

IN THE HIGH COURT OF PATNA

FULL BENCH

Tax Case No. 3 of 1975

Decided On: 10.01.1984

Appellants: **Commissioner of Income Tax**

Vs.

Respondent: **Atma Ram Budhia**

Income Tax Act, 1961---Section 67(1)(b), 40 (b), 256(2)— Tax liability of Hindu Undivided Family (HUF)-- Reference at the instance of CIT, Bihar to determine as to whether the salary received by an employee of the firm in which he was a partner as *karta* of his HUF, is includible in the total income of the assessee-HUF---- assessee-HUF challenged the inclusion of the salary income, Rs. 18,000, of Shri Budhia as an income of the HUF on the ground that the firm was paying the salary to Shri Budhia in his individual capacity so much so that the ITO, Ranchi, had already included the salary income in the personal assessment of Shri Budhia— *Held*: unless it was established that remuneration received by the manager of an HUF was not the income of the family and the remuneration was for services rendered by him and that there was no real and sufficient connection between the investment of the joint family assets and the remuneration paid to him, the remuneration received by the manager or *karta* of an undivided family working as a partner could not be treated as an income of the family and as such was not liable to Income Tax—since the salary received by Shri Budhia was in his individual capacity for services rendered by him personally to the firm, the Tribunal has taken a right view of the matter—reference answered in the negative, i.e., in favour of the assessee and against the Department. (**Para 2, 5, 23, 24**)

MANU/UP/0424/1982;MANU/SC/0193/1967;MANU/SC/0178/1967;
MANU/SC/0081/1968; MANU/SC/0293/1970; MANU/SC/0283/1970

.....**Relied upon.**

MANU/GH/0036/1977; MANU/SC/0217/1976

.....**Disagreed with.**

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Appellants: **Commissioner of Income Tax**
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Respondent: **Atma Ram Budhia**

Hon'ble Judges/Coram:

H.L. Agarwal, Nazir Ahmad and P.S. Mishra, JJ.

Counsels:

For Appellant/Petitioner/Plaintiff: B.P. Rajgarhia and S.K. Sharan, Advs.

For Respondents/Defendant: L.K. Bajla and S.K. Poddar, Advs.

JUDGMENT

H.L. Agarwal, J.

1. This is a reference under Section 256(2) of the I.T, Act, 1961, at the instance of the CIT, Bihar, Patna, and at the direction of this court the Income Tax Appellate Tribunal, Bench 'B', Patna, has referred the following question for determination by the court:

"Whether, on the facts and in the circumstances of this case, the salary of Rs. 18,000 paid to the partner, Shri Atma Ram Budhia, the assessee, is includible in his personal, assessment under Section 67(1)(b) of Income Tax Act, 1961?"

2. After hearing this reference, we found that the question directed to be referred to this court required to be refrained. I have accordingly refrained it as follows :

"Whether, on the facts and in the circumstances of this case, the salary of Rs. 18,000 received by Shri Atma Ram Budhia from the firm, M/s. R. K. Budhia & Co., in which he was a partner as karta of his HUF, is includible in the total income of the assessee-HUF ? "

3. The assessment year involved is 1967-68 and the facts found and/or admitted are shortly as under :

The assessee, Shri Atma Ram Budhia was being assessed in the status of HUF as well as 'Individual'. The present case relates to the assessment of the HUF, Shri Budhia was also, a partner in the firm, M/s. R. K. Budhia & Co., in his capacity as karta of his HUF. The ITO while making the assessment of the assessee-HUF included the share income received, from the firm, M/s. R. K. Budhia & Co., as per share allocation as well as the salary paid to Shri Budhia to the extent of Rs. 30,602 which included salary of Rs. 18,000.

4. Undisputedly the salary income had not been included in the assessment of the HUF in the earlier years and this was the position up to the assessment year 1965-66.

5. The assessee filed an appeal to the AAC challenging the inclusion of the salary income, Rs. 18,000, of Shri Budhia as an income of the HUF on the ground that the firm was paying the salary to Shri Budhia in his individual capacity so much so that the ITO, Ranchi, had already included the salary income in the personal assessment of Shri Budhia.

6. The appellate authority, taking the view that "no specific reason has been given by the ITO for taking this amount of salary to the total income of the appellant-HUF", excluded the amount of Rs. 18,000 and held that it was assessable in the hands of Shri Budhia in the status of "individual".

7. An appeal was taken by the Department to the Income Tax Appellate Tribunal, Patna. The assessee did not appear before the Tribunal but sent a copy of the order of the Tribunal in I.T.A. No. 888-Patna, dated February 23, 1973, for the assessment year 1966-67, wherein a similar point had come up for consideration and the Tribunal had dismissed the Department's appeal.

8. The Tribunal again dismissed the appeal by its order dated September 20, 1973, on the ground that the identical point in issue having already been decided in the immediately preceding year and the facts and the circumstances for the year in question remaining the same there was no merit in the appeal.

9. Some statements of fact which are very material and, if I may say so, crucial for deciding the issue in question, as recorded in the "statement of the case" are as follows :

"In the earlier year the Appellate Assistant Commissioner had found that the salary was being paid to Sri Atma Ram Budhia for services rendered to the firm and the services were rendered in his individual capacity. The Tribunal had found in the earlier year that the salary income had never been assessed in the hands of the HUF and it was being included in the assessment of the individual. Before the Tribunal the Department had not controverted the fact that the salary had been received by Sri Budhia in his individual capacity for services rendered by him personally to the firm."

10. In the meantime an important development had taken place. In the assessment year 1966-67, in the case of the firm, M/s. R. K. Budhia & Co., the assessee had disputed disallowance of the sum of Rs. 18,000 made under Section 40(b) of the Act on the same ground and the AAC had allowed the deletion of this sum from the income of the firm against which the Department had filed an appeal which was decided in favour of the Department by the Tribunal by its order dated September 29, 1973, and thus the disallowance of Rs. 18,000 under Section 40(b) was restored.

11. In the statement of facts as well as in the course of the argument this point was emphasised on behalf of the Department before us that according to the provisions of Section 67(1)(b) of the Act the income of a partner is to be computed after taking into consideration the interest, salary, commission and other remuneration paid to the partner by the firm and the amount is to be included along with the share income of the business of the firm. Therefore, in computing the income of the partner who was representing the HUF the remuneration paid to Shri Budhia in his capacity as a partner in the firm was bound to be added to the share income and as a result it was

to be treated as the partner's share in the income of the firm.

12. Mr. Rajgarhia, appearing for the Department, placed reliance upon Lindley on Partnership (13th Edn.), where at p. 26 it has been stated that a partner cannot "be employed by his firm for a man cannot be his own employer" and, therefore, he contended that the payment of salary to Shri Budhia was nothing else than representing a mode of income from the profit of the firm in which he was a partner. Strong reliance was placed by him on a recent decision of the Supreme Court in the case of CIT v. R.M. Chidambaram Pillai MANU/SC/0217/1976 : [1977]10ITR292(SC) , which is the decision of the two learned judges of the Supreme Court wherein it was observed that since a contract of employment required two distinct persons, viz., the employer and the employee, there could not 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. So that any agreement for remuneration of a partner for taking part in the conduct of the business must be regarded as a portion of the profits made over as reward for human capital brought in.

13. Although there are other lines of distinction which I would venture to account for in not following this decision, the question of law and the facts found in that case before the learned judges of the Supreme Court were entirely different. The simple question was as to whether any portion of the salary drawn for services rendered by a partner of the firm was agricultural income liable to Income Tax.

14. In the case before us, it is not disputed that the sum of Rs. 18,000 drawn as salary by Shri Budhia was liable to Income Tax. The only dispute that arises on the facts found by the Revenue, is as to whether that will be included in the personal assessment of Shri Budhia or it will go to the income of the HUF of which he happened to be the karta ?

15. Mr. Rajgarhia's other emphasis was that under the scheme of Section 140(b) read with Section 67 of the Act, as already indicated above, any payment of salary made to a partner shall not be deducted in computing the, income chargeable under the head "Profits and gains of business of the firm". That might be so for the purpose of computing the total income of the assessee-firm (in this case M/s. R.K. Budhia & Co.), as the provision contained in this clause is absolute and makes no difference between payment by way of interest, commission, salary, etc., made to a person as a partner or such payments made to him in a different character, for example, in his personal capacity when he is a partner in his capacity as karta of a joint family, etc. But notwithstanding the provisions contained in Clause (b) of Sub-section (1) of Section 67, in my opinion, there is no bar for a partner to prove and establish that any amount apportioned to his account as salary or remuneration, etc., will not be added to the share income of the firm.

16. Although a Full Bench of the Gauhati High Court in the case of CIT v. Amsoi Tea Estate MANU/GH/0036/1977, applying the ratio of the case of R.M. Chidambaram Pillai MANU/SC/0217/1976 : [1977]10ITR292(SC) , included the salary and interest paid to a partner received by him on the monetary contribution, a Division Bench of the Allahabad High Court in Laxman Das v. CIT MANU/UP/0424/1982 : [1982]138ITR628(All) , did not follow the said decision. In the case before the Allahabad High Court the nature of the case was very much similar to the case in hand. There also an HUF was a partner in a firm through its karta who had received remuneration from the firm because of his special aptitude for the business of the

firm and for services rendered by him to the firm. Following, some earlier decisions of the Supreme Court of larger Benches and the proposition laid down in them, where a line of distinction has been laid down that if the remuneration is earned by the partner 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 unless the remuneration has direct nexus with the investment of funds in the family of the firm. R.M. Chidambaram Pillai's case MANU/SC/0217/1976 : [1977]10ITR292(SC) was distinguished by the learned judges of the Allahabad High Court in these words (pp. 631-632):

" 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..... Even if it be taken that in Chidambaram Pillai's case MANU/SC/0217/1976 : [1977]10ITR292(SC) , 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."

17. I find myself in complete agreement with the above view expressed by the Division Bench of the Allahabad High Court.

18. The decision of a five judges' Bench of the Supreme Court in the case of V.D. Dhanwatey v. CIT MANU/SC/0193/1967 : [1968]68ITR365(SC) is directly on the point. Four out of five learned judges took the view that unless there was real and sufficient connection between the investment from the joint family funds and the salary paid to the karta by the firm, it was not assessable as an income of the HUF.

19. There is another case of the Supreme Court of three judges, namely, Palaniappa Chettiar v. CIT MANU/SC/0178/1967 : [1968]68ITR221(SC) , the question there being as to whether the remuneration and commission received by the karta as managing director of the company was assessable as the income of the family. It was 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 in the purchase of the shares and the payment of the remuneration to the karta, 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 were not assessable as the income of the HUF.

20. To the same effect is yet another decision of the Supreme Court in the case of CIT v. Gurunath V. Dhakappa MANU/SC/0081/1968 : [1969]72ITR192(SC) , where in the absence of a clear finding that the salary received by the karta was directly related to the assets of the family utilised in the firm in which the HUF was a partner, the sum of Rs. 6,000 paid to the karta was held not to be treated as the income of the HUF.

21. Perhaps, in view of these conflicting decisions of the highest court of the land, the Division Bench of this court referred the case to a larger Bench, but could not refrain from making an observation that "prima facie we feel inclined to accept the

contention of the assessee".

22. Some other cases of the Supreme Court were brought to our notice by Mr. Bajla, learned counsel appearing for the assessee, where similar principles have been laid down, those cases being (1) Rajkumar Singh Hukam Chandji v. CIT MANU/SC/0293/1970 : [1970]78ITR33(SC) and (2) Prem Nath v. CIT MANU/SC/0283/1970 : [1970]78ITR319(SC) .

23. The irresistible conclusion that follows from a resume of the above decisions of the Supreme Court and some other High Courts, is that unless it was established that remuneration received by the manager of an HUF was not the income of the family and the remuneration was for services rendered by him and that there was no real and sufficient connection between the investment of the joint family assets and the remuneration paid to him, the remuneration received by the manager or karta of an undivided family working as a partner could not be treated as an income of the family and as such was not liable to Income Tax.

24. From the statement of case already enumerated earlier, it has been seen that the fact that the salary of Rs. 18,000 received by Shri Budhia was in his individual capacity for services rendered by him personally to the firm, M/s. R. K. Budhia & Co., was a non-issue. In view of this finding, in my opinion, the Tribunal has taken a right view of the matter in law.

25. I would accordingly answer the question referred to us, in the negative, i.e., in favour of the assessee and against the Department. The assessee is also entitled to costs which, however, is assessed at Rs. 250 only.

Nazir Ahmad, J.

26. I agree.

P.S. Mishra, J.

27. I have the privilege of going through the proposed judgment of brother, Hari Lal Agrawal J. I propose to record my agreement with the conclusion arrived at by him that the question referred to us under Section 256(2) of the I.T. Act, 1961, at the instance of the Commissioner of Income Tax, Bihar, Patna, has to be answered in all its aspects in the negative that is to say in favour of the assessee and against the Department. As it appears from the various judgments of the Supreme Court of India, the question referred to us has to be answered by determining the fact 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 service rendered by the individual coparcener. If it is the former, it is an income of the HUF but if it is the latter then it is. the income of the individual coparcener. If the income was essentially earned as the 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 circumstances 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 HUF.

28. In the instant case the assessee, Shri Atma Ram Budhia, was being assessed as

the karta of the HUF, as well as in his individual capacity. It is not in dispute that Shri Budhia is a partner in the firm, M/s. R. K. Bhudhia & Co., in his capacity as karta of his undivided Hindu-family and has been receiving the share allocation as a partner on behalf of the family. Shri Budhia has also been receiving salary by way of remuneration for the service rendered by him in the firm. He received a sum of Rs. 30,602 including Rs. 18,000 as salary for the assessment year in question, that is to say, 1967-68. We do not have before us any facts showing that the amount of Rs. 18,000 paid to Shri Budhia was essentially a return made to the family because of the investment of the family funds in the business of the firm or that it was an income essentially earned as a result of the funds invested on behalf of the family. The assessee has maintained that the said amount of Rs. 18,000 was a compensation or remuneration made/paid for the services rendered by him. In view of the law since settled and concluded, the circumstances that his services were availed of because of the reason that he was a member of the family which had invested funds in the business of the firm, is of no consequence. There being no material to show that Shri Budhia was appointed for service on behalf of the family or as a result of any outlay or expenditure or detriment to the family property, or that his appointment was linked with the acquisition of the business, it has to be held that his employment was an employment of personal responsibility and ability and the remuneration paid to him is in lieu of the contract of service.

29. In the case of CIT v. R.M. Chidambaram Pillai MANU/SC/0217/1976 : [1977]10ITR292(SC) , there are words which appear to give an impression that any agreement for remuneration of a partner for taking part in the conduct of, the business must be regarded as his portion of the profits being made over as reward for the human capital brought in by a partner. It has been observed in the said case that partnership is a certain relation between persons, the product of agreement to share the profits of a business. "Firm" is a collective noun and a compendious expression to designate an entity, not a person ; in Income Tax law a firm is a unit of assessment, by special provisions, but is not a full person which leads to the next step that since a contract of employment requires two distinct persons, viz., the employer and the employee, there cannot be a contract of service in strict law between a firm and one of its partners ; and any agreement for remuneration of a partner for taking part in the conduct of the business must be regarded as portion of the profits being made over as a reward for the human capital brought in. Hon'ble Krishna Iyer J., who delivered the judgment on behalf of the court, while considering Sections 10 and 16 of the Indian I.T. Act, 1922, the new provisions being Sections 40 and 67 of the I.T. Act, 1961, has pronounced (p. 296):

"The anatomy of the provision is obvious, even if the explanation or motivation for it may be more than one. It is implicit that the share income of the partner takes in his salary. The telling test is that where a firm suffers loss the salaried partner's share in it goes to depress his share of income. Surely, therefore, salary is a different label for profits, in the context of a partner's remuneration."

30. Hon'ble Krishna Iyer J. was, however, not considering a case of a karta of an HUF holding a salaried post in the firm in which the HUF was a partner. None of the cases decided by the Supreme Court laying down the law in regard to the remuneration paid to a member of the HUF for the services rendered by him to the firm of which the family is a partner were referred to or even casually adverted to by him (Hon'ble Krishna Iyer J.) as, obviously, the question for consideration in the case before him was completely different. The view taken by the Supreme Court in the cases of Raj

Kumar Singh Hukam Chandji v. CIT MANU/SC/0293/1970 : [1970]78ITR33(SC) , Prem Nath v. CIT MANU/SC/0283/1970 : [1970]78ITR319(SC) , CIT v. Gurunath V. Dhakappa MANU/SC/0081/1968 : [1969]72ITR192(SC) , V.D. Dhanwatey v. CIT MANU/SC/0193/1967 : [1968]68ITR365(SC) and CIT v. D.C. Shaḥ MANU/SC/0199/1969 : [1969]73ITR692(SC) , are all authorities being judgments of the Supreme Court of India for the principle that in the absence of any evidence that the remuneration agreed to be paid was not for services rendered to the firm but was a profit in lieu of the investment of the family funds in the business, the irresistible conclusion will be that the salary/remuneration paid to an individual member of the family was not the income of the family, but was in consideration of the contract of service and by way of compensation for services rendered by him.

31. I am in complete agreement with the refraining of the question and the conclusion that Rs. 18,000 received by Shri Budhia by way of salary is not a share of profit of the family (HUF) and it is his individual income for services rendered by him personally to the firm, M/s. R. K. Budhia & Co. I concur with the conclusion and answer the question referred to us in the negative, that is to say, in favour of the assessee and against the Department. I agree with the assessment of costs payable by the Department to the assessee.
