

IN THE HIGH COURT OF HIMACHAL PRADESH, SHIMLA

Income-tax Appeal No. 4 of 2005

Reserved on: 4.3.2011.

Date of decision: 11.3.2011.

M/s Durga Dass Devki Nandan

...Appellant.

Versus

Income-tax Officer, Palampur

...Respondent.

Coram

The Hon'ble Mr. Justice Deepak Gupta, J.

The Hon'ble Mr. Justice Sanjay Karol, J.

Whether approved for reporting? . Yes.

For the appellant:

**Mr. Goverdhan Sharma with Mr. Vayur
Gautam, Advocate.**

For the respondent:

Mr. Vinay Kuthiala, Advocate.

Per Deepak Gupta, J.

1. This Income-tax Appeal was admitted on the following questions of law:-

- a) *Whether Circular No. 739 dated 25.3.1996 issued by CBDT can exceed the domain of operation as permitted under the provisions of the Act i.e. Sections 28 to 40?*
- b) *Whether circular No. 739 dated 25.3.1996 over-rides the provisions of Section 40(b)(v)(i)(ii) of the Income-tax Act, 1961 so as to disallow the salary actually paid and recorded in the books of accounts?*
- c) *Whether the learned Assessing Officer was legally justified in disallowing the salary actually paid monthly and debited regularly in the books of accounts as an*

expense, just on the basis of the circular No. 739 dated 25.3.1996 surpassing the provisions of the Income-tax Act, 1961 which otherwise permits the allowing of expenses actual and regularly made and also clause 3 of the Circular referred to above?

d) Whether the circular so issued by CBDT being a guideline for framing the assessment to the authorities concerned is also being on the assessee surpassing the provisions of the Act?

2. The main question which arises for consideration is whether as per the partnership deed in question, any remuneration was fixed for payment to the partners of the Firm. Relevant portion of Section 40(b)(v)(1) of the Income Tax Act, 1961 (hereinafter referred to as "the Act") reads as follows:

"40. Notwithstanding anything to the contrary in sections 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) xxxxxx xxxxxx xxxxxx

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

(i) xxxxx xxxxxx xxxxxxx

(ii) xxxxx xxxxxx xxxxxxx

(iii) xxxxx xxxxxx xxxxxxx

(iv) xxxxx xxxxxx xxxxxxx

(v) any payment of remuneration to any partner who is a working partner, which is authorized 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:-

(1) in case of a firm carrying on a profession referred to in section 44AA or which is notified for the purpose of that section –

<i>(a) on the first Rs.1,00,000 of the book-profit or in case of a loss</i>	<i>Rs.50,000 or at the rate of 90 per cent of the book-profit, whichever is more;</i>
<i>(b) on the next Rs.1,00,000 of the book-profit</i>	<i>at the rate of 60 per cent;</i>
<i>(c) on the balance of the book-Profit</i>	<i>at the rate of 40 per cent;</i>

3. This provision of law was the subject matter of a number of conflicting decisions and, therefore, Central Board of Direct Taxes (CBDT) issued circular No.739, dated 25.3.1996, wherein the Board clarified in para 4 of the circular as follows:

“4. It is clarified that for the assessment years subsequent to the assessment year 1996-97, no deduction under section 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.”

4. It would be pertinent to mention that for the earlier assessment years 1993-94 to 1996-97, the Board took a lenient view of the matter and decided that keeping in view the ambiguity in the language of the Section even if the remuneration was not fixed in the partnership deed, the firm shall be entitled to deduct the amount payable under Section 40(b)(v). However, for the assessment year 1996-97 and subsequent thereto, the circular provided that unless the partnership deed specified the amount of remuneration payable to each individual working partner or lays

down the manner of quantifying such remuneration, the benefit of Section 40(b)(v) would not be available to the assessee Firm.

5. The relevant portion of the partnership deed reads as follows:-

“That both the partners above mentioned shall be the working partners within the meaning of Section 40(b) of the Income-tax Act to be actively engaged in looking after the affairs of the business of the firm diligently and honestly and each of them will be paid a monthly salary as per the income-tax provisions and which can be revised from time to time in the best interest of the partnership.”

6. The Assessing Officer was of the opinion that the partnership deed did not provide for payment of remuneration in terms of CBDT circular No. 739 dated 25.3.1996 because it did not specify the amount of remuneration payable to the individual working partner or lays down the manner of quantifying such remuneration. The Commissioner Income-tax held that the method of quantifying the remuneration was fixed in the partnership deed since the partnership deed clearly stated that the partners would be entitled to monthly salary as per the provisions of the Income-tax Act. However, the Income-tax Tribunal allowed the appeal of the revenue and held that the clause in the agreement quoted hereinabove did not meet with the requirements of the circular and therefore, deduction of the salary paid to the partners was not admissible.

7. It is settled law that the Central Board of Direct Taxes cannot issue a circular which goes against the provisions of the Act. The CBDT can only clarify issues but cannot insert terms and conditions which are not part of the main statute. A delegate or person authorized to issue delegated legislation cannot virtually set at naught the provisions of the main statute. A reading of Section 40(b)(v) clearly shows that amount of remuneration which does not exceed the amount given in the Income-tax Act is deductible. The CBDT has provided that either the amount of remuneration payable to each individual should be fixed in the agreement or the partnership agreement deed should lay down the manner of quantifying such remuneration. In the present case when the partnership deed provides that the remuneration will be as per the provisions of the Income-tax Act, it clearly means that the remuneration payable to the partners shall be quantified as per the provisions of the Act and shall not exceed the maximum remuneration provided. In the present case, it is not disputed that the partners were paid remuneration which was less than the maximum provided by the Income-tax Act. None of the authorities have doubted the payment of remuneration and in fact account books of the assessee firm have been accepted to be correct. Therefore, nobody has doubted the payment of remuneration to the partners.
8. It has been urged by Shri Vinay Kuthiala, learned counsel for the respondent that as per the CBDT circular the

partnership deed should specify the amount of remuneration or should give a specific method of quantifying such remuneration, otherwise deduction cannot be allowed. We are unable to accept such contention. The circular has to be read alongwith Section 40(b)(v) and has to be made subject to Section 40(b)(v). This section does not lay-down any condition of fixing the remuneration or the method of remuneration in the partnership deed. All that the Section provides is that in case the payment of remuneration made to any working partner is in accordance with the terms of the partnership deed and does not exceed the aggregate amount as laid down in the subsequent portion of the Section the deduction is permissible. Therefore, if in the partnership deed it was clearly mentioned that the partners would get remuneration calculated as per the provisions of the Income-tax Act which means that this would not exceed the maximum amount provided under the Act.

9. In ***ITA 9 of 2005 decided on 2.9.2009 titled as Commissioner of Income-tax, Shimla vs. M/s Anil Hardware Store, Manali*** this Court was dealing with a partnership deed where the provisions of the Income-tax Act itself had been incorporated in the partnership deed. This Court held that this itself provides a method of computation. In that case we had not gone into the validity of the CBDT circular. The CBDT circular can only be held to be valid if it is in terms of the main section. As held above, the Section 40(b)(v) only lays down that either the working partner should be paid an amount specified in the partnership deed or it

should not exceed the amount laid down in the Section. In the present case the partners have been paid their remuneration/salary strictly in accordance with the terms of the partnership deed and this amount paid to the partners does not exceed the maximum permissible amount and therefore, the assessee is entitled to the deduction.

10. In view of the above discussion, the appeal is allowed and the substantial questions of law are decided in favour of the assessee and against the revenue. No costs.

(Deepak Gupta), J.

11th March, 2011.
TM

(Sanjay Karol), J.