

Settlement amount paid by firm on behalf of its partner couldn't be treated as exp. in its hand

Summary – The High Court of Karnataka in a recent case of H.R. Doddannavar., (the Assessee) held that where partnership firm of H and D dissolved and in terms of compromise, all assets and liabilities were taken by H, if subsequently H formed new firm taking new partners, payment made by new firm to D in terms of compromise between H and D could not be allowed

Facts

- In the return filed for the assessment year 2006-07, the assessee-firm claimed deduction of an amount of Rs. 1.80 crores as revenue expenditure on the plea that it was paid to one 'D' as compensation in terms of a Court decree/order dated 29-9-2005.
- It stated that initially a partnership firm in the name and style of 'R' was founded on 29-5-1976. It consisted of two partners, namely, 'D' and his father 'H'. It was in the business of mining and the mining lease was in the name of 'H'. On 13-10-2003, it was dissolved and its entire assets and liabilities came to the partner 'H'. Thereupon 'H' started acting in his capacity as a proprietor. Subsequently on 19-1-2004, a new firm, *i.e.*, the assessee-firm was formed by 'H' converting the proprietary concern into a partnership firm by taking new partners. 'H', the owner of the mining lease, allowed the assessee-firm to undertake mining operations. Thus the assessee-firm got rights of mining. Subsequently 'D' claiming to be a partner in firm 'R' started questioning the dissolution of the firm 'R' and commenced some litigation in that behalf. In order to settle the said disputes, 'D' was paid a sum of Rs. 1.80 crores as per the decree of the Court dated 29-9-2005.
- The Assessing Officer having noticed that 'D' had nothing to do with the assessee-firm held that the question of making payment of compensation, which was in the nature of capital expenditure, would not have arisen at all. He further having found that there was no direction by any Court to pay the amount of compensation to 'D' held that liability did not arise out of any decree of the Court, but it was in terms of compromise arrived at between 'H' and his son 'D'. He on verification of deed of dissolution came to the conclusion that the assessee was not liable to pay any compensation to 'D' and the liability arose on account of a dispute related with the dissolution of erstwhile partnership firm and not to the business of the assessee. Therefore, the payment was not made within the course of business for the profit of the firm and it could not be allowed under section 37(1).
- The Tribunal allowed the claim of deduction.
- On appeal to High Court by revenue:

Held

- From a reading of dissolution deed dated 13-10-2003 of the erstwhile firm, it is clear that after dissolution of the partnership, 'D' did not have any right in the assets of the firm.

- The records reveal that both 'H' and 'D' filed writ petitions before the Karnataka High Court in regard to mining lease. The High Court *vide* orders dated 1-4-2005 and 15-4-2005 dismissed the writ petitions.
- Thereupon both 'H' and 'D' filed writ appeals. The High Court *vide* order dated 29-9-2005 in terms of a compromise directed 'H' to pay an amount of Rs. 1.80 lakhs to 'D' towards full and final settlement of his mining lease claims.
- It is relevant to note that 'D' had filed the writ petition in his capacity as a partner of erstwhile firm which stood dissolved as on 13-10-2003. Therefore, litigations instituted by 'D' had no nexus with the assessee-firm warranting payment of Rs. 1.80 crores.
- In the instant case, the compromise was arrived at between father and son. Records do not disclose any compelling circumstances to enter into such compromise. The recipient of money was the partner of dissolved firm 'R'. Even after dissolution, he had misrepresented himself as the partner of a firm which was not in existence. Therefore, he was not a party to the proceedings in writ appeal in his individual capacity. Therefore, in law, recipient of money was a non-party to the proceedings. This is nothing but abuse of process of law.
- The Tribunal has come to an erroneous conclusion that the payment was made to 'D' on account of various disputes raised by him to put an end to the litigation and to give way to smooth operation of the business. It has also erroneously held that the payment was made as per directions of the Court, which is factually incorrect. There existed no commercial expediency to pay Rs. 1.80 crores much less was there any direction by the Court to pay any money to 'D'.
- Therefore, the payment of Rs. 1.80 crores to 'D' was not an allowable expenditure in the hands of the assessee-firm under section 37(1).