

Keshavji Ravji & Co. Etc. Etc. v. Commissioner of Income Tax

Civil Appeal Nos. 1177-1184 (NT) of 1990

[1990] 1 SCR 243 | 1990-02-05

Under historical section 40(b), was interest disallowable on a gross basis, or only to the extent that interest paid by a firm to a partner exceeded the interest received from that same partner on partnership-fund drawings?

40(b) (historical pre-1985 wording) | 119 (circulars discussion) | 256(1)

Three-judge bench | M.N. Venkatachaliah, J. | N.D. Ojha, J. | J.S. Verma, J.

Assessment years: 1975-76

Historical net-interest rule: same partner and mutuality required

Relief rests on partnership-fund mutuality between the firm and the same partner, not broad real-income netting or retrospective application of the 1984 Explanation. The circulars discussion does not make Board directions binding on courts. The source contains an anomalous Tribunal sentence; later statutory wording differs. Comprehensive later treatment, current-law mapping and the companion's post-remand outcome remain unverified.

01 FACTS OF THE CASE

The eight appeals challenged Madras High Court reference answers applying its earlier O.M.S.S. Sankaralinga Nadar & Co. decision and requiring gross-interest disallowance. The common question arose where the firm both paid interest to a partner and received interest from that partner on borrowings from the firm (paragraphs 1-3; physical pages 7-9).

The representative appellant was a six-partner registered firm manufacturing and exporting stainless-steel articles. For AY 1975-76, its return disclosed Rs 2,55,225 and the assessment fixed income at Rs 2,79,730 after disallowing partner interest without deducting the interest received back. The Appellate Assistant Commissioner allowed netting, and the Tribunal dismissed Revenue's appeal. The High Court answered the referred question against the assessee. These are representative-case figures and the stated year, not findings for every appeal in the group (paragraph 3; physical pages 8-9).

Source: See the proposition-specific paragraph and PDF-page references below.

02 DISCUSSION BY THE HON'BLE COURT

The Court rejected two suggested shortcuts. First, the non-obstante disallowance could not be cut down by a broad real-income theory: that approach could wrongly permit interest paid to one partner to be offset against receipts from another or from unrelated dealings. Secondly, reenactment of language does not mechanically adopt every earlier construction. Sri Ram Mahadeo Prasad had not given "interest" a special technical meaning which the 1961 Act necessarily carried forward (paragraphs 6–7; physical pages 13–17).

The successful ground was narrower. Paragraph 8 expressly confines the point to interest on a partner's capital and interest paid by that same partner on drawings. General partnership-law incidents remain relevant unless the taxing statute expressly or by necessary implication displaces them; they cannot override a statutory departure. The firm's treatment as a separate assessment unit did not preclude identifying the true legal relationship. Nor did splitting the dealings across several accounts change their character when they were otherwise parts of the same transaction (paragraphs 8–10; physical pages 17–22).

Where both sides of the interest dealings have mutuality and are referable to partnership funds as such, the firm's payment is quantified by the excess over the interest received from that partner. The Court used insolvency mutual-dealing set-off as a non-conclusive analogy and considered a contextually permissible construction which avoided an unintended result; it did not license free-standing equity to defeat clear tax legislation (paragraphs 10–12; physical pages 21–23).

The 1965 Board circular broadly agreed with this construction, but did not dictate it. The Court distinguished beneficial section 119 circulars binding on departmental administration from judicial interpretation: the Board cannot pre-empt the courts, impose a burden beyond the Act or require the Tribunal and High Court to interpret the provision according to a circular. It did not need to decide the separate question whether circulars were legitimate external interpretative aids (paragraph 13; physical pages 23–24). The source's anomalous sentence about the Tribunal is addressed in the source caution below; the explicit non-binding statement and subsequent explanation are clear.

The 1984 net-interest Explanation 1 was expressly effective for AY 1985-86 onward and did not operate of its own force for the earlier year. The effect of any statutory Explanation depends on its wording. Having allowed the mutuality argument, the Court found it unnecessary to determine further whether this Explanation also constituted an exposition of the earlier law. The judgment therefore does not establish a general rule that Explanations are retrospective (paragraphs 4, 14–15; physical pages 9–10 and 24–25).

Source: See the proposition-specific paragraph and PDF-page references below.

03 JUDICIAL DECISION

The Court allowed all eight appeals, set aside the High Court orders and answered the referred question in the affirmative expressly in the terms of paragraph 12: only the excess interest paid to the same partner is disallowed where the requisite mutuality and partnership-fund character are shown. It made no order as to costs (paragraph 16; physical page 25).

Source: See the proposition-specific paragraph and PDF-page references below.

04 OUTCOME / IN WHOSE FAVOUR

In whose favour: Assessee firms, subject to the paragraph 12 qualification

Eight appeals allowed; High Court answers set aside; references answered affirmatively on net-interest quantification; no costs

Final substantive answer to the historical section 40(b) question; no quantified final tax liability stated

Same-partner mutuality and partnership-fund character are essential. No cross-partner pooling, unrelated-dealing offset or universal retrospective-Explanation rule was decided. The separate Devi Cine companion involved a confined ITAT remand and is not the disposition of these eight appeals.

Source: See the proposition-specific paragraph and PDF-page references below.

05 AKHB REVIEW POINT

For the historical provision, examine each partner separately, trace the capital and drawing funds, and reconcile all relevant accounts before computing the net interest. Several ledger accounts are not decisive; mutuality and the legal character of the funds are. The rejected real-income submission must not be presented as the ratio.

Keep the binding effect of administrative circulars separate from a court's construction of the Act. Bounded later-treatment check: the complete circulars discussion in the preserved official Ahmedabad Urban Development Authority judgment of 19 October 2022 was read at paragraphs 115–123, physical pages 66–70. It expressly endorses Keshavji's court/administration distinction while requiring departmental circulars to remain within the statute's framework. This was not a review of later treatment of the net-interest holding or of all subsequent circular cases.

Bounded historical-statute check: the Department-hosted section 40 page expressly labelled Year 1998, footnote 64, identifies substitution of clause (b) from 1 April 1993 and reproduces the former net-interest Explanation. Its later Explanation 1 has a different subject. Accordingly, neither the historical blanket-disallowance language nor the old Explanation number should be silently presented as the current provision. No present-law or 2025-Act crosswalk is certified.

Related application: Devi Cine Projector Manufacturing Co., decided the same day, applied Keshavji and sent the extent-of-interest-disallowance issue back to the Tribunal. That source is linked for procedural context; it does not establish that every companion firm finally obtained the claimed deduction. Its post-remand results have not been verified.

Source: See the proposition-specific paragraph and PDF-page references below.

PROPOSITION-SPECIFIC SOURCE PARAGRAPHS AND PDF PAGES

1.

Topic: Identity, bench, appeal group and common issue

Source url: [Open cited source](#)

Pdf pages: 1; 7; 8; 9

Paragraphs: Cover; opening paragraph and paragraphs 2–3

Source role: reported identity and judicial text

2.

Topic: Representative facts, AY and two income figures

Source url: [Open cited source](#)

Pdf pages: 8; 9

Paragraphs: Paragraph 3

Source role: judicial text

3.

Topic: Historical text, 1984 Explanation and 1965 circular

Source url: [Open cited source](#)

Pdf pages: 9; 10

Paragraphs: Paragraph 4

Source role: judicial text

4.

Topic: Rejected broad real-income and reenactment arguments

Source url: [Open cited source](#)

Pdf pages: 13; 14; 15; 16; 17

Paragraphs: Paragraphs 6–7

Source role: judicial text

5.

Topic: Same-partner boundary and general-law/statutory relationship

Source url: [Open cited source](#)

Pdf pages: 17; 18; 19; 20; 21

Paragraphs: Paragraphs 8–9

Source role: judicial text

6.

Topic: Multiple accounts, mutuality, contextual construction and exact holding

Source url: [Open cited source](#)

Pdf pages: 21; 22; 23

Paragraphs: Paragraphs 10–12

Source role: judicial text

7.

Topic: CBDT/courts distinction and anomalous printed sentence

Source url: [Open cited source](#)

Pdf pages: 23; 24

Paragraphs: Paragraph 13

Source role: judicial text

8.

Topic: Explanation limits and actual group disposition/costs

Source url: [Open cited source](#)

Pdf pages: 24; 25

Paragraphs: Paragraphs 14–16

Source role: judicial text

9.

Topic: Same-day application; separate procedural history and confined remand

Source url: [Open cited source](#)

Pdf pages: 2; 3; 4

Paragraphs: Paragraphs 1–6

Source role: related application judgment

10.

Topic: Bounded later circulars discussion, rendition-specific pins

Source url: [Open cited source](#)

Pdf pages: 66; 67; 68; 69; 70

Paragraphs: Paragraphs 115–123, especially 120 and 123

Source role: bounded later judgment text

11.

Topic: Bounded historical replacement of section 40(b) and Explanation numbering

Source url: [Open cited source](#)

Paragraphs: Department-hosted Year 1998 version, section 40(b) and footnote 64

Source role: bounded historical statutory comparison

RELATED DECISIONS AND LIMITS

1.

Title: Devi Cine Projector Manufacturing Co., Etc. Etc. v. Commissioner of Income Tax

Decision date: 1990-02-05

Source asset id: 1990_1_268_271

Citation: [1990] 1 SCR 268

Source url: [Open cited source](#)

Relationship: Same-day application of Keshavji; appeal/remand disposition is separate

Standalone public note: False

Summary: The Court bypassed an otherwise redundant reference sequence, treated the petitions as challenges to the main ITAT orders, and remitted only the extent-of-interest-disallowance issue for fresh disposal under Keshavji. No costs; assessment years and post-remand results not stated or verified.

JUDICIAL AUTHORSHIP AND SEPARATE OPINIONS

M.N. Venkatachaliah, J.

OTHER STATUTORY CONTEXT

Taxation Laws (Amendment) Act, 1984: former section 40(b), Explanation 1, effective from 1 April 1985; not applied retrospectively as the basis of relief; Income-tax Act, 1922, section 10(4)(b): predecessor comparison only; Partnership-law incidents; Provincial Insolvency Act section 46 and Companies Act, 1956 section 529: analogy, not operative insolvency or company-law adjudication

ACT IDENTIFIED IN THE REVIEWED SOURCE

Income-tax Act, 1961

ASSESSMENT-YEAR CONTEXT AND LIMITS

AY 1975-76 is expressly supplied only for the representative Keshavji firm, whose accounting year ended 13 November 1974. The judgment says the other appeals arise in broadly similar circumstances but does not enumerate their assessment years; do not assign AY 1975-76 to all eight appeals.

SPECIFIED COMPARISONS AND THEIR VERIFICATION LIMITS

1.

Kind: same day application

Source asset id: 1990_1_268_271

Extent: All four pages and all four page images

Result: Keshavji applied; limited ITAT remand, no distinct tax-merits determination or final quantification

2.

Kind: later judicial comparison

Source url: [Open cited source](#)

Extent: Complete circulars section, paragraphs 115–123 on physical pages 66–70; material images 68 and 70

Result: Court/administration distinction endorsed and circumscribed by statute; not a net-interest later-treatment check

3.

Kind: historical statutory comparison

Source url: [Open cited source](#)

Extent: Section 40(b), Explanations and footnote 64 in displayed Year 1998 text

Result: Clause (b) replaced from 1 April 1993; historical net-interest Explanation distinct from later numbering

SOURCE & VERIFICATION

[Hon'ble Supreme Court source PDF \(reported judgment\)](#)

Identified source rendition: 25 PDF pages; SHA-256

dcbd77e5732bf491fd0a5a5a07a93c148ece7a00ebab6d5273bfeff9117245e1. Original bytes preserved.

Judicial text begins at physical page 7/SCR 249-D with Venkatachaliah J. and continues through paragraph 16 at physical page 25/SCR 267-F. Editorial headnote physical pages 1–7 and footer outcome label separately distinguished. Paragraphs 1–16, including 5A, read completely; no adjoining judgment.

[Open cited source rendition](#)

Physical page 23/SCR 265-G visibly prints "The Tribunal, muchless the High Court, is an authority under the Act", immediately followed by "The circulars do not bind them." The first sentence appears internally anomalous and is not silently emended or treated as a holding about section 116. The note follows the explicit non-binding statement and physical page 24's explanation. The preserved official AUDA quotation repeats the same wording; it does not cure the source anomaly.; All five contentions (a)–(e) must be separated from the Court's answers. The expansive real-income theory and reenactment argument were rejected; mutuality contention (c) succeeded; the circular-as-aid and Explanation-as-exposition questions were left unnecessary to pursue further.; AY 1975-76 and the two income figures belong to the representative case only. No assessment-year mapping or final tax amount is supplied for the other seven appeals.; Editorial headnotes label Sankaralinga Nadar "overruled" and Ramanaiah "approved". This note states the actual contrary gross-interest approach rejected and the qualified rule adopted, rather than claiming wholesale treatment of every proposition in those High Court decisions.; The historical 1984 Explanation 1 is not the same provision as Explanation 1 in the Department's later Year 1998 section 40(b) text. The latter is a bounded historical comparison, not a current-law check.; The related Devi source's running heading says "Devi Cinema", while its cover title is Devi Cine Projector Manufacturing Co. The cover identity is used. Its four appeals are distinct from Keshavji's eight appeals.; AUDA paragraph numbers are tied to the preserved 149-page official PDF: circulars conclusion paragraph 123 at physical page 70. Search and reported renditions can use different numbering; no interchangeable pinpoint is asserted.

Eight appeals disposed of together; representative proceeding was SLP (C) No. 14291 of 1985. The lead appeal number in ingestion metadata is not the whole group.

STATUTORY SCOPE

No automatic Income-tax Act, 2025 mapping or present-law certification. The 1984 Explanation and later substitution are distinguished from the historical provision decided.

LATER TREATMENT

Source checked 2026-10-04. Comprehensive later judicial treatment remains unverified. The same-day companion and a bounded 2022 circulars discussion were actually checked as identified separately below; no exhaustive citator or post-remand outcome check was performed.

IDENTIFIED SOURCE LINKS

[reported judgment - PDF pages: 25](#)

SHA-256: dcbd77e5732bf491fd0a5a5a07a93c148ece7a00ebab6d5273bfeff9117245e1

[related application and remand judgment - PDF pages: 4](#)

SHA-256: c7f1efafafe4089a90023afa07c99b57dd52830f1a899d036033f3c1f3eb4ec0

[bounded later judgment comparison - PDF pages: 149](#)

SHA-256: 337506bb14011d607bd09bff7abb821aa77aa618be94632ed8edc1716667f33f

[official department hosted historical statutory text](#)

AI DISCLOSURE

AI-assisted research checked against the identified source. Extraction, interpretation or omission errors remain possible. Source review does not mean independent approval by a practising professional. Verify every material statement against the complete original judgment.

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