

(1982) 07 AHC CK 0009

In the Allahabad High Court

Case No : Income-tax Reference No. 169 of 1978

Laxman Das

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 13-07-1982

Acts Referred:

Income Tax Act, 1961 — Section 40
Income Tax Rules, 1922 — Rule 24
Partnership Act, 1932 — Section 13

Citation : (1982) 31 CTR 210 : (1982) 138 ITR 628 : (1983) 12 TAXMAN 58

Hon'ble Judges : R.R. Rastogi, J;H.N. Seth, J

Bench : Division Bench

Advocate : R.K. Gulati, for the Appellant; M. Katju, for the Respondent

Judgement

Rastogi, J.—The Income Tax Appellate Tribunal, Allahabad Bench, Allahabad (hereafter "the Appellate Tribunal"), has referred the following question of law for the opinion of this court :

" Whether, on the facts and in the circumstances of the case, was the salary received by Laxman Das from the firm, M/s. Rama Textiles, in which he was a partner as karta of his HUF includible in the assessment of the HUF of which Sri Laxman Das was the karta ? "

2. The assessee is Sri Laxman Das, HUF, and the assessment years involved are 1972-73 and 1973-74, for which the accounting periods respectively were Samvat 2028 and Samvat 2029. The assessee was a partner in a partnership firm, M/s. Ramji Laxman Das through its karta, Laxman Das. Sri Laxman Das, for services rendered to the firm, had received a sum of Rs. 12,000 in each of the aforesaid years from the aforesaid firm and the question was whether this amount could be included in the assessment of the assessee-HUF. The assessee had claimed that this income had been earned by Sri Laxman Das, the karta of the HUF, in his individual capacity for services rendered by him to the partnership firm and hence it could be not treated as the income of the assessee-HUF. The

ITO was not impressed with this contention and he treated these payments as the assessee's income and added the same in its total income for each of the aforesaid two years.

3. Aggrieved, the assessee filed appeals before the AAC and urged that the payments of Rs. 12,000 in each of the aforesaid assessment years by the partnership firm to Sri Laxman Das were in his individual capacity for services rendered by him to the firm and the same could not be treated as the income of the assessee-HUF. In support of this contention reliance was placed on two decisions of the Supreme Court, viz., Commissioner of Income Tax, Mysore Vs. Gurunath V. Dhakappa, and Shri Raj Kumar Singh Hukam Chandji Vs. Commissioner of Income Tax, Madhya Pradesh, . It was also urged that no detriment had been caused to the HUF firm by payment of this salary by the firm to the karta, Sri Laxman Das. These contentions found favour with the AAC and he held that the ITO had failed to make out any case for treating these salary payments made to the individual as income of the assessee-HUF and as such he deleted the additions in respect of the same.

4. The department thereafter took up the matter in appeal before the Appellate Tribunal. The Appellate Tribunal took view that "since the payment is part of the partnership agreement and is by virtue of being the karta of the assessee-HUF", there was no justification on the part of the assessee-HUF to question the action of the ITO in treating these payments as its own income and it placed reliance on the decision of the Supreme Court in Commissioner of Income Tax, Madras Vs. R.M. Chidambaram Pillai and Others, , wherein it has been held that a firm is not a legal person even though it has some attributes of personality. It has also been held that under the Income Tax law the firm is a unit of assessment by special provisions but is not a full person. Since a contract of employment requires two distinct persons, viz., employer and employee, there cannot be a contract of service, in strict law, between a firm and one of its partners. A payment of salary to a partner represents a special share of the profits. Salary paid to a partner retains the same character as the income of the firm. On this view the Appellate Tribunal held that the AAC was not justified in taking a contrary view. Further, the Appellate Tribunal distinguished the decisions on which the AAC had placed reliance by observing that in Chidambaram Pillai's case [1979] 106 ITR 292 , " the court dealt with the matter in a wider perspective wherein they have noted that the salary paid to a partner is nothing but the payment to self and it is another form of sharing profit of the firm. " Accordingly, the additions made by the ITO were restored.

5. Now, at the instance of the assessee, the question mentioned above has been referred for the opinion of this court.

6. It was urged before us on behalf of the assessee-HUF by its learned counsel, Sri R. K. Gulati, that the payment of salary by the partnership firm to Sri Laxman Das, karta of the assessee-HUF, was for services rendered by him to the firm and this payment was not to the detriment of the HUF funds. The sales of the firm

which, in the previous year relevant to the assessment year 1971-72, stood at Rs. 10,27,422 had risen to Rs. 18,50,177 and Rs. 21,13,227 in the two years under consideration and that was due to the services and efforts of Sri Laxman Das only and on a consideration of these facts the AAC recorded a finding of fact that the payment of salary by the firm to Sri Laxman Das was for services rendered by him and no detriment had been caused to the assessee-HUF by the payment of such salary. The learned counsel urged that these findings have not been upset by the Appellate Tribunal. We find that it is indeed so. The Appellate Tribunal was swayed by the fact that the payment of salary to Sri Laxman Das was part of the partnership agreement. In our opinion, this consideration is not very relevant. Clause 6 of the partnership agreement dated 26th of July, 1970, a copy of which is annexed to the statement of the case, reads as under :

" That Sri Laxman Das has special aptitude for carrying on and managing the business in Banarasi goods which is carried on by the firm. He shall be paid monthly Rs. 1,000 (Rupees one thousand) individually by way of salary for managing the affairs of the partnership and rendering services to the firm which shall be taken to be establishment expenses of the firm."

7. u/s 13 of the Partnership Act payment of salary to a partner of the firm is not unjustified if there is stipulation in that behalf. Apart from this u/s 40(b) of the I.T. Act, 1961, "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 " shall not be deducted in computing the income chargeable under the head " Profits and gains of business or profession ". Therefore, merely because the payment of salary to Sri Laxman Das was on account of a clause in the partnership agreement, that by itself, would not necessarily render the payment to the individual, a payment to his HUF and liable to be treated as the HUF's income.

8. Apart from this the decision in Commissioner of Income Tax, Madras Vs. R.M. Chidambaram Pillai and Others, is distinguishable. In that case the court was not concerned with the question which is now before us. There the respondents were partners in two partnership firms and in addition to their share in profits were entitled to salaries for services rendered by them to the firms. The controversy was not that the salary so received was not the taxable income of those partners. The sole controversy was whether the sums so drawn as salaries were wholly liable to Income Tax or only to the extent of 40 per cent, thereof which fell within the non-agricultural sector. The two firms, in which they were partners, had two tea estates. In the case of the business of a tea estate 60 per cent, of the income is exempt from tax for the reason that the income of the tea estate is treated as agricultural income. The respondent-partners claim that instead of treating the whole of their salary income, only 40 per cent, could be taxed. Thus, the question was whether any portion of the salary so drawn for services rendered is at all agricultural income to be non-exigible to Income Tax. On these facts the view taken by the court was that payment of salary to a partner represents a special share of the profits and the salary to a partner

retains the same character as the income of the firm. Therefore, the salary paid to a partner by a firm which cuts and sells tea is exempt from tax under Rule 24 of the Indian J.T. Rules, 1922, to the extent of 60 per cent, thereof representing agricultural income and is liable to tax only to the extent of 40 per cent.

9. In the present case, we are concerned with the assessment of the HUF which is a partner in a partnership firm through its karta and the dispute is in regard to the salary paid to the karta in his individual capacity for services rendered by him to the firm. This payment is without any detriment to the HUF firm. We find that the matter stands squarely concluded by a string of decisions of the Supreme Court. In *Commissioner of Income Tax, Mysore Vs. Gurnath V. Dhakappa*, , the karta of an HUF was a partner in a registered partnership firm representing his family. He was appointed manager of the firm on a remuneration of Rs. 500 per month. For the assessment year 1960-61 a sum of Rs. 14,737 was allocated to him as his share of the profits of the firm. That amount included the sum of Rs. 6,000 which was the salary payable to him for managing the firm's business. There was no finding that the salary received by the karta was directly related to the assets of the family utilised in the firm. The view taken was that the sum of Rs. 6,000 could not be treated as an income of the HUF.

10. The same view was taken in *Commissioner of Income Tax, Mysore Vs. D.C. Shah*, . The facts of that case were that the respondent, an HUF, was a partner in two firms through its karta. The karta was paid by the two firms remuneration as managing partner. He was found to be a man of rich experience in the line of business which the two firms were carrying on. The relevant partnership deeds of both the firms provided that the aforesaid karta shall be the managing partner thereof. No partner was paid any salary. On these facts it was held by the court that there was no real connection between the investment of the joint family funds and the remuneration paid to the karta. The remuneration was not earned on account of any detriment to the joint family assets and the remuneration received by the karta as the managing partner of the two firms was not assessable as the income of the HUF.

11. From these two decisions two principles can be culled out. Firstly, that where an HUF is a partner in a partnership firm through its karta and if the karta has received any remuneration from the firm because of his special aptitude in the business carried on by the firm and for services rendered by him to the firm and, secondly, if the remuneration is earned not on account of any detriment to the joint family assets, then such remuneration received by the karta is not assessable as the income of the HUF. Both these cases were decided by a Bench of three judges. Even if it be taken that in *Commissioner of Income Tax, Madras Vs. R.M. Chidambaram Pillai and Others*, , the Supreme Court has departed from this legal position, then this departure will not have a binding effect because this decision is by a Bench of two judges only.

12. There is another decision of the Supreme Court which is directly on the point

and it was in the case of V.D. Dhanwatey Vs. The Commissioner of Income Tax, M.P. Nagpur, . That case was decided by a Bench of five judges, four of whom took the view that unless there is a real and sufficient connection between the investment from the joint family funds and the remuneration paid to the karta, the salary paid to the karta by the firm is not assessable as an income of the HUF. The facts of that case may be noted. V, who was the karta of an HUF, was a partner of a partnership firm. His contribution to the capital of the firm belonged to the family and interest was payable on the capital contributed by each partner. Under Clause 7 of the deed of partnership, V was responsible for general management and supervision of the partnership business and under Clause 16, he was to be paid a monthly remuneration out of the gross earnings of the partnership business. The question arose as to whether the salary received by V, was assessable in the hands of the HUF. It was found that V was in the partnership as representing the family and he became a partner on account of the investment of the joint family assets in the capital of the partnership and that the remuneration received by V was only an increased share of the profits paid to him as a representative of the family. It was on these facts that it was held that the remuneration paid by the firm to V was directly related to the investment in the partnership business from the assets of the family and the salary paid to V was assessable as the income of the HUF. The position in the present case is quite contrary, and it is, that the salary was paid by the firm to Sri Laxman Das on account of the services rendered by him to the firm and, further, he had special aptitude for the business which the firm was carrying on. Another finding is that this payment had no connection whatsoever with the investment of the HUF in the capital of the firm. In other words, this payment was not at the cost of any detriment to the family funds. Applying the test laid down in V.D. Dhanwatey Vs. The Commissioner of Income Tax, M.P. Nagpur, , therefore, it is clear that the disputed payments are not assessable as the income of the assessee-HUF.

13. There is yet another decision of the Supreme Court to which our attention was invited by the learned counsel for the assessee-HUF and it is in the case of S. RM. CT. PL. Palani Appa Chettiar Vs. The Commissioner of Income Tax, Madras, . In that case the karta of an HUF had certain shares in a company which had been acquired with family funds. He was the managing director of that company. The question was whether the remuneration of the karta as managing director of the company was assessable in the hands of the family. It had been found that the shares had been acquired by the family not with the object that the karta should become the managing director but in the ordinary course of investment. There being no real and sufficient connection between the investment of the joint family funds and the purchase of the shares and the payment of the remuneration to the karta as managing director of the company, it was held that the remuneration paid to him as managing director was not earned by any detriment to the joint family assets and the amounts received by him as managing director's remuneration, commission and sitting fees were not

assessable as the income of the HUF. This was also a decision of a Bench of three judges.

14. In *Raj Kumar Singh Hukam Chandji* [1977] 78 ITR 33 , the test applicable in this behalf has been laid down thus (at p. 43):

" 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 the coparcener had 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. "

15. The principle now thus stands well crystallized and it is that payment by way of remuneration to the karta or a coparcener of the family by the firm in which the family is a partner cannot be assessable as the income of the family unless it has a direct nexus with the investment of funds of the family in the firm. In other words, unless such payment is to the detriment of the family funds invested in the firm, it cannot be treated as the income of the family. Reference may also be made to *Prem Nath and Others Vs. Commissioner of Income Tax, Delhi and Rajasthan*, , in this connection. The above mentioned principle laid down in the case of *Raj Kwmar Singh Hukam Chandji* [1977] 78 ITR 33 and *V.D. Dhanwatey Vs. The Commissioner of Income Tax, M.P. Nagpur*, , has been followed by the court in *Y.L. Agarwalla and Others Vs. Commissioner of Income Tax, Central Calcutta*, and by our court in *Commissioner of Income Tax Vs. Partap Veer Kakkar*, .

16. In our opinion, therefore, on the facts found in the present case, the view taken by the Appellate Tribunal was erroneous in law. The disputed payments having been made to *Sri Laxman Das* for services rendered by him to the firm and not by any detriment to the funds invested by the assessee-HUF in the firm, cannot be treated as the assessable income of the assessee-HUF.

17. We, therefore, answer the question referred to us in the negative, in favour of the assessee and against the department. The assessee is entitled to costs, which are assessed at Rs. 250.