

(1975) 04 KAR CK 0003

In the Karnataka High Court

Case No : Income-tax Referred Case No. 68 of 1973

N.M. Anniah and Co.

APPELLANT

Vs

Commissioner of Income Tax, Mysore

RESPONDENT

Date of Decision : 08-04-1975

Acts Referred:

Income Tax Act, 1961 — Section 256 (1), 30, 31, 40 (b), 40 A

Citation : (1975) 101 ITR 348

Hon'ble Judges : E.S. Venkataramaiah, J;D.M. Chandrashekhar, J

Bench : Division Bench

Advocate : K. Srinivasan, for the Appellant; S.R. Rajasekhara Murthy, for the Respondent

Judgement

Venkataramiah, J.—The Income Tax Appellate Tribunal, Bangalore Bench (hereinafter referred to as the Tribunal), has referred u/s 256(1) of the Income Tax Act, 1961 (hereinafter referred to as "the Act"), the following question for our opinion :

"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the salary payment of Rs. 12,000 to Sri. N. M. Anniah by the firm is not an admissible deduction in the computing of its business income ?"

2. The facts of the case are these. The assessee is a registered firm and the year of assessment is 1969-70. The Income Tax Officer, Special Survey Circle, Bangalore, by his order dated January 27, 1970, determined the taxable income of the assessee at Rs. 94,620. While doing so he excluded the sum of Rs. 12,000 which had been paid by the assessee to one of its partners, namely, N. M. Anniah, by way of salary. On a perusal of the said order of assessment, the Commissioner of Income Tax, Bungler, felt that the non-inclusion of Rs. 12,000 referred to above in the taxable income of the assessee was prejudicial to the interest of the revenue. He, therefore, issued notice to the assessee to show cause as to why the order of assessment should not be revised. After considering

the objections of the assessee the commissioner set aside the order of assessment and directed the Income Tax Officer to pass a fresh order by including Rs. 12,000 in the taxable income of the assessee. Aggrieved by the order of the Commissioner, the assessee filed an appeal before the Tribunal. The Tribunal found that :

(1) that the partnership deed dated April 1, 1968, under which the assessee-firm was constituted stated that N. M. Anniah had entered into partnership in his capacity as the karta of his Hindu undivided family;

(2) that the partnership deed further stated that N. M. Anniah was entitled to a salary of Rs. 1,000 per month in his individual capacity "for his personal skill, driver and ability"; and

(3) that the salary of Rs. 12,000 paid to N. M. Anniah was not deductible in computing the income chargeable to tax in view of section 40(b) of the Act.

3. The Tribunal accordingly dismissed the appeal. Thereafter, at the instance of the assessee, the Tribunal referred the question set out above for our opinion.

The relevant part of section 40 of the Act which arises for consideration in this case reads as follows :

"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....."

4. In this court two contentions were urged by Sri. K. Srinivasan, learned counsel for the assessee, in support of its case. The first contention is based on the constriction placed by the Supreme Court on section 16(1)(b) of the Indian Income Tax Act, 1922, which corresponds to section 67(1) of the Act. The first case relied on by the assessee is V. D. Dhanwatey v. Commissioner of Income Tax. The facts of that case were these : One Vasantharao who was the karta of the Hindu undivided family was a partner of a firm. The capital contributed by him to the firm belonged to the family. Under the partnership deed interest was payable on the capital contributed by the partners to the firm. Vasantharao was also paid a monthly remuneration for the services rendered by him. It was found that he was in the partnership as representing the undivided family and the remuneration paid to him was only an increased share of profits paid to him as representing the family. It was held that the remuneration paid to him was assessable as part of the income of the Hindu undivided family and not as his individual income of although section 16(1)(b) stated that when the assessee was a partner of the firm, his share of profit should be included in his income for purposes of assessment.

5. The next case relied on by Sri Srinivasan is Commissioner of Income Tax V.

Gurunath V. Dhakappa. In that the case karta of the Hindu undivided family was a partner in s firm. He was paid a monthly remuneration of Rs. 500 for managing the firm's business. There was no finding that the remuneration could not be assessed as the income of the Hindu undivided family.

6. On the basis of these two decisions of the Supreme Court it was argued that while construing section 40(b) of the Act also it had to be held that when a person was a partner in his character as karta of the family, the remuneration paid to him should be held to be non-deductible from the total income for the purposes of levying Income Tax only when the remuneration paid directly related to the funds of the family contributed as capital and not when there is no such relationship between the remuneration paid and the capital contributed.

7. It is well-settled that a Hindu undivided family, as such, cannot enter into a partnership with another person or persons, that a karta of a Hindu undivided family may, and frequently does, enter into partnership on behalf of the family with outsiders and that when he does so, the other members of the family do not, vis-a-vis the outsiders, become the partners of the firm and that so far as outsiders are concerned, it is the karta who alone is, and is in law, recognised as the partner.

8. We do not think that the contention urged on behalf of the assessee on the basis of the two decisions of the Supreme Court is tenable. We are of the view that section 40(b) which say that in the case of the firm any payment of salary made by the firm to any partner is not deductible is absolute in its terms and it is applicable to all cases irrespective of the character in which a person has become a partner of a firm. The principal enunciated in Dhanwatey's case and the principle underlying section 40(b), of the Act are entirely different from one another. In the first case the reason for treating the remuneration received by a karta, which is related to the family funds contributed as capital of the firm, as part of the income of the Hindu undivided family is that the karta has to be regarded as having entered into the partnership for the benefit of the Hindu undivided family and as between him and the other members of the family, he would be accountable for all profits or remuneration received by him. The object of enacting section 40(b) however, is entirely different. Ordinarily, any salary paid to a partner for the services rendered by him to the firm in accordance with a bona fide agreement entered into by and amongst the partners would have been deductible as expenditure u/s 37 of the Act but for section 40(b). The question whether an agreement to pay salary to a partner is a bona fide one or not is a question of fact. Obviously, considering the opportunities for fraud that any such alleged agreement would offer to make unreasonable and excessive claims, Parliament enacted section 40(b) making the payments referred to therein made by the firm to any of its partners non-deductible while computing the income of the firm for purposes of levy of Income Tax.

9. Section 10(4)(b) of the Indian Income Tax Act, 1922, corresponded to section 40(b) of the Act. In R. A. Goodsir and Co. v. commissioner of Excess Profits Tax it

was held that section 10(4)(b) referred to above made no distinction between payment made by a way of interest, commission, salary or remuneration to partner as a partner and made to him in a different character. All such payments were held too be non-deductible from the income. In *A. S. K. Rathnaswamy Nadar Firm v. Commissioner of Income Tax (Mad)*. the High Court of Madras held that section 10(4)(b) of the Indian Income Tax act 1922, enacted an absolute prohibition extended to salary paid to a partner in any capacity.

10. In *GIRIDHARILAL GHASIRAM Vs. COMMISSIONER OF Income Tax, WEST BENGAL.*, . it was contended that where a person was a partner in his capacity as the karta of a Hindu undivided family and was remunerated in the capacity of a servant of the firm, section 10(4)(b) was not applicable. The High Court of Calcutta rejected the above contention holding that in whichever capacity the partner might have received the remuneration, no deduction could be claimed in that behalf. The High Court a Allahabad and the High Court of Delhi have expressed the same view in *Commissioner of Income Tax Vs. Ram Laxman Sugar Mills*, . and *Pannalal Girdharilal v. Commissioner of Income Tax* respectively.

11. In view of the decisions referred to above, with which we concur, the first contention urged on behalf of the assessee has to fail.

The next contention urged of Sri K. Srinivasan is based on section 40A of the Act which was inserted by the Finance Act, 1968. The relevant part of the that section reads :

"40A. (1) The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other provisions of this Act relating to the computation of income under the head "profits and gains of business of professions".

(2)(a) Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause (b) of this sub-section, and the Income Tax Officer is of opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or occurring to him therefrom, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction :

Provided that the provisions of this sub-section shall not apply in the case of an assessee being a company in respect of any expenditure to which sub-clause (i) of clause (c) of section 40 applies.

(b) The persons referred to in clause (a) are the following, namely :

(i) where the assessee is an any relative of the assessee individual

(ii) where the assessee is any director of the company, partner of company, firm, association of the firm, or member of the association or persons or Hindu

undivided family, or any relative of such family director, partner or member;....."

12. It was contended that as salary was a payment in lieu of services rendered, by reason of section 40A which contained a non-obstinate clause, salary paid to a partner by a firm became deductible, notwithstanding the provisions of section 40(b), provided it was not excessive or unreasonable only that part of the salary which was found to be excessive or unreasonable would have to be disallowed. In other words, it is was contended that the total been found in section 40(b) was virtually lifted by Parliament by enacting section 40A and that the sum paid to a partner by the firm by way of salary became deductible provided that was neither excessive not unreasonable.

13. It is difficult to agree with the above submission. Sub-section (1) of section 40A no doubt says that the provisions of that section shall have effect notwithstanding anything to the contrary contained in any other provision of the Act relating to the computation of income under the head "profits and gains of business or profession". But, can it be said that section 40(b) which continues on the statute book has been made nugatory by section 40A ? In order to decide the above question we have to determine first the matters to which section 40A applies. A fair reading of section 40A shows that it is enacted with the object of conferring power on the assessing authorities to determine whether the expenditure referred to therein in respect of which deduction is claimable, is excessive or unreasonable and to disallow only so much of such expenditure as is found excessive or unreasonable. Disallowance arises only when an allowance is claimable. If no allowance can be claimed under the other provisions of law, the question of disallowance does not at all arise. Because u/s 40(b) amounts paid to a partner by the firm by way of interest, salary, bonus, commission or remuneration cannot be deducted in computing the income chargeable under the head "profits and gains of business or profession" there is no occasion on to apply section 40A to such payments. Section 40A deals with three classes of persons so far as a firm is concerned, viz., partners, members of the family of partners and relatives of partners. Section 40(b) refers to some of the payments made to partners only. section 40A applies in the case of firms only to payments made in lieu of goods, services and facilities to partners which are not covered by section 40(b) and all payment made for the goods, services and facilities to members to of the family of a partner, or any relative of a partner. In the intention of Parliament was to apply section 40A to matters contained in section 40(b) also, it would have repealed section 40(b) has been lifted and that payments made to a partner by a firm which are referred to in section 40(b), have become deductible after the inspection of section 40A, cannot be accepted. It was, however, argued that if two views are possible the one favourable to the assessee should be accepted. It may be so. But in this case no view other than the one expressed above is possible.

14. Sri Srinivasan urged that the necessary implication of the power concerned on the Income Tax Officer u/s 40A of the Act to disallow as deduction so much of

the expenditure incurred by a firm for payment to a partner in respect of goods, services and facilities, which he (the Income Tax Officer) considers to be unreasonable having regard to the fair market value of such goods, service and facilities, which he (the Income Tax Officer) considers to be unreasonable having regard to the fair market value of such goods, services and facilities, is that the Income Tax Officer shall have power to allow so much of the expenditure incurred by the firm for payment for the services of a partner to the firm, which the Income Tax Officer consider to be reasonable having regard to the fair market value of services.

15. We are unable to accept the above contention of Sri Srinivasan. As observed by Rowlatt J. in *Cape Brandy Syndicate v. Commissioners of Inland Revenue* 21] 12 TC 358. taxation we have to look simply at what is clearly said; there is no room for any intendment, we imply nothing; but we look fairly at what is said and what is said clearly.

16. The second contention also, therefore, fails.

In the result, the question referred to this court is answered in the affirmative and against the assessee. The answer is :

"On the facts and in the circumstance of this case, the Tribunal was justified in law in holding that the salary payment of Rs. 12,000 of N. M. Anniah by the firm was not an admissible deduction in the computation of its business income."