COMMISSIONER OF INCOME-TAX, BIHAR

v.

RAMNIKLAL KOTHARI

March 7, 1969

[J. C. SHAH AND A. N. GROVER, JJ.]

Income-tax Act (11 *of* 1922), *ss.* 10(1) & (2), 16(1)(*b*) *and* 23(5)(*a*)(*ii*) *Partnership carrying on business—Partner's where determined—Partner if further entitled to deductions under s.* 10(2).

The respondent was carrying on business in diverse lines as a partner in four different firms. For the assessment years 1955-56 and 1956-57 he declared his share of profits from the four firms and claimed deductions made up of salary and bonus to staff, expenses for maintenance and depreciation of motor-car, travelling expenses and interest. The Income-tax Officer and the Appellate Assistant Commissioner allowed only the claim for interest as a permissible deduction. The Tribunal set aside the orders and remanded the cases for the two years for an examination of the nature of expenditure claimed to have been incurred by the respondent, as, in its view, deductions admissible under s. 10(2) of the Income-tax Act, 1922 were allowable in computing the taxable income of the respondent. On the question, whether expenses incurred by the respondent (who was not carrying on any independent business of his own), in earning income from the various firms in which he was a partner, were allowable in law as deductions, the High Court held in favour of the respondent.

In appeal to this Court,

HELD : Section 23 (5)(a)(ii) of the Income-tax Act, 1922 provides that the share of the partner in the profits and gains of a registered firm shall be included in the total income of the partner. The share so received by the partner is 'profits and gains of business' carried on by him and is on that account liable to be computed under s. 10. The receipt being business income for the purpose of s. 10(1) expenditure necessary for the purpose of earning that income and allowances appropriate under s. 10(2) are deductible therefrom in determining the taxable income of the partner. The facts that in computing the total profits of the partnership *allowances admissible to the partnership* in the computation of its profits and gains were taken into account, in the manner provided by s. 10, or that s. 16(1)(b) requires that salary, interest, commission or other remuneration payable by the firm besides the share in the balance of profit is to be taken into account, do not imply that in determining the taxable income of the *partner*, expenditure incurred by the partner in earning the profits, salary, interest, commission or other remuneration is not to be allowed. [862 C-H]

Shantikumar Narottam Morarji v. *Commissioner of Income-tax, Bombay City*, 27 I.T.R. 69, *Jitmal Bhuramal* v. *Commissioner of Income-tax, Bihar & Orissa*, 37 I.T.R. 528 and *Basantlal Gupta* v. *Commissioner of Income-tax, Madras*, 50 I.T.R. 541, approved.

M/s. Iswardas Subhkaran v. *Commissioner of Income-tax West Bengal*, Income-tax Reference No. 38 of 1952 dated June 2, 1953, of the Calcutta High Court, disapproved.

A CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 575 and 576 of 1966.

Appeals by special leave from the judgment and order dated October 5, 1963 of the Patna High Court in Misc. Judicial Cases Nos. 1274 and 1275 of 1960.

B *D. Narasaraju, S. K. Aiyar, R. N. Sachthey* and *B. D. Sharma,* for the appellants (in both the appeals).

M. C. Chagla and *U. P. Singh,* for the respondent (in both the appeals).

C The Judgment of the Court was delivered by

Shah, J. The respondent Ramniklal Kothari carried on business in diverse lines as a partner in four different firms. He received from time to time income from the different registered firms as his share of profits.

D For the assessment year 1955-56 the respondent declared his share of profits from the four firms at Rs. 77,027/- and he claimed an allowance of Rs. 13,283/- being payment of salary and bonus to staff, expenses for maintenance and depreciation of motor-car, travelling expenses and interest. The Income-tax Officer, Hazaribagh, allowed the claim for interest as a permissible deduction and disallowed the rest. In the view of the Income-tax E Officer since the respondent did not carry on any independent business, the amount, except interest, were not claimable by the respondent on his own account; if at all, the amounts should have been claimed as business expenses incurred in the accounts of the four firms.

F For the assessment year 1956-57 the respondent declared Rs. 53,540 as his share of the profits in the four firms and claimed an aggregate amount of Rs. 19,380 as admissible deduction on various grounds including Rs. 1,956 as interest paid by him. The Income-tax Officer allowed the claim for interest and disallowed the rest of the claim.

G The Appellate Assistant Commissioner confirmed the orders of the Income-tax Officer. But the Income-tax Appellate Tribunal set aside the orders passed by the Income-tax Officer and remanded the cases for examination of the nature of expenditure claimed to have been incurred by the respondent. In the view of the Tribunal share of the profits received by the respondent H from the firms was taxable as business income, and appropriate deductions admissible under s. 10(2) of the Income-tax Act, 1922, were allowable in computing the taxable income of the respondent.

The Tribunal then referred the following question in the two cases to the High Court of Patna for opinion under s. 66(1) of the Indian Income-tax Act, 1922: A

> "Whether the expenses incurred by the assessee (who was not carrying on any independent business of his own), in earning income from various firms in which he was a partner, are allowable in law as deductions?" B

The High Court of Patna answered the reference in favour of the respondent. With special leave granted by this Court, these two appeals have been preferred by the Commissioner of Income-tax.

Where a person carries on business by himself or in partnership with others, profits and gains earned by him are income liable to be taxed under s. 10 of the Indian Income-tax Act, 1922. Share in the profits of a partnership received by a partner is "profits and gains of business" carried on by him and is on that account liable to be computed under s. 10, and it is a matter of no moment that the total profits of the partnership were computed in the manner provided by s. 10 of the Income-tax Act and allowances admissible to the partnership in the computation of the profits and gains were taken into account. Income of the partnership carrying on business is computed as business income. The share of the partner in the taxable profits of the registered firms liable to be included under s. 23(5)(a)(ii) in his total income is still received as income from business carried on by him. Counsel for the Commissioner accepted, and in our judgment counsel was right in so doing, that the share of the respondent from the profits of the firm was income from business carried on by the partner. Business carried on by a firm is business carried on by the partners. Profits of the firm are profits earned by all the partners in carrying on the business. In the individual assessment of the partner, his share from the firm's business is liable to be taken into account under s. 10(1). Being income from business, allowances appropriate under s. 10(2) are admissible before the taxable income is determined. C D E F

Section 23(5)(a)(ii) provides that the share of the partner in the profits and gains of a registered firm shall be included in the total income of the partner; and s. 16(1)(b) requires that salary, interest, commission or other remuneration payable by the firm beside the share in the balance of profits is to be taken into account in determining the total income. But it is not thereby implied that expenditure properly allowable in earning the profits, salary, interest, commission or other remuneration is not to be allowed in determining the taxable total income of the partner. The receipt by the partner is business income for the purpose of G H

A s. 10(1), and being business income, expenditure necessary for the purpose of earning that income and appropriate allowances are deductible therefrom in determining the taxable income of the partner.

The legal principles which we have endeavoured to set out are
B well settled by several decisions. In *Shantikumar Narottam Morarji* v. *Commissioner of Income-tax, Bombay City*(1) the High Court of Bombay held that it is not correct as a general legal proposition that a partner in a registered firm is not entitled to claim any deduction against the share of the profits included in his total income, the share having been arrived at on the assessment of the firm with regard to its profits. It would be open
C to the partner to claim a deduction provided he satisfies the taxing authority that such deduction represents necessary expenditure, the expenditure being incurred in order to enable him to earn the profits which are being subjected to tax.

In *Basantlal Gupta* v. *Commissioner of Income-tax, Madras*(2)
D the High Court of Madras held that in determining the income of an assessee who is a partner, deduction under s. 10(2) of the Income-tax Act may be made from his share of income in the firm even after the share has been ascertained. An allowance under s. 10(2) will be permissible in proper cases even after the share has been ascertained if the expenditure sought to be deducted was incurred by the partner solely and exclusively for the pur-
E pose of earning his share in the income of the firm.

In a case decided by the High Court of Patna in *Jitmal Bhuramal* v. *Commissioner of Income-tax, Bihar & Orissa*(3) a Hindu undivided family which was a partner in a firm claimed that the salary paid to its members for attending to the business of the
F firm was incurred as a matter of commercial expediency and for the purpose of earning profits from the partnership business. The Court held that in the assessment of the Hindu undivided family the expenditure would be properly claimed as an allowance under s. 10(2)(xv) of the Indian Income-tax Act, 1922. *Jitmal Bhuramal's* case(3) was brought in appeal to this Court : see *Jitmal Bhuramal* v. *Commissioner of Income-tax, Bihar & Orissa*(4). It
G was observed by this Court that a Hindu undivided family will be allowed to deduct salary paid to members of the family, if the payment is made as a matter of commercial or business expediency, but the service rendered must be to the family in relation to the business of the family.

H Counsel for the Commissioner relied upon an unreported judgment of the High Court of Calcutta in *Messrs. Iswardas Subh-*

(1) 27 I.T.R. 69.
(2) 50 I.T.R. 541.
(3) 37 I.T.R. 528.
(4) 44 I.T.R. 887. (S.C.)

karan v. *Commissioner of Income-tax, West Bengal*(1). In that case a Hindu undivided family entered into a partnership agreement with third parties for the purpose of carrying on a rice mill business. It was not possible for any of the members of the family to attend personally to that business and, therefore, the family employed a Munim to look after its interest. Salary paid to the Munim was claimed as an allowance in determining the taxable income out of the share of the partnership income. Chakravartti, C.J., delivering the judgment of the Court was of the opinion that since the Munim did not look after the interest of the assessee in the firm's business, but only as a servant of the assessee, the amount paid to the Munim was not an allowance admissible in determining the taxable income. In any event, observed the learned Chief Justice, the profits which have come to the assessee from the partnership have come as net profits, and after they have so come, there cannot be any further deduction on account of expenditure incurred not by the partnership but by the partner who received the share or incurred on any account whatsoever.

We are unable to agree with the view expressed by the learned Chief Justice. The case was apparently not fully argued and counsel for the assessee conceded that the amount paid to the Munim was not a permissible deduction in assessing the taxable income of the family out of the share of the profits received from the firm.

The appeals fail and are dismissed with costs. One hearing fee.

V.P.S. *Appeals dismissed.*

(1) Income Tax Reference No. 38 of 1952 decided on June, 2, 1953.