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BADAL RAM LAXMI NARAIN

v.

C.I.T. LUCKNOW

JULY 12, 1991

B [K. JAGANNATHA SHETTY AND YOGESHWAR DAYAL, JJ.]

*Income Tax Act, 1922: Section 36(1)(iii)—Computation of Income—Interest paid on borrowed capital—Deduction of—Partition of HUF business—Formation of partnership firm by members of HUF—Take over of HUF business and debit balance—Whether interest paid on debit balance an allowable deduction.*

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The partners of the assessee-firm were members of a HUF, which was carrying on business with borrowed capital. Consequent on partial partition in the family and partition of the family business, the members formed the assessee-firm. There was a debit balance in the capital account of the family which was transferred to the personal accounts of the partners of the firm. The firm, which continued the family business and took over the business assets and the liabilities of the HUF, claimed that the interest paid on the debit balance was an allowable deduction in the computation of income since it had taken over the debit balance in consideration of the goodwill of the business. The Appellate Assistant Commissioner held that the HUF business had no goodwill. On appeal, the Tribunal held that the HUF had a very long-standing and flourishing business, and hence the firm could be deemed to have taken over the liability in consideration of the sale of goodwill and the interest paid thereon was an allowable deduction.

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On a reference made by the Tribunal the High Court held that the goodwill of the HUF business was never sold or purchased, and that the partners of the firm were bound to take over the HUF's liability, since it was that of the family of which they were members, and became liable to discharge their share of the debt.

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Allowing the appeals preferred by the assessee, this Court

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**HELD:** 1.1 Clause (iii) of Section 36(1) of the Income Tax Act, 1922 applies only where capital has been borrowed for the purposes of the business or profession. The amount of interest paid on the borrowed capital is an allowable deduction. It cannot be disputed that if the goodwill is purchased out of the borrowed capital, the interest paid on the borrowed capital is an allowable deduction. [923B]

1.2 In the instant case, there was only a partial partition in the family, particularly with regard to HUF business and it was not necessary for the firm to have taken over the debit balance of the HUF, since the HUF had other properties. [923D]

1.3 The Tribunal has corelated the debit balance to the purchase of goodwill since the firm had taken over the business. The High Court has held that there was no sale of goodwill by the HUF to the firm in view of the absence of related entries in the books of account of HUF. The conclusion of the High Court is as much an inference as that the Tribunal on the same set of facts and circumstances. The Tribunal was right in holding that the firm had taken over the debit balance in consideration of the sale of the goodwill and this conclusion is neither unreasonable or unwarranted, nor arbitrary or unjust. The High Court ought not to interfere with such conclusion even if another view is possible. Besides, the relevant point to be considered is the rights of the assessee and not the liability of the individual members of the HUF. The claim of the assessee for allowable deduction of the interest paid cannot be defeated by the existence of personal liability of the members of HUF. [923C, E, F]

CIVIL APPELLATE JURISDICTION: Civil Appeal Nos. 657 of 1979 & 2117-21 of 1977.

From the Judgment and Order dated 20.1.1978 & 6.5.1976 of Allahabad High Court in Income Tax Rule No. 502/74 and Income Tax Reference No. 827 of 1973.

S.B.L. Srivastava, Manoj Swarup and Lalita Kohli for the Appellants.

J. Ram Murthy, K.P. Bhatnagar and Ms. A. Subhashini for the Respondent.

The Judgment of the Court was delivered by

**K. JAGANNATHA SHETTY, J.** The common question which arises for decision in these appeals by special leave is whether the interest paid on a debit balance of Rs.1,75,310 taken over by the assessee firm from the erstwhile Hindu Undivided Family (HUF), would be an allowable deduction under Section 36(1) (iii) of the Income Tax Act, 1922.

A The partners of the firm were members of the HUF which carried on business at Varanasi in the name of M/s Badal Ram Laxmi Narain. The family had no capital of its own and had been running business with the help of borrowed money. On 20 October 1951, there was partial partition in the family. As a result whereof the business of the family was partitioned between the members of the family. The members formed themselves into partnership and continued the same business. On the date of partition, there was a debit balance of Rs. 1,75,310 in the capital account of the family. This debit balance was transferred in equal proportion to the personal accounts of the three partners of the firm. The newly formed firm took over the business assets as well as liabilities of the HUF. The question arose as to whether the interest paid by the firm on the said debit balance was an allowable deduction in the computation of its income? One of the contentions urged for the firm was that the debit balance was taken over by the firm in consideration of the goodwill of the business. The Appellate Assistant Commissioner has held that the HUF business had no goodwill. The Tribunal did not agree with the Appellate Assistant Commissioner. It has observed that the business of the HUF was of a very long standing and the previous years returns and assessment of income prior to the date of partition indicated that the HUF had flourishing business. Since the running business was taken over by the assessee with the debit balance, the Tribunal expressed the view that the firm could be deemed to have taken the liability of Rs. 1,75,310 in consideration of the sale of goodwill and the interest paid thereon was an allowable deduction.

The following question of law was referred to the High Court.

F “Whether on the facts and in the circumstances of the case, the assessee was entitled to the deduction of interest on a debit balance of Rs. 1,75,310 taken over from the erstwhile Hindu Undivided Family?”

G The High Court examined the facts of the case to find out whether there was any sale of the goodwill. It observed that the goodwill of the HUF business was never sold or purchased. Had there been any such transaction, appropriate entries in the books of account of the HUF would have been made. The HUF should have credited the amount in its account in respect of the price paid for the goodwill and since there was no such entries, there could not be any inference that the firm has taken over the liability of Rs. 1,75,310 for the sale of goodwill. The High Court also has observed that the partners of the

firm were bound to take over the liability of the HUF because, the liability was that of the family of which they were members and on partition every member became liable to discharge the debt according to his share.

Clause (iii) of Section 36(1) applies only where capital has been borrowed for the purposes of the business or profession. The amount of interest paid on the borrowed capital is an allowable deduction. It is not in dispute and indeed cannot be disputed that if the goodwill is purchased out of the borrowed capital, the interest paid on the borrowed capital is an allowable deduction. The Tribunal has correlated the debit balance to the purchase of goodwill since the firm has taken over the running business. The High Court has held that there was no sale of goodwill by the HUF to the firm in view of the absence of related entries in the books of account of HUF. The conclusion of the High Court seems to be as much an inference as that of the Tribunal on the same set of facts and circumstances. It is important to point out that there was only a partial partition in the family, particularly with regard to HUF business. It was not necessary for the firm to have taken over the debit balance of the HUF since the HUF had other properties. The conclusion of the Tribunal that the firm has taken over the debit balance of Rs.1,75,310 in consideration of the sale of the goodwill, in the premises, stands to reason. Indeed, it seems to be neither unreasonable or unwarranted, nor arbitrary or unjust. The High Court ought not to interfere with such conclusion even if another view is possible.

The second reason given by the High Court is also not acceptable. We are concerned with the rights of the assessee and not the liability of the individual members of the HUF. The claim of the assessee for allowable deduction of the interest paid cannot be defeated by the existence of personal liability of the members of the HUF. That is wholly beside the point. We are therefore, unable to sustain the order of the High Court.

In the result, the appeals are allowed and the decision of the High Court is set aside. The question referred to the High Court in each case is answered in favour of the assessee and against the revenue.

The assessee shall be entitled to one set of costs in this Court.