
(1997) 12 SC CK 0149

Supreme Court of India

Case No: Civil Appeal No"s. 4589-90 of 1992 (From the judgment and order dt. 1st November, 1991 of the Orissa High Court in SJC No. 36 of 1985, reported as Rashiklal and Co. vs. CIT (1992) 196 ITR 106 (Ori)

RASHIK LAL and CO.

APPELLANT

Vs

COMMISSIONER OF
Income Tax.

RESPONDENT

Date of Decision: Dec. 9, 1997

Acts Referred:

- General Clauses Act, 1897 - Section 3
- Income Tax Act, 1961 - Section 184, 256, 40
- Partnership Act, 1932 - Section 13, 4

Citation: (1998) 86 CLT 583 : (1998) 144 CTR 161

Hon'ble Judges: Suhas C. Sen, J

Bench: Division Bench

Final Decision: Dismissed

Judgement

SUHAS C. SEN, J. :

The following question of law was referred by the Tribunal to the Orissa High Court under S. 256(1) of the IT Act, 1961 :

"Whether, on the facts and in the circumstances of the case, the commission paid by the assessee-firm to Sri Rashiklal P. Rathor (individual) is allowable under S. 40(b) of the IT Act, 1961, as a deduction while computing the business income of the assessee."

2. The assessee is a partnership firm carrying on a number of businesses including sale and purchase of various commodities as well as mining. The partners of the firm were :

(1) Popatlal Devram

(2) Jayantilal Jagmal

(3) Pragji Devram

(4) Ratilal Odhavji

(5) Rashiklal P. Rathor

Popatlal is Rashiklals father. On 1st April, 1967, there was an oral partition of the share of Popatlal in the firm amongst Popatlal, his wife and his two sons including Rashiklal. The assets of Rashiklal continued to be invested in the partnership firm. Rashiklal was Karta of a smaller HUF. On 17th October, 1978, there was an agreement between Rashiklal and the firm Rashiklal & Co. that Rashiklal will receive 37 paise per tonne of mineral sold by the firm. In the asst. yr. 1980-81 Rashiklal received a sum of Rs. 28,579 as commission. The firm claimed deduction of this amount from its income. The claim was negated by the ITO. The AAC allowed the appeal., holding that the commission was paid to Rashiklal in his individual capacity and not as Karta of the smaller HUF which is the partner of the firm. Since the payment was not made to the partner, S. 40(b) of the IT Act was not attracted. The amount of commission paid to Rashiklal could not be included in the income of the firm. On further appeal by the Revenue, the Tribunal held that S. 40(b) of the IT Act clearly applied in this case. Payment to Rashiklal will be payment to a partner. The partnership firm could not claim any deduction for this payment from its income. The High Court on reference held that there was clear material that Rashiklal had invested his joint family funds to enter into the partnership. Payment was made to Rashiklal who was a partner. Accordingly, the Tribunal was correct in coming to the conclusion that S. 40(b) will be applicable in this case. The firm was not entitled to claim any deduction on account of payment of commission to one of its partners.

3. The firm has come up in appeal against the judgment of the High Court. Sec. 40(b) of the IT Act, at the material time, stood as under :

"40. Notwithstanding anything to the contrary in Ss. 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".

(a) xxx

(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 our view the answer to the question raised in this case is self-evident. There is no dispute that Rashiklal was a partner of the assessee-firm. For assessment of the firm under the head profits and gains of business and profession any payment of commission by the firm to any partner of the firm will not be allowed as deduction. The firm has paid a commission of Rs. 28,579 to Rashiklal and has claimed that amount as deduction. Such

deduction is not permissible in clear terms of S. 40(b).

5. The language of the section is simple and clear. But to complicate the matter an argument was sought to be made that Rashiklal had not joined the firm as an individual but was really representing an HUF. The real partner of the firm was the HUF. The payment to Rashiklal did not amount to payment of commission to the HUF which was the real partner. Therefore, the amount of commission paid by the firm to a non-partner or a partner who had joined the firm in a representative capacity, will not fall within the mischief of S. 40(b).

6. We are unable to uphold this contention for a number of reasons. A firm is a compendious way of describing the individuals constituting the firm. An HUF directly or indirectly cannot become a partner of a firm because the firm is an association of individuals.

7. In the case of 280735 , it was held by a Bench of three judges of this Court that a firm is not a "person" and as such was not entitled to enter into a partnership with another firm or an HUF or an individual. In that case, an individual, a joint family and three firms purported to enter into a partnership. The agreement of partnership was signed by the individual partner, the Karta of the joint family and one partner each of the three firms. The firm applied for registration under S. 26A of the IT Act. The application was signed by the aforesaid five individuals. This Court held that there could be no question of granting registration to a partnership purporting to be one between three firms, an HUF and an individual. In coming to this conclusion, this Court relied on the provisions of Indian Partnership Act wherein, partnership, partner, firm and firm name were defined in the following manner :

"4. Definition of "partnership", "partner", "firm" and "firm name" :

"Partnership" is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

Persons who have entered into partnership with one another are called individually "partners" and collectively "a firm", and the name under which their business is carried on is called the "firm name".

S. R. Das, C.J. speaking for the Court observed :

"This section clearly requires the presence of three elements, namely, (1) that there must be an agreement entered into by two or more persons; (2) that the agreement must be to share the profits of a business; and (3) that the business must be carried on by all, or any of those persons acting for all. According to this definition "persons" who have entered into partnership with one another are collectively called a "firm" and the name under which their business is carried on is called the "firm name". The first question that arises is as to whether a firm as such can enter into an agreement with another firm or

individual. The answer to the question would depend on whether a firm can be called a "person".

Das, C.J., thereafter, went on to examine the meaning of the word "person" in the Partnership Act. It noted that "person" had not been defined in the Partnership Act. However, the General Clauses Act, 1897, had defined person in S. 3(42) as under :

"Person" shall include any company or association or body of individuals whether incorporated or not."

After referring to the definition of person in the General Clauses Act, Das, C.J. observed that the firm was not a company but was certainly an association or BOI.

The Court, however, after examining the scheme of the Partnership Act and the corresponding provisions of the English law on the subject, held that the definition given to "person" by the General Clauses Act could not be extended to the Partnership Act having regard to the various provisions of that Act. The Court concluded :

"It is clear from the foregoing discussion that the law, English as well as Indian, has, for some specific purposes, some of which are referred to above, relaxed its rigid notions and extended a limited personality to a firm. Nevertheless, the general concept of partnership, firmly established in both systems of law, still is that a firm is not an entity or "person" in law but is merely an association of individuals and a firm name is only a collective name of those individuals who constitute the firm."

The view of this Court was that when S. 4 of the Partnership Act spoke of "persons" who had entered into partnership with one another, it could only be individuals and not a body of persons. A body of persons like a firm could not enter into partnership with other individuals.

8. An HUF cannot be in a better position than a firm in the scheme of the Partnership Act. The reasons that led this Court to hold that a firm cannot join a partnership with another "individual" will apply with equal force to an HUF. In law, an HUF can never be a partner of a partnership firm. Even if a person nominated by the HUF joins a partnership, the partnership will be between the nominated person and the other partners of the firm. Having regard to the definition of "partnership" and "partners" and in view of the principle laid down in *Dulichands case* (supra), it is not possible to hold that an HUF being a fluctuating BOI, can enter into a partnership with other individual partners. It cannot do indirectly what it cannot do directly. If a Karta or any other member of the HUF joins a partnership, he can do so only as an individual. His rights and obligations vis-a-vis other partners are determined by the Partnership Act and not by Hindu law. Whatever may be the relationship between an HUF and its nominee partner, in a partnership, neither the HUF nor any member of the HUF can claim to be a partner or connected with the partnership through a nominee. Where the Karta of an HUF enters into a partnership agreement with a stranger, the Karta alone in the eye of law is the partner. If any payment

by the firm to a partner is prohibited by law, the Karta cannot be heard to say that the payment was received by him not as a partner but in some other capacity. Within the partnership, the Karta is a partner like any other partner with whom he has entered into a partnership agreement individually. It is essential to have an agreement between the partners to form a partnership. An HUF not being a "person" cannot enter into an agreement of partnership. If the Karta of an HUF enters into partnership with a stranger, upon the death of the Karta, the partnership will stand dissolved. In the absence of a contract to the contrary, another member of the family cannot step into the shoes of the Karta claiming that the Karta was merely representing the HUF and the real partner was the HUF. A Karta who enters into a contract of partnership with a stranger may be accountable to the other members of the HUF for the profits received from the partnership business. But that is something between the Karta and the HUF. But so far as the partnership firm is concerned, the Karta is a partner like any other partner. If a commission is paid to a partner who happens to be a nominee of an HUF, the commission is not paid to the HUF. It is paid by the firm to one of its individual partners. The partner may have to account for the monies received from the firm to another person or another firm or an AOP or an HUF. But that will not alter the fact that commission was paid by the firm to one of its partners.

9. The Partnership Act contains various provisions regulating the relationship between partners. The partners are bound to carry on the business of the firm to the greatest common advantage, to be just and faithful to each other and to render true account and true information of all things affecting the firm to any partner or his legal representative. Every partner has a right to take part in the conduct of the business. Every partner is bound to attend diligently to his duties in the conduct of the business. Any differences arising as to ordinary matters connected with the business may be decided by majority of the partners and every partner shall have the right to express his opinion before the matter is decided. No change can be made in the nature of the business without the consent of all the partners. Every partner has a right to have access to and to inspect and copy any of the books of the firm. All these provisions will apply to a partner who represents another body. The HUF who has a nominee partner in a firm has neither any right nor any obligation under the provisions of the Partnership Act. Sec. 13 provides that a partner is not entitled to receive remuneration for taking part in the conduct of the business. The partners are entitled to share equally in the profits earned and shall contribute equally to the losses sustained by the firm. Where a partner is entitled to interest on the capital subscribed by him, such interest shall be payable only out of profits. A firm has to indemnify a partner in respect of payments made and liabilities incurred by him in the ordinary and proper conduct of business and in doing such act, in an emergency for the purpose of protecting the firm from any loss as would be done by a person of ordinary prudence under similar circumstances. The partner has also a duty to indemnify for any loss caused to the firm by his wilful neglect in the conduct of the business of the firm.

10. 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 an HUF can intrude into the relationship created by a contract between certain individuals. The only right of the HUF 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 HUF with which the partnership is not concerned.

11. The specific provision in S. 13 of the Partnership Act that a partner is not entitled to receive any remuneration for taking part in the conduct of the business has been interpreted to 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.

12. Sec. 40(b) of the IT Act will apply even when 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 an HUF or any other body of persons then the position in law will not be any different. The HUF 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 HUF. 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.

13. We were referred to two decisions of this Court on this point, 264978 and 289188 . Both the cases dealt with payment of interest to a partner who had joined the firm in a representative capacity. Sec. 40(b) prohibits deduction on account of payment of interest, salary, bonus or remuneration by a firm to any partner of the firm. Expln. II was added to S. 40(b) specifically providing that where an individual was a partner in a firm in a representative capacity for and on behalf of any other person, the interest paid by the firm to such individual shall not be taken into account for the purpose of cl. (b) of S. 40.

This Court held that in view of this Explanation, when a Karta of an HUF had joined a firm representing his HUF and had made deposits in the firm in his individual capacity, the interest paid to him could not be disallowed by reason of the Expln. II added to S. 40(b) of IT Act, 1961. It was further held that the Explanation was only clarificatory. It is difficult to agree with that proposition because the Explanation was added by the Taxation Laws (Amendment) Act, 1984 w.e.f. 1st April, 1985, i.e., from the asst. yr. 1985-86. By adding the Explanation, the legislature altered the law prospectively on and from 1st April, 1985. If what was contained in the Explanation was already the law in force, then giving effect to the Explanation from 1st April, 1985 does not make any sense.

14. However, in the case before us, no question of payment of any interest is involved. A commission was paid by the firm for the services rendered by the partner. Such commission cannot be paid because of the provisions of S. 13 of the Partnership Act in the absence of a special contract. Even if a special contract exists S. 40(b) of the IT Act prohibits allowance of such commission as deduction from the business income of the firm.

The argument that Rashiklal had joined the firm Rashiklal & Co. not as an individual but in a representative capacity overlooks the fact that the partnership Rashiklal & Co. is a compendious way to describe the individuals who are partners of the firm. The other partners of the firm have a contractual relationship with Rashiklal only. Sec. 40(b) categorically disallows any deduction of payment of commission to a partner.

15. The position of a person belonging to an HUF who has joined a firm on behalf of the family has been explained in Mulla's Hindu Law, Sixteenth Edn., p. 265 :

"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 manager, no doubt, is accountable to the family, but the partnership is exclusively one between the contracting members including the manager and the stranger. Such a partnership would be governed by the provisions of the Indian Partnership Act, 1932, with the result that if the manager died, the partnership would be dissolved on his death."

16. Under the IT Act, 1961, firm, partner and partnership have been given the same meaning as assigned to them in the Partnership Act. But the expression partner has been extended to include any person who, being a minor, has been admitted to the benefits of a partnership. Therefore, there is no scope for any argument that even though under the Indian Partnership Act, an HUF not being a person cannot be a partner, but the payment of commission to the nominee partner will tantamount to payment to the HUF and therefore, such payment will not come within the mischief of S. 13 of the Partnership Act or S. 40(b) of the IT Act. To repeat what has been stated in Mulla's Hindu Law only the members who have entered into partnership are to be regarded as partners. The position of the other members is no higher than sub-partnership.

17. The application for registration of a firm has to be made under S. 184 of the IT Act. It is specifically provided that :

- (1) the partnership must be evidenced by an instrument in writing;
- (2) the individual shares of partners must be specified in that instrument;
- (3) the application for registration shall be signed by all the partners.

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 an HUF 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 IT Act. This aspect of the matter was explained by Subba Rao, J. (as his Lordship, then was) in the case of CIT vs. Bagyalakshmi & Co. (1985) 55 ITR 660 in the following words :

"A partnership is a creature of contract. Under Hindu Law a joint family is one of status and right to partition is one of its incidents. The IT law gives the ITO a power to assess the income of a person in the manner provided by the Act. Except where there is a specific provision of the IT Act which derogates from any other statutory law or personal law, the provision will have to be considered in the light of the relevant branches of law. A contract of partnership has no concern with the obligation of the partners to others in respect of their shares of profit in the partnership. It only regulates the rights and liabilities of the partners. A partner may be the Karta of a joint Hindu family; he may be a trustee; he may enter into a sub-partnership with others; he may, under an agreement, express or implied, be the representative of a group of persons; he may be a benamidar for another. In all such cases he occupies a dual position. Qua the partnership, he functions in his personal capacity; qua the third parties, in his representative capacity. The third parties, whom one of the partners represents, cannot enforce their rights against the other partners nor the other partners can do so against the said third parties."

This judgment given by a Bench of three Judges of this Court is a complete answer to the argument advanced on behalf of the assessee. 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 IT 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, S. 40(b) will apply even if the partner has joined the firm as a nominee of an HUF. The HUF 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 IT Act. The assessment of a firm will have to be made strictly in accordance with the provisions of the IT Act. The law has to be taken as it is. Sec. 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 but 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 payment because of S. 40(b) of the Act expressly prohibits such deduction.

18. The basic principle that a firm is a compendious mode of describing the persons constituting the firm must not be overlooked. It is the individuals constituting the firm who are its partners. The partner may be under an obligation to hand over the monies

received by him to somebody else by virtue of a sub-contract or any other arrangement. That will not change the character of the payment by the firm to its partner or the status of the partner in the firm. The firm is not entitled to get any deduction on account of payment of commission to a partner merely because the partner has an obligation to share the money with somebody else. So far as the firm was concerned, the commission was paid to one of the partners in his personal capacity.

The provisions relating to assessment of the firm should not be construed in a way to defeat its object. Sec. 40(b) forbids deduction of any amount paid by way of commission to partner. In the instant case, Rashiklal is a partner of the firm Rashiklal & Co. The commission received by him from the partnership firm cannot be allowed as a deduction from the business income of the partnership.

The appeals, therefore, fails and are dismissed with no order as to costs.