

(1984) 11 KAR CK 0013

In the Karnataka High Court

Case No : Income-tax Reference Case No's. 208 to 210 of 1980

D.N. Bhandarkar and Others

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 27-11-1984

Acts Referred:

Income Tax Act, 1961 — Section 256 (2)

Citation : (1986) 54 CTR 223 : (1985) ILR (Kar) 1659 : (1986) 158 ITR 724

Hon'ble Judges : S.A. Hakeem, J; Mohammad Sharif, J

Bench : Division Bench

Advocate : S.P. Bhat, for the Appellant; K. Srinivasan, for the Respondent

Judgement

K. Jagannatha Shetty, J.—u/s 256(2) of the Income Tax Act, 1961, the Tribunal has referred the following question :

"Whether, on the facts and circumstances of the case, the Tribunal was right in holding that the salary income from the two firms, viz., M/s. Mahalaxmi Beedi Works and M/s. Bhandarkar Bros., to the assessee was not their individual income but was the income of the Hindu undivided families of which they were the kartas and confirming the assessments of the said income in the hands of the respective Hindu undivided families ?"

2. The assessees are three divided brothers. They became partners of two firms representing their respective joint families. The firms were constituted as far back in 1962. Up to 1974, the partners were not drawing any remuneration for the services rendered by them in the firms. But, on March 31, 1974, the partners passed a resolution in the respective firms for payment on salary to each one of them with effect from April 1, 1974. They were accordingly paid remuneration more or less equal to the profit-sharing ratio to which they are entitled under the deed of partnership.

3. Before the Income Tax Officer, the assessees claimed that such salary income from the firms should be treated as their individual income and should not be

included and taxed in the hands of the Hindu undivided family. The Income Tax Officer rejected that contention and taxed the salary income from the two firms in the hands of the Hindu undivided family. The appeals preferred by the assesseees were rejected by the Appellate Assistant Commissioner who took the view that any partner in a firm has to work for the advancement of the business and the mere fact that some salary income is derived from the firm by the karta would not entitle the partner assesseees to consider such income separately.

4. The assesseees preferred further appeals before the Tribunal. The Tribunal also has concurred with the view taken by the Appellate Assistant Commissioner. The Tribunal in its brief order marked with clarity of thought has recorded the following findings :

"....., the position is that the salary paid to the three partners is in substance a return made to the family because of the investment of the family funds in the business and is not really, though so stated in the agreement, the compensation for services rendered by the individual partners. The partners have no special qualification. They were doing the same thing previously when no salary was paid and they have been doing the same thing after the salary has been paid. There is no individual or special skill and experience of the partners which would justify the payment all of a sudden for their individual services under the resolution passed by the two firms. The salaries paid are also more or less in their profit-sharing ratio except with a minor difference, since Shri P. N. Bhandarkar was paid a total sum of Rs. 1,000 p.m. and the other two partners have been paid Rs. 800 p.m. each. The narration in the resolutions that the salaries were paid for putting in extra extra and exertion is really a self-serving statement because it cannot be said that till they were paid these salaries they were not putting in full effort and exertion in the conduct of the business. On the facts, I agree with the learned Appellate Assistant Commissioner that the payment of salary cannot be treated as the payment to the individual partners, but is really a mode of return to the family, for the investment of the Hindu undivided family funds and the payment is to the detriment of the Hindu undivided family and, therefore, is the income of the Hindu undivided family and not of the individual partners."

5. The answer to the question raised, in our opinion, is not complex. Nor is it far removed from certainties. There is a string of decisions of the Supreme Court on the similar question beginning with the case in *The Commissioner of Income Tax, West Bengal Vs. Kalu Babu Lal Chand*, and ending with the case in *Shri Raj Kumar Singh Hukam Chandji Vs. Commissioner of Income Tax, Madhya Pradesh*,

6. In *P.N. Krishna Iyer Vs. Commissioner of Income Tax, Kerala*, Shah J., speaking for the Supreme Court, reviewed all the earlier decisions on the question of remuneration earned by a member of a Hindu undivided family or as an officer of the company or the firm, and concluded thus (p. 545);

"Income received by a member of a Hindu undivided family from a firm or a

company in which the funds of the Hindu undivided family are invested, even though the income may be partially traceable to personal exertion of the member, is taxable as the income of the Hindu undivided family, if it is earned by detriment to the family funds or with the aid or assistance of those funds; otherwise it is taxable as the member's separate income."

7. Again, the Supreme Court speaking through Justice Hegde in *Shri Raj Kumar Singh Hukam Chandji Vs. Commissioner of Income Tax, Madhya Pradesh*, reviewed all the decisions including the principles enunciated in *P.N. Krishna Iyer Vs. Commissioner of Income Tax, Kerala*. The learned judge summarised the principles as follows (p. 43 of 78 ITR) :

"(1) whether the income received by a coparcener of a Hindu undivided family as remuneration had any real connection with the investment of the joint family funds;

(2) whether the income received was directly related to any utilization of family assets;

(3) whether the family had suffered any detriment in the process of realization of the income; and

(4) whether the income was received with the aid and assistance of the family funds.

In our opinion, from these subsidiary principles, the broader principle that emerges is whether the remuneration received by the coparcener in substance though not in form was but one of the modes of return made to the family because of the investment of the family funds in the business or whether it was a compensation made for the services rendered by the individual coparcener. If it is the former, it is an income of the Hindu undivided family but if it is the latter, then it is the income of the individual coparcener. If the income was essentially earned as a result of the funds invested, the fact that a coparcener has rendered some service would not change the character of the receipt. But if on the other hand it is essentially a remuneration for the services rendered by a coparcener, the circumstance that his services were availed of because of the reason that he was a member of the family which had invested funds in that business or that he had obtained the qualification shares from out of the family funds would not make the receipt, the income of the Hindu undivided family."

8. The principles being thus clear, we shall now turn to the facts of the present case.

9. The firms are family partnerships. There are only three partners in each of the two firms. The partners are divided brothers. No stranger is a partner. They have become the partners by contributing the family funds as capital. They have not rendered any special service other than the services rendered by them from the commencement of the firm in 1962, till the date of receiving the remuneration in 1974. The partners do not possess any special qualification in the business,

warranting the special remuneration paid to them. The remuneration was not paid either for their special knowledge, or for their special position in the firms like managing partner or a managing director in the company. All the three persons became partners by the investment of the family funds and continued as partners and partners only. They continued to discharge the same old duties with the same old responsibilities.

10. The Tribunal has found, as a matter of fact, that the increase in the business turnover cannot be attributed to any extra service rendered by the partners. The Tribunal has also found that the remuneration to the partners was more or less in the profit-sharing ratio. More than that, the Tribunal, having regard to the substantial payments to all the three partners, found that it was detrimental to the family funds. This finding is justified in the sense that there were no other partners in the firms and, if the remuneration was not paid, such remuneration would have gone to the family as share income.

11. Having regard to these findings, it appears to us that the conclusion reached by the Tribunal that the salary income of the assessee cannot be treated as their individual income is inescapable. As observed by the Supreme Court in *Shri Raj Kumar Singh Hukam Chandji Vs. Commissioner of Income Tax, Madhya Pradesh*, that, if the income was essentially earned as a result of the funds invested, the fact that a coparcener has rendered some service would not change the character of the receipt. This principle squarely applies to the present case. Since there is no evidence to show that the partners have rendered any special services or acquired any special qualifications or occupied any special positions in regard to the business of the firm, the Tribunal is justified in taking the view that the salary income from the two firms should be treated as the income of the joint family.

12. The decision of this court in *V.C. Rajarathnam Vs. Commissioner of Income Tax Bangalore*, on which Mr. Bhat placed reliance in support of his contention, is clearly distinguishable. There it was found that there was no material to hold that the shares in question were purchased by Rajarathnam with the object of becoming a director of the company. It is well known that all shareholders with qualifying shares cannot become directors of a company. The position as to partners in firms is quite different. A person could become a partner only by contributing capital, unless he is taken as a working partner.

13. In the result, we answer the question in the affirmative and against the assessee.