

(1997) 11 MAD CK 0117

In the Madras High Court

Case No : Tax Cases No's. 1224 and 1225 of 1984 (References No's. 1043 and 1044 of 1984)

Commissioner of Income Tax

APPELLANT

Vs

N. Deenadayalan

RESPONDENT

Date of Decision : 06-11-1997

Acts Referred:

Income Tax Act, 1961 — Section 28, 67

Citation : (2000) 241 ITR 133

Hon'ble Judges : P. Thangavel, J;N.V. Balasubramanian, J

Bench : Division Bench

Advocate : Deokinandan and C.V. Rajan, for the Appellant; K.M.L. Majele, for the Respondent

Judgement

N.V. Balasubramanian, J.—At the instance of the Department, the Income Tax Appellate Tribunal has stated a case and referred the following common question of law for the assessment years 1979-80 and 1980-81 u/s 256(1) of the Income Tax Act, 1961, for our opinion :

"Whether, the Appellate Tribunal was justified in law and had material facts to hold that the remuneration paid to the partner by the partnership firm in his capacity as, and by virtue of the partnership contract between the partners, is deductible from the share income, computed u/s 67 of the Act, as the share of the Hindu undivided family which has the beneficial interest in the said partnership firm in which it is represented by that partner ?"

2. The assessee is a Hindu undivided family. The assessee filed returns for the assessment years 1979-80 and 1980-81 and the Income Tax Officer completed the assessments rejecting the claim of the assessee to treat the payment of salary paid to Deenadayalan, its karta, was not liable to be assessed in the hands of the assessee. The claim of the assessee was that Deenadayalan was a partner in a firm as the karta of the Hindu undivided family, but looked after the business and for the services rendered by him in his individual capacity, the firm paid

salary and the salary was paid by the firm for the exertion made by Deenadayalan for the business of the firm. The Income Tax Officer noticed that there were four partners in V. A. A. Natarajan and Sons, viz., N. Rajasekaran, N. Deenadayalan, N. Gunasekaran and N. Sivaraj and all of them were partners representing the Hindu undivided family firm. The firm called V. A. A. Natarajan and Sons was reconstituted with five partners and one N. Parameswari was taken in as a partner along with other original partners who were already there representing the Hindu undivided family respectively in the firm. The Income Tax Officer found that the partners represented their Hindu undivided family and whatever the salary was paid to the karta would be the income of the joint Hindu undivided family and, therefore, the salary income paid to Deenadayalan was assessable in the assessment of the Hindu undivided family and in this view of the matter, he completed the assessment for the two assessment years in question.

3. The assessee preferred appeals before the Appellate Assistant Commissioner. The Appellate Assistant Commissioner found that N. Parameswari was a widow and she was an old woman and she was not conversant with the management of the business. Rajasekaran, the other partner, was a practising doctor and N. Gunasekaran was an engineer. The Appellate Assistant Commissioner found that the personal exertion of Deenadayalan was vital for the efficient running of the business and earning of the profit by the firm. He also found that Deenadayalan has engaged himself full time in the supervision of the business of the firm and there was an agreement for the payment of salary by the firm. In these circumstances, he came to the conclusion that the payment of salary did not have the character of any return or reimbursement to the individual of the funds invested by the family and N. Deenadayalan received salary by virtue of his personal exertion in the management of the affairs of the firm. The Appellate Assistant Commissioner, therefore, held that the salary paid to Deenadayalan was paid for the personal services rendered by him and it had no real and sufficient connection with the investment of joint family assets. The Appellate Assistant Commissioner, in this view, allowed both the appeals preferred by the assessee.

4. The Revenue carried the matter on appeal before the Income Tax Appellate Tribunal. The Appellate Tribunal by a common order held that the salary paid to Deenadayalan was his individual income and it cannot be assessed as an income of the joint family.

5. The Revenue has challenged the finding of the Appellate Tribunal in the present tax case reference and at the instance of the Revenue, the Appellate Tribunal has stated a case and referred the question of law referred to supra. Mr. C. V. Rajan, learned counsel for the Revenue, submitted that Deenadayalan was the karta of the joint family and the salary paid to him should be taken as an income of the joint family and it cannot be regarded as an individual income of Deenadayalan. The assessee was served, but there was no representation on

behalf of the assessee.

6. We have carefully considered the submissions made by Mr. C. V. Rajan, learned counsel for the Revenue, and perused the records carefully. The Appellate Tribunal has concurred with the finding of the Appellate Assistant Commissioner that the salary paid to Deenadayalan has no connection with the investment of the joint family assets and it was also found that Deenadayalan had exerted himself for the earning of the salary by looking after the business activities of the firm in his individual capacity and the salary was paid to Deenadayalan as he engaged himself full time in the supervision of the business of the firm. The Appellate Tribunal also confirmed the finding of the Appellate Assistant Commissioner that the payment of salary was not in any way related to the funds invested by the Hindu undivided family in the firm. In this factual situation, the question that has to be considered is whether the salary income received by Deenadayalan can be regarded as an income of the joint family. The test whether the salary received by a partner is the individual income or that of the joint family which he represents in the firm was the subject-matter of consideration in several decisions of the apex court as well as by this court and recently in *Commissioner of Income Tax, Tamil Nadu-II Vs. V.S. Thyagaraja Mudaliar*, this court considering earlier case law, has laid down the following tests to determine when the income can be assessed as that of the individual or that of the joint family (headnote) :

"The question that will have to be considered in deciding whether the remuneration received by a coparcener is his individual income will be whether the remuneration received by the coparcener is in substance though not in form, one of the modes of return made to the family because of the investment of the family funds in the business or whether it is a compensation made for the services rendered by the individual coparcener and if it is the former it is the income of the Hindu undivided family and if it is the latter it would be the income of the individual coparcener. If income is earned essentially as a result of the funds invested by the family, the fact that the coparcener had rendered some service would not change the character of the receipt. But if the remuneration is really for services rendered by the coparcener, the mere fact that his service was availed of because he was a member of the family which had invested funds in the business or he had obtained qualification shares from and out of the family funds will not make the receipt the income of the family."

7. In *Commissioner of Income Tax, Tamil Nadu-I, Madras Vs. Surendra Manilal Mehta and Suresh B. Mehta*, , another Bench of this court held that the remuneration paid to the karta or a coparcener of a family by a firm in which the family is a partner cannot be assessed as the income of the family unless there is a direct nexus between the investment of the funds of the family in the firm and the payment of the salary. Applying the principles laid down by the two decisions of this court, we are of the opinion that there was no direct or immediate nexus or link at all between the investment of the funds by the family and the payment

of salary to Deenadayalan. The salary was paid to Deenadayalan and it was paid without any detriment to the investment of the family funds in the firm. It is also relevant to notice that only because of the special skill or the personal exertion of Deenadayalan, the salary was paid to him and the salary was paid for his personal exertion in looking after the business of the firm and the salary was earned by him without detriment to the investment of the funds of the family and therefore, the salary income received by Deenadayalan has to be regarded as the individual income of the person who received it and cannot be regarded as income of the joint family. We are of the view that since the income was liable to be assessed in the individual hands of Deenadayalan, it is not liable to be assessed in the assessment of the Hindu undivided family, though he was a partner in the firm in a representative capacity. We therefore, hold that there is no infirmity in the order of the Appellate Tribunal in holding that it cannot be assessed as a part of the income of the Hindu undivided family. Accordingly, we answer the common question of law referred to us in the affirmative and against the Revenue. No costs.