(2007) 07 P&H CK 0069

In the Punjab And Haryana At Chandigarh

Commissioner of Income Tax	APPELLANT
Vs	
Unimax Laboratories	RESPONDENT

Date of Decision : 09-07-2007

Acts Referred:
Income Tax Act, 1961 — Section 2, 256, 30, 31, 32

Citation : (2007) 213 CTR 92 : (2009) 311 ITR 191

Hon'ble Judges : M.M. Kumar, J;Ajay Kumar Mittal, J

Bench : Division Bench

Judgement

MM. Kumar, J.—The short question which permeates this reference is whether Section 40(b) of the IT Act, 1961 (for brevity, ''the Act'') is applicable to the amount of salary and bonus paid by the assessee firm to its partners for their individual service as against their HUF character. It is at the instance of the Revenue that the Income Tax Appellate Tribunal Chandigarh Bench, Chandigarh (for brevity, ''the Tribunal'') has referred the following question of law, which is stated to have emerged from its order dt. 11th March, 1992, passed in ITA No. 284/Asr/1987, in respect of the asst. yr. 1983-84. The question of law referred reads as under:

Whether on the facts and in the circumstances of the case, the Tribunal was right in law in allowing the amount of salary and bonus paid by the firm to partners for services rendered by them on the ground of having technical qualification and expertise, though they represented their HUF and Section 40(b) of the IT Act was not attracted ?

2. Brief facts of the case which are necessary for disposal of this case are that the AO made an addition of Rs. 62,015 u/s 40(b) of the Act on account of salary and bonus paid by the assessee firm to its four working partners. Those partners were partners in their representative capacity as Karta of the HUF. Since these partners represented their respective HUFs, they were treated to be partners for the purpose of disallowance of benefits u/s 40(b) of the Act by the AO. However, on appeal the addition of Rs. 62,015 was deleted on the ground that the salary

and bonus were paid to these persons as individual and in these circumstances Section 40(b) of the Act has no application. The amount received by them was not assessed in the hands of the HUF. The assessee had pleaded that these persons rendered personal services to the firm because they had technical qualification and expertise. It was in lieu of rendering of personal services by them that the salary and bonus were claimed to have been paid.

3. The Revenue felt aggrieved by the order passed by the CIT(A) and preferred an appeal before the Tribunal. The appeal was dismissed vide order dt. 11th March, 1992 (Annex. C).

4. The view of the Tribunal is discernible from para 3 of its order, which in turn has placed reliance on a judgment of Andhra Pradesh High Court in the case of N.T.R. Estate Vs. Commissioner of Income Tax, , wherein it has been held that the salary and interest paid by the firm to some of the partners is to individual even if they had become partner in their capacity as Karta in HUF. Therefore, the same could not be disallowed by applying the provisions of Section 40(b) of the Act. The Tribunal has approved the reasoning adopted by the CIT(A) while applying the ratio of the judgment in the case of N.T.R. Estate (supra). The order of the CIT(A) is as under:

...I have given a careful consideration to the submissions made by the learned Counsel of the appellant and have also gone through the various assessment orders of the partners for the asst. yr. 1983-84. It is a fact that salary and bonus paid to the partners S/Shri Madan Lai Jain, Rakesh Kumar Jain, Kimti Lai Jain and S.K. Jain, have been assessed in their individual hands by the ITO himself vide orders dt. 11th July, 1985 and 27th Dec, 1983. It has thus been conceded that the partners are rendering personal services to the firm and they have necessary technical qualifications and expertise in the respective fields as explained by the learned Counsel for the appellant. It is also a fact that Shri Janak Raj Jain who has no technical knowledge of the working of the business of the firm has not been paid any salary. In view of this position, there is no doubt that the facts of the present case are on all fours with the Andhra Pradesh High Court decision in the case of N.T.R. Estate Vs. Commissioner of Income Tax, , and the ratio of that judgment shall therefore squarely apply therein. Considering the facts and circumstances of the case, therefore, the addition of Rs. 62,015 made by the ITO, u/s 40(b) of the IT Act deserves to be deleted.

5. However, the Revenue approached the Tribunal with an application u/s 256(1) of the Act claiming that two questions of law would require determination by this Court and prayed for referring those questions. Accordingly, the Tribunal accepted the prayer of the Revenue and has referred the abovementioned question of law for opinion of this Court.

6. No one has put in appearance on behalf of the assessee despite service.

7. We have heard learned Counsel at a considerable length and are of the view that the controversy has been set at rest by Hon''ble the Supreme Court in the

case of Brij Mohan Das Laxman Das Vs. Commissioner of Income Tax, Allahabad, . The view taken by the Rajasthan High Court in Gajanand Poonamchand & Bros. v. CTT (1988) 73 CTR (Raj) 255 : (1988) 174 TTR 346 (Raj), has been approved by accepting that Expln. 2 added to Section 40(b) of the Act is declaratory in nature and the same is to apply to the cases like the one in hand concerning assessment years prior to 1st April, 1985. Section 40(b) as it stood at the relevant time and Expln. 2 inserted by Taxation Laws (Amendment) Act, 1984 w.e.f. asst. yr, 1985-86 may first be read, which is as under:

40. 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.

Explanation 1.--...

Explanation 2.-- Where an individual is a partner in a firm on behalf, or for the benefit, of any other person (such partner and the other person being hereinafter referred to as ''partner in a representative capacity'' and ''person so represented'' respectively),--

(i) interest paid by the firm to such individual or by such individual to the firm otherwise than as partner in a representative capacity, shall not be taken into account for the purposes of this clause;

(ii) interest paid by the firm to such individual or by such individual to the firm as partner in a representative capacity and interest paid by the firm to the person so represented or by the person so represented to the firm, shall be taken into account for the purposes of this clause.

8. The view of their Lordships in Brij Mohan Das Laxman Das''s case (supra) is discernible from paras 6, 7 and 8, which reads as under:

...Explanation is merely declaratory in nature and that, therefore, even for the assessment years prior to 1st April, 1985, the position of law should be understood to be the same. In support of this proposition, the High Court relied upon the fact that ordinarily the purpose of an Explanation is to clarify that which is already enacted and not to introduce something new. The High Court opined that the Explanation was inserted by Parliament with a view to settle the controversy as to the meaning and effect of the said clause among the several High Courts and that the Explanation puts a seal of approval on the view taken by the majority of the High Courts. The High Court also referred to the definition of "person" in Clause (31) of Section 2. It pointed out that the definition shows clearly that an individual, an HUF and a firm are distinct persons/entities for the purpose of the IT Act. The High Court, therefore, concluded that since an individual and an HUF are two distinct entities for the purpose of the Act, Clause (b) of Section 40 has no application where the interest is paid to the partner on deposits made by him with the firm in his individual capacity where such person is a partner not in his individual capacity but as representing a HUF....

7. Clause (b) of Section 40 is based upon and is a recognition of the basic nature of relationship between a firm and its partner. In State of Haryana and Others Vs. Karnal Distillery Co. Ltd. and Another, ...

...The provisions in Chapters III and IV of the Partnership Act, 1932 amply define and delineate the duties, obligations and rights of the partners vis-a-vis the firm. The question yet remains where an individual is a partner in one capacity, e.g., as a representative of another person, can he have no other capacity vis-a-vis the firm. To be more precise, does the above position of law preclude an individual, who is a partner representing a HUF, from depositing his personal funds with the partnership and receiving interest thereon ? Explanation 2 says in clear terms that there is no such bar. This is the legislative recognition of the theory of different capacities an individual may hold-- doubt confined to Clause (b) of Section 40. Once this is so, we see no reason to hold that this theory of different capacities is not valid or available for the period anterior to 1st April, 1985. Accordingly, we hold that even for the period anterior to 1st April, 1985, any interest paid to a partner, who is a partner representing his HUF, on the deposit of his personal/individual funds, does not fall within the mischief of Clause (b) of Section 40. In this view of the matter, we agree with the view taken by the Rajasthan High Court in Gajanand Poonam Chand that Expln. 2, in the context of Clause (b) of Section 40, is declaratory in nature....

9. Once the character of an individual has been treated different than HUF for the purposes of interest then we see no reason as to why this would not extend to the salary and bonus paid to such partners on account of their personal services rendered to the firm in contradistinction to their capacity as a representative of HUF. The aforementioned conclusion would necessarily flow from the concept of partner representing HUF in contradistinction to his individual capacity, as explained in the case of Brij Mohan Das Laxman Das (supra). Therefore, the same reasoning would apply to the cases where payment in the form of salary and bonus has been made to a partner in his individual capacity in contradistinction to his representative character of the HUF.

10. In view of the above, the question referred is answered in favour of the assessee and against the Revenue.

