

**IN THE HIGH COURT OF KARNATAKA CIRCUIT BENCH AT
GULBARGA**

DATED THIS THE 24TH DAY OF SEPTEMBER, 2010

PRESENT

THE HON'BLE MR.JUSTICE N.KUMAR

AND

THE HON'BLE MR. JUSTICE SUBHASH B.ADI

I.T.A.No.869 OF 2008

C/W.

I.T.A.Nos.870, 871 & 872 OF 2008

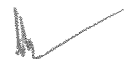
ITA No.869/2008:

BETWEEN

M/S. DR BIDARI ASHWINI HOSPITAL
BLDE HOSPITAL ROAD
BIJAPUR, REP BY ITS PARTNER
SRI L H BIDRI.

...APPELLANT

(By Sri.ASHOK KULKARNI & G.B.YADAV FOR
M/S. K R PRASAD, ADVOCATES)



AND

THE INCOME TAX OFFICER
WARD - 1
BIJAPUR.

...RESPONDENT

(By Sri. AMEET KUMAR DESHPANDE,
ADVOCATE)

THIS APPEAL U/S 260A OF THE INCOME TAX ACT, 1961, PRAYING THAT THIS HON'BLE COURT MAY BE PLEASED TO ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE INCOME-TAX APPELLATE TRIBUNAL IN ITA NO. 1223/B/2007 DTD 23.05.2008 AND CONSEQUENTIALLY CANCEL THE ORDER OF THE COMMISSIONER OF INCOME-TAX (APPEALS) VIDE APPEAL NO. ITA NO.56/B.JP/2005-06 DTD 18.09.2007 AND CANCEL THE ASSESSMENT ORDER PASSED BY THE INCOME-TAX OFFICER, WARD-1, BIJAPUR VIDE ORDER DTD 29.12.2006.

ITA No.870/2008:

BETWEEN

M/S. DR BIDARI ASHWINI HOSPITAL
BLDE HOSPITAL ROAD
BIJAPUR, REP BY ITS PARTNER
SRI L H BIDRI.

.. APPELLANT

(By Sri.ASHOK KULKARNI & G.B.YADAV FOR
M/S. K R PRASAD, ADVOCATES)

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THIS APPEAL U/S 260A OF THE INCOME TAX ACT, 1961, PRAYING THAT THIS HON'BLE COURT MAY BE PLEASED TO ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE INCOME-TAX APPELLATE TRIBUNAL IN ITA NO. 1222/B/2007 DTD 23.05.2008 AND CONSEQUENTIALLY CANCEL THE ORDER OF THE COMMISSIONER OF INCOME-TAX (APPEALS) VIDE APPEAL NO. ITA NO.52/BJP/2005-06 DTD 18.09.2007 AND CANCEL THE ASSESSMENT ORDER PASSED BY THE INCOME-TAX OFFICER, WARD-1, BIJAPUR VIDE ORDER DTD 27.12.2006.

ITA No.871/2008:

BETWEEN

M/S. SRINATH DRUGS DISTRIBUTORS
SARAF BAZAAR,
RAM MANDIR ROAD
BIJAPUR
REP BY ITS PARTNER
SRI D.C.DARBAR.

.. APPELLANT

(By Sri.ASHOK KULKARNI & G.B.YADAV FOR
M/S. K R PRASAD, ADVOCATES)



AND

THE INCOME TAX OFFICER
WARD - 1
BIJAPUR.

.. RESPONDENT

(By Sri. AMEET KUMAR DESHPANDE,
ADVOCATE)

THIS APPEAL U/S 260A OF THE INCOME TAX ACT, 1961, PRAYING THAT THIS HON'BLE COURT MAY BE PLEASED TO ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE INCOME-TAX APPELLATE TRIBUNAL IN ITA NO. 1220/B/2007 DTD 23.05.2008 AND CONSEQUENTIALLY CANCEL THE ORDER OF THE COMMISSIONER OF INCOME-TAX (APPEALS) VIDE APPEAL NO. ITA NO.55/BJP/2005-06 DTD 18.09.2007 AND CANCEL THE ASSESSMENT ORDER PASSED BY THE INCOME-TAX OFFICER, WARD-1, BIJAPUR VIDE ORDER DTD 27.02.2006.

ITA No.872/2008:

BETWEEN

SHREE GURURAJ AGENCIES
GAJANAN COMPLEX,
AZAD ROAD,
BIJAPUR.
REP BY ITS PARTNER
SRI R.A.KULKARNI.

.. APPELLANT

(By Sri.ASHOK KULKARNI & G.B.YADAV FOR
M/S. K R PRASAD, ADVOCATES)



AND

THE INCOME TAX OFFICER
WARD - 1
BIJAPUR.

.. RESPONDENT

(By Sri. AMEET KUMAR DESHPANDE,
ADVOCATE)

THIS APPEAL U/S 260A OF THE INCOME TAX ACT, 1961, PRAYING THAT THIS HON'BLE COURT MAY BE PLEASED TO ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE INCOME-TAX APPELLATE TRIBUNAL IN ITA NO. 1221/B/2007 DTD 23.05.2008 AND CONSEQUENTIALLY CANCEL THE ORDER OF THE COMMISSIONER OF INCOME-TAX (APPEALS) VIDE APPEAL NO. ITA NO.51/BJP/2005-06 DTD 18.09.2007 AND CANCEL THE ASSESSMENT ORDER PASSED BY THE INCOME-TAX OFFICER, WARD-1, BIJAPUR VIDE ORDER DTD 27.02.2006.

THESE ITAS, COMING ON FOR ADMISSION, THIS DAY, **N.KUMAR J.**, DELIVERED THE FOLLOWING:

J U D G M E N T

A common question of law is involved in all these four appeals. Therefore, they are taken up for consideration together and disposed of by this common order.

2. For proper appreciation of the legal position, facts in one of the cases is set out. M/s.Srinath Drugs Distributors,

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is a partnership firm. It consisted of five partners. Two of the partners D.C.Darbar and R.C.Darbar represented their Hindu Undivided Family in the partnership firm (hereinafter for short, referred to as 'HUF') being the karta of their family. In the partnership deed, there is no provision for payment of commission to them. These two persons possess Certificate of Diploma in Pharmacy. To carry on the business of drugs atleast one person has to be qualified for selling the drugs. The firm paid commission to the aforesaid two partners, in their individual capacities amounting to Rs.2,57,470/- each for the services rendered by them by virtue of the specialized qualification they possessed. The assessing officer held that, the said amount cannot be allowed as deduction at the hands of the firm in view of Section 40(b) of the Income Tax Act, 1961 (hereinafter for short, referred to as the 'Act'). In coming to the said conclusion, he relied on the judgment of the Apex Court in the case of *Rashik Lal & Co. vs. CIT reported in 229 ITR 458* and that a HUF cannot be a partner, in a partnership firm. The individual in a representative capacity, on behalf of the HUF, is the partner. Commission paid to him is to be treated as



commission paid to the partner. A partner cannot be heard to say that he has not received commission as a partner in the firm, but in a different capacity. If he was a working partner, he could have been treated as such and remuneration or commission paid to such working partner was allowable for deduction. Explanation (4) to Section 40(b) of the Act does not specify payment of commission to an individual where he is a partner in HUF capacity. Hence, explanation given by the assessee was not accepted. Aggrieved by the same, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals). The appellate authority, after considering the submissions of the assessee and pursuing the various case laws, upheld the disallowance of commission paid to two partners placing reliance on the decision of the Apex Court in *Rashik Lal & Co's case*. Aggrieved by the same, the assessee preferred an appeal before the tribunal.

3. The tribunal held, commission paid to a partner who is not a working partner is not allowable in the case of assessment of the firm. The word 'commission' as mentioned



in Section 40(b)(i) of the Act has been subsequently referred to as 'remuneration' in Section 40(b)(iii). Hence, commission which could be considered as part of remuneration is allowable in case the same is authorized by the partnership deed. If the partnership deed has not authorized, then the same cannot be considered for deduction in the assessment of the firm. The legislature was fully aware of the fact that, sometimes the partner is a partner on behalf of and for the benefit of any other person. An exception has been provided in respect of interest and not in respect of commission or remuneration. If the legislature wanted to allow such deduction in respect of commission or remuneration, then either an exception would have been provided or the word 'remuneration' should have also been added to interest in Explanation (1). Section 40 contains a non-obstante clause. The commission, if any, payable for specific services is allowable under Section 37 of the Act. However Section 40 says that, notwithstanding anything to the contrary in Sections 32 to 38, the amounts mentioned in Section 40 will not be allowed. As per the amended provisions, commission can be allowed to the working



partner provided it is authorized in the partnership deed. The partnership deed in question does not provide for payment of any commission to the partners. Hence, commission paid to the partners is not allowable as per the provisions of Section 40(b) and therefore, they dismissed the appeal affirming the orders passed by the appellate authority.

4. In fact, in the other two cases, the partners representing the HUF as karta were duly qualified doctors who are rendering services to the partnership firm which was running nursing homes. Therefore, in these two cases, the said partners are chemists, duly qualified and in other two cases they are doctors who were duly qualified, without whose services partnership firm could not carry on their business. That is how the common question of law do arise for consideration in all these cases.

5. At the time of admitting these appeals, the substantial question of law which is framed is as under:

Whether on the facts and in the circumstances of the case, the commission payable individually to

Dr.L.H.Bidri in his individual capacity by the appellant firm are an inadmissible item of expenditure while computing the income of the firm?

6. The learned counsel for the appellant contended that, in the partnership firm though individual names are mentioned, it is clear from the description, they were representing the HUF as karta. Therefore, the HUF is the partner in the firm and not the individual. The individuals are paid commission for the specialized services rendered by them. If such remuneration was being paid to an employee with that qualification, that was eligible for deduction under Section 37 of the Act. If that is so, the commission paid to these individuals who possess special qualifications, without which the partnership business could not be carried on, is also eligible for deduction. Therefore, it is not a case of remuneration paid to a partner which does not satisfy the requirements of Section 40(b) of the Act and therefore, he contends, the authorities have not properly appreciated the facts and the law on the point and committed a serious error in disallowing the said expenditure.



7. Per contra, learned counsel appearing for the revenue submitted, under the Partnership Act, this dual capacity is not recognized. The partnership being a special contract can be only between two individuals or legal persons. A HUF can never be a partner in a partnership firm. Even though the karta or a member of HUF may become a partner, under the Partnership Act, they are treated as individuals and HUF is not treated as a partner. Such a partner cannot be treated as representing HUF as well as an employee because of his specialized qualification. Any amount paid to him is treated as payment to the partner only.

8. The Supreme Court had an occasion to consider the said question in the case of Rashik Lal & Co. vs. Commissioner of Income Tax and has held as under:-

“A firm is a compendious way of describing the individuals constituting the firm. A Hindu undivided family directly or indirectly cannot become a partner of a firm



because the firm is an associate of individuals. Under Hindu law, not all members of the joint family, but only such of its members as have, in fact, entered into partnership with the stranger, become partners. The Partnership Act, 1932, contains various provisions regarding the relationship among partners. All these provisions relating to mutual rights and liabilities are only applicable to the individual partners who are members of the firm. There is no way that a Hindu undivided family can intrude into the relationship created by a contract between certain individuals. The only right of the Hindu undivided family is possibly to call upon its nominee partner to render accounts for the profits that he has made from the partnership business. But that is something between the nominee and the Hindu undivided family, with which the partnership is not concerned. The specific provision in Section 13 of the Partnership Act, 1932, that a partner is not entitled to receive any remuneration for taking part in the conduct of the business, has been interpreted to

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mean that every partner is bound to attend diligently to the business of the firm. For doing his duties, he cannot charge his co-partners any sum or remuneration, whether in the shape of salary, commission or otherwise, on account of the trouble taken by him in conducting the partnership business. There, however, can be a special contract to the contrary in which case, the provisions of that contract will prevail. Section 40(b) of the Income Tax Act, 1961, will apply, even where there is such a special contract. Any commission paid by a firm to its partner will not be permitted as deduction from the business income of the firm. If a claim is made by a partner that he is representing a Hindu undivided family or any other body of persons, then the position in law will not be any different. The Hindu undivided family is not and cannot be a partner in a partnership firm. The remuneration or the commission that is paid to the partner cannot be claimed to be a remuneration or commission paid to the Hindu undivided family. The partner may be accountable to the family for the monies received by him from the partnership. But, in



the assessment of the firm, the partner cannot be heard to say that he has not received the commission as a partner of the firm, but in a different capacity. The application for registration of a firm has to be made under Section 184 of the Income Tax Act. The very fact that individual shares of the partners have to be specified and that such partners must personally sign the partnership deed and also the application for registration go to show that even if a person joins a firm as a representative of a Hindu undivided family or any other body or association, within the firm, his position is that of an individual. He may have an agreement with a third party to divide the profits received from the firm, but that agreement does not bind the firm nor does it alter the position of the partners under the Partnership Act or the income Tax Act. A partner does not act in a representative capacity in the partnership. He functions in his personal capacity like any other partner. The provisions of the Partnership Act and the Income Tax Act relating to partners and partnership firms will apply in full force in

respect of such a partner. If any remuneration is paid or a commission is given to a partner by a partnership firm, Section 40(b) will apply even if the partner has joined the firm as a nominee of a Hindu undivided family. The Hindu undivided family or its representative, does not have any special status in the Partnership Act. Although the partnership firm is not a legal entity, it has been treated as an independent unit of assessment under the Income Tax Act. The assessment of a firm will have to be made strictly in accordance with the provisions of the Income Tax Act. The law has to be taken as it is. Section 40(b) applies to certain payments made by a firm to its partners. Neither the firm nor its partners can evade the tax law on the pretext that although in law he is a partner, in reality he is not so. He may have to hand over the money to somebody else. That may be his position qua a third party. But the firm has nothing to do with it. It has paid the commission to one of its partners. It cannot get any deduction in its assessment for that

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payment, because Section 40(b) of the Act expressly prohibits such deduction.”

9. Partnership is an association of individuals. The said individuals may be a natural person or a legal person. A partnership firm is a compendious way of describing individuals constituting the firm. The Partnership Act, 1932 contains various provisions regarding the relationship among partners. All these provisions relating to the mutual rights and liabilities are only applicable to the individual partners who are members of the firm. A partner does not act in a representative capacity in the partnership. He functions in his personal capacity like any other partner. The provisions of the Partnership Act and the Income Tax Act relating to partners and partnership firms will apply in full force in respect of such a partner. The application for registration of a firm has to be made under Section 184 of the Income Tax Act. The very fact that individual shares of the partners have to be specified and that such partners must personally sign the partnership deed and also the application for registration go to show his position

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is that of an individual, though he may be representing certain interest. The firm has nothing to do with such interest he represents. Although a partnership is not a legal entity, it has been treated as an independent unit for assessment under the Income Tax Act. The law has to be taken as it is. Section 40(b) of the Income Tax Act applies to certain payments made by a firm to its partners.

10. A HUF is not a legal person for the purpose of the Partnership Act. A HUF directly or indirectly cannot become a partner of a firm. There is no way that a HUF can intrude into the relationship created by a contract between certain individuals. The HUF is not and cannot be a partner in a partnership firm. If a claim is made by a person who is a partner in a partnership firm as representing HUF or any other body of persons, in law it makes no difference. In the assessment of the firm, such a partner cannot be heard to say that he has not received the remuneration as a partner of the firm but in a different capacity. He may have to account for the remuneration received as a partner to third parties and in the



case of a HUF to other members of the HUF. But, that agreement does not bind the firm nor does it alter the position of the partners under the Partnership Act or the Income Tax Act. He may have to hand over the money to some others. That may be his position *qua* a third party. The Partnership Firm has nothing to do with it. Once it has paid the commission/remuneration to one of its partners it cannot get any deduction in its assessment for that payment because Section 40(b) of the Act expressly prohibits such deduction.

11. In this background it is also necessary to see Section 13 of the Partnership Act, which provides for mutual rights and liabilities of the partner. It reads as under:

“13. Mutual rights and liabilities.- Subject to contract between the partners.- Subject to contract between the partners-

(a) a partner is not entitled to receive remuneration for taking part in the conduct of the business;

(b) xx xx xx

(c) xx xx xx

(d) xx xx xx

(e) xx xx xx

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Section 40 (b)(v) of the Income Tax Act reads as under:-

40. **Amounts not deductible**

.Notwithstanding anything to the contrary in section 30 to [38], the following amounts shall not be deducted in computing the income chargeable under the head "profits and gains of business or profession",-

(a) xxx xxx

(b) in the case of any firm assessable as such.-

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(v) any payment of remuneration to any partner who is a working partner, which is authorised by, and is in accordance with, the terms of the partnership deed and relates to any period falling after the date of such partnership deed in so far as the amount of such payment to all the partners during the previous year exceeds the aggregate amount computed as hereunder:-

a) on the first Rs.3,00,000 of the book-profits or in case of loss	Rs.1,50,000 or at the rate of 90 per cent of the book-profit, whichever is more.
b) on the balance	At the rate of 60 per

13. If all these conditions are fulfilled, a partner is entitled to remuneration by way of salary, commission, bonus etc., apart from share in the profit. Therefore, any payment made to a partner if it is to be eligible for deduction as explained under Section 37 of the Act, should satisfy the aforesaid requirements. Otherwise, the amount paid to such partner cannot be deducted as expenditure under Section 37 of the Act.

14. Realizing this difficulty, the argument canvassed is, though the said persons named is shown in the partnership deed as partners, as is clear from the description, it is the HUF which is the partner and therefore, that individual is not a partner. The individual is paid remuneration by way of commission for the services rendered for which he is duly qualified. In other words, the said remuneration is paid to him not in his capacity as a partner, but in his capacity as an employee who rendered services. This is precisely what is prohibited under law. Unless such partner is a working partner and the partnership deed provides for remuneration to him for

the services rendered by him, any remuneration paid to any partner, is not deductible under Section 37 of the Act. Even if he possess a specialized qualification, he is rendering services and without that service the partnership business cannot be carried on, still for the services rendered by him as a partner of the firm, if he wants remuneration to be paid by way of salary, commission, bonus, etc., then the requirements of Section 40(b) of the Act has to be complied with. Otherwise, as is clear from the non obstante clause contained under Section 40(b) of the Act, any remuneration paid to a partners in whatever capacity, in whatever manner, is not deductible as an expenditure under Section 37.

15. The learned counsel for the assessee relied on the judgment of the Andhra Pradesh High Court and Punjab and Haryana High Court where taking clue from the exception (1) to Section 40(b) where a specific provision is made recognizing the distinction between a partner in an individual capacity and partner in a representative capacity and the benefit of deduction to the firm in respect of interest paid to a partner in

his individual capacity is given. When payment of interest is in his individual capacity is deductible, the same analogy is to be applied in so far as the remuneration, salary is concerned, we are afraid that, such an analogy is not permissible in law. If the legislature thought it fit to expressly state that, interest paid to a partner in his individual capacity is deductible as an exception and the same interest paid to him in a representative capacity is not deductible, and the law do not extend the said benefit to other payments such as remuneration, bonus or salary, it is clear that, the legislature had no intention of extending such benefit. It is settled law, while interpreting the statutory provisions, not only the court has to keep in mind the express words used in the Section, it ought to keep in mind what is not expressed expressly. If the legislature in its wisdom do not expressly extend the said benefit to the salary, remuneration, bonus, etc., the courts by interpreting the same cannot extend the said benefit, when the same is deliberately omitted by the legislature. Otherwise, it amounts to re-writing the Section by the Court, which is impermissible. In fact, this is precisely what the tribunal has held after referring to all



these judgements and the statutory provisions. There is no merit in the said contention also.

16. In that view of the matter, we do not see any error committed by the tribunal in disallowing remuneration paid to these qualified partners as a permissible deduction under Section 37 of the Act. Accordingly, we answer the aforesaid question of law in favour of the revenue and against the assessee. Hence, we pass the following:

ORDER

All the appeals are dismissed.

Sd/-
JUDGE

Sd/-
JUDGE

Cm/-