

(2000) 02 DEL CK 0135

In the Delhi High Court

Case No : Income-tax Reference No. 21 of 1979

Commissioner of Income Tax

APPELLANT

Vs

Amar Co.

RESPONDENT

Date of Decision : 03-02-2000

Acts Referred:

Income Tax Act, 1961 — Section 40

Citation : (2000) 159 CTR 230

Hon'ble Judges : D.K. Jain, J;Arun Kumar, J

Bench : Division Bench

Advocate : R.C. Pandey and Premlata Bansal, for the Appellant; None, for the Respondent

Judgement

Arun Kumar, J.—At the instance of the Revenue, the Income Tax Appellate Tribunal (hereinafter referred to as "the Tribunal"), has referred the following question for the opinion of this court u/s 256(1) of the Income Tax Act, 1961 :

"Whether, on the facts and in the circumstances of the case, the Tribunal was legally correct in allowing the deduction of Rs. 12,107 in the computation of the assessor's income for the assessment year 1973-74" ?

2. The matter pertains to the assessment year 1973-74 for which the previous year ended on July 12, 1972. At the relevant time Section 40 of the Income Tax Act, 1961, stood as under :

"40. Amounts not deductible.--Notwithstanding anything to the contrary in Sections 30 to 39, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",-- . . .

(b) in the case of any firm, any payment of interest, salary, bonus, commission or remuneration made by the firm to any partner of the firm."

3. Briefly the facts are that the assessee-firm consisted of four partners, one of

whom was Smt. Gindori Devi. The capital account of Gindori Devi showed an opening balance of Rs. 35,859 and the closing balance in this account was Rs. 56,216 in the year under consideration. Gindori Devi was also the sole proprietor of another concern Amar Udyog, Faridabad. This concern was dealing in "mehandi" and used to supply the same to the assessee-firm for sale. The assessee-firm had a separate account in the name of Amar Udyog in its books of account which was a running account showing receipts on account of goods received and payments with respect thereto. The payments made were debited in the account along with some petty expenses. The account showed an opening balance of Rs. 66,416 and a closing balance of Rs. 1,29,890, which was the amount due to the said concern. The assessed paid an interest of Rs. 12,107 to Amar Udyog which was credited in the account of Amar Udyog. As a matter of fact this amount was paid to Gindori Devi, the partner of the assessee-firm who was the proprietor of Amar Udyog. The Assessing Officer held that this payment of interest was a payment of interest to a partner and, Therefore, it was disallowed u/s 40(b) of the Act. The Appellate Assistant Commissioner confirmed this order.

4. The assessed challenged this disallowance before the Tribunal.

5. The main question for consideration before the Tribunal was whether the payment of interest to Gindori Devi was by way of payment of interest to a partner and was liable to be disallowed u/s 40(b) of the Act, The Tribunal was of the opinion that it was a payment by way of interest. However, the Tribunal following the decision of the Allahabad High Court in *The Commissioner of Income Tax Vs. Ram Laxman Sugar Mills, Mohiuddinpur*,) , held that the payment could not be disallowed u/s 40(b) of the Act. In *Ram Laxman Sugar Mills* case salary was paid to some of the partners who were appointed to a board of management by the Central Government exercising its powers under the Essential Supplies (Temporary Powers) Act, 1946, owing to dissensions among the partners. It was held that this payment could not be disallowed u/s 10(4)(b) of the Indian Income Tax Act, 1922, which corresponds to Section 40(b) of the 1961 Act. The decision of the Allahabad High Court was based on the fact that payment of remuneration to the partners was not in the capacity as partners but in the capacity as special appointees by the Government.

6. The Tribunal noted that there was divergence of opinion on the point. However, it chose to follow the view, which was in favor of the assessed and, Therefore, directed deletion of the sum of Rs. 12,107 paid as interest.

7. In the first instance learned counsel for the Revenue brought to our notice the fact that the appeal filed by the Commissioner of Income Tax against the decision of the Allahabad High Court in *The Commissioner of Income Tax Vs. Ram Laxman Sugar Mills, Mohiuddinpur*, was dismissed by the Supreme Court in *Commissioner of Income Tax Vs. Ram Laxman Sugar Mills*, , not on the merits but on account of the fact that small sum was involved and there was huge lapse of time.

8. The decision in *The Commissioner of Income Tax Vs. Ram Laxman Sugar Mills, Mohiuddinpur*, was distinguished by this court in *K.C. Raja Co. Vs. The Commissioner of Income Tax, New Delhi*, . It was noticed that Section 10(4)(b) of the 1922 Act which was the provision under consideration in that case, placed an absolute bar against allowance of expenditure in the nature of interest, salary or commission paid by a firm to any partner. A partner so long as he is a partner in a firm, enjoys a particular status as a partner as envisaged under the Indian Partnership Act. It did not make the slightest difference whether the partner joins the partnership firm as an individual or in a representative capacity as karta of his Hindu undivided family. In *K.C. Raja Co. Vs. The Commissioner of Income Tax, New Delhi*, the firm consisted of four partners. Three of the partners entered into partnership on behalf of their respective Hindu undivided families. The partners were kartsas of their respective Hindu undivided families. The firm allowed salaries to these partners for the services rendered by them to the partnership firm as working partners. The partners claimed that the salaries paid to them were in their individual capacities for the services rendered by them while they were partners in the capacity as karta of their respective Hindu undivided families and the payment was not in that capacity. It was held that a Hindu undivided family cannot enter into a partnership. However, the karta of a Hindu undivided family can enter into partnership with others on behalf of the Hindu undivided family. But that does not mean that the members of the Hindu undivided family can interfere into the affairs of the partnership. So far as the firm is concerned, it is the individual alone who is recognised as a partner. Whatever arrangement he may have with his family with regard to the share income from the partnership, that is his personal outlook and the firm does not come into the picture. The salary was paid to the partner for working as a partner in the firm, and, Therefore, was clearly barred under the provisions of the Income Tax Act as applicable at the relevant time. In *The Commissioner of Income Tax Vs. Ram Laxman Sugar Mills, Mohiuddinpur*,) the payment was made to the partners not as partners of the firm but as authorised controllers under the orders of the Central Government. That status was treated as distinct from that of a partner. This was the point of distinction on the basis of which *Ram Laxman Sugar Mills*" case [19751 90 ITR 73 was distinguished by this court.

9. The above discussion highlights the reason for the provision regarding disallowance of payment of interest, salary, commission, remuneration, etc., to a partner. The essential element of a partnership is the concept of agency according to which a partner acts for and on behalf of all the partners including himself in the matter of conduct of partnership affairs/business. Section 4 of the Indian Partnership Act defines a partnership as : ""partnership" is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

Section 12 of the said Act further enjoins :

"(a) every partner has a right to take part in the conduct of the business :

(b) every partner is bound to attend diligently to his duties, in the conduct of the business . . ."

These provisions show that there is an element of mutual agency amongst the partners. The partners are supposed to work diligently and to the best of their abilities for the partnership. For doing his duties a partner is not supposed to charge his other partners any sum or remuneration in the shape of salary, commission, etc. Under the Income Tax Act Section 40(b) is meant to prevent avoidance of payment of tax by payments under these heads to partners and claiming the same as revenue expense.

10. In *Rashiklal and Co. Vs. Commissioner of Income Tax, Orissa*, , the question for consideration was again about whether payment of commission to a partner who became partner in his capacity as a karta of his own Hindu undivided family could be disallowed. It was held that the payment of commission could not be allowed as a deduction. The remuneration or the commission that is paid to a partner cannot be claimed to be a remuneration or commission paid to the Hindu undivided family on the ground that the partner is a partner in his capacity as karta of a Hindu undivided family. The partner may be accountable to the family for the monies received by him from the partnership. But in the assessment of the firm the partner cannot be heard to say that he has not received the commission as partner of the firm but in a different capacity.

11. The decision of the Gujarat High Court in *Commissioner of Income Tax Vs. Yoganand Textiles*,) , contains an elaborate discussion on the point. It was held that the word "any" used in the sub-section is of very wide meaning and import. This would mean that any payment on account of remuneration, commission, interest, salary to a partner of the assessee-firm would attract the said provision. The provision did not differentiate between nature of payment by way of interest, remuneration, etc., given to a partner. There is a complete embargo on deductions on account of any payment mentioned in the sub-section made to a partner. Explanation 2 which has been added subsequently clarifies that interest paid by a firm to an individual who is a partner in the firm in a representative capacity shall not be taken into account for purpose of the said clause.

12. It follows that Section 40 covers all payments of any kind whatsoever in the nature of salary, commission, remuneration, interest, etc., to a partner. It does not envisage any differentiation based on the nature of payment or the capacity of the partner concerned qua the payment. So long as it is a payment to a partner of the kind mentioned in the section it will be covered under the section and is not deductible. The concept of capacity of a partner in which he or she received payment from the partnership firm brought out by the Tribunal on the basis of the decision in *The Commissioner of Income Tax Vs. Ram Laxman Sugar Mills, Mohiuddinpur*, has no place in the scheme of the provision. The provision is based on the concept of obligations of a partner qua the partnership firm according to which every partner is an agent of the other partners and is supposed to work diligently for purposes of advancement of the business interest

of the partnership firm. The absence of distinction based on capacity of an individual partner has been explained in Commissioner of Income Tax Vs. Yoganand Textiles,) by way of an illustration which we find quite apt. Just as a sole proprietor doing business in a shop who could possibly get the work of fixing gadgets or electrical fittings done through someone else and may be able to claim deductible expenditure for such work which he may get done, cannot claim such deduction when he himself does such work, a partner who does the work of his firm in fact does his own work and would stand on the same footing as an individual doing his own work. If deductions were to be allowed for remuneration given to a partner for doing the firm's own work, by creating an artificial distinction of his having worked in a different capacity, the very purpose underlying the provision of Section 40(b) will be frustrated.

13. The result of the above discussion is that the question referred by the Tribunal for the opinion of this court is answered in the negative, It is held that the Tribunal was not correct in allowing the deduction of Rs. 12,107 in the computation of the assessor's income for the assessment year 1973-74. The reference is answered accordingly.