income of the assessee firm. In considered opinion of this Court, such unexplained credits may be added to the income of the partners concerned in terms of Section 69 and not u/s 68 of the Act of 1961.

8. For the aforementioned reasons, in our view, no substantial question of law arises out of the order impugned passed by the learned ITAT for consideration of this Court."

A similar view has been taken by the Hon'ble Madras High Court in case of CIT Pandian Distributors (supra) as well as the Hon'ble Allahaband High Court in case of India Rice Mills vs. CIT (supra). Therefore in view of a series of decision on this point that the capital introduced/ contributed by the partners before the commencement of the business of the partnership firm cannot be treated as income of the partnership firm. The AO was free to examine the addition of the said amount in the hand of the partners

instead of adding the same in the hand of the assessee firm. Following the decisions as relied upon by the assessee cited (supra) the addition made on account of capital contribution by the partners is deleted.

15. Further, the disallowance made by the Id. CIT(A) on account of payment of interest to the partners is also allowed being consequential to the issue of contribution of capital by the partners.

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

Order pronounced in the open court on 08/03/2018.

Sd/-
(विजय पाल राव)
(VIJAY PAL RAO)
न्यायिक सदस्य / Judicial Member

जयपुर / Jaipur

दिनांक / Dated:- 08/03/2018

*Santosh

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

1. अपीलार्थी / The Appellant- M/s Karni Maa International , Jaipur.
2. प्रत्यथी / The Respondent- The ITO, Ward 6(2), Jaipur.
3. आयकर आयुक्त / CIT
4. आयकर आयुक्त(अपील) / The CIT(A)
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, जयपुर / DR, ITAT, Jaipur
6. गार्ड फाईल / Guard File (ITA No. 527/JP/15)

आदेशानुसार / By order,

सहायक पंजीकार / Asst. Registra