

PATNA HIGH COURT

Commissioner of Income-Tax

Vs

Jainarain Jagannath

(Fazl Ali, C.J)

15.08.1945

JUDGMENT

Fazl Ali, C.J

1. This case has been referred to us under Section 66 (1) of the Income-tax Act on the application of the Commissioner of Income-tax for the decision of the following question :-

"Can the amount paid to members of a Hindu undivided family by way of remuneration for services rendered in the business of the family be legitimately deducted in computing the profit of the business ?"

The assessee in this case is a Hindu undivided family which, it is stated in the order of the Income-tax Officer, is the biggest wholesale dealer in grain and grocery in the district of Manbhum. It appears that several members of this family worked in the business carried on by the family and a sum of Rs. 8,901 was paid to them, the payments being described as salary. The Tribunal has found that the sum paid as salary was not excessive or unreasonable and this finding is borne out by the fact that the gross profits made by the family during the year was Rs. 17,42,182. The assessee's claim was that the whole of the sum should be deducted in computing the profits of the business, whereas it was contended on behalf of the Income-tax department that this claim should be disallowed on the ground that the payments in question amounted to distribution of profits among the members of the family. The Tribunal has upheld the assessee's contention. In *Messrs. B. K. Paul & Co. v. Commissioner of Income-tax, Bengal*, the question referred to the Calcutta High Court in 1933 was whether the remuneration paid to the members of a Hindu undivided family was to be assessed as an income of the individual members or as an income of the family, but since the Commissioner found as a fact in that case that the alleged salaries were not bona fide payments to bona fide employees of the business but merely a device to escape income-tax, the High Court returned the reference as not raising any question of law and hence incompetent. No other case involving the precise question which arises now before us has been brought to our notice, but a similar question, namely as to whether and if so under what

circumstances salaries paid to the partners of a firm are admissible deductions has been raised and decided in a number of cases and some of these may be usefully referred to here. In *B. S. Mining Co. v. Commissioner of Income-tax, Madras*, it was held that on the facts there stated by the Commissioner the drawings of the partners by whatever name they were described were part of the profits and therefore taxable. In *Ramakrishna Ramnath Firm of Tirora v. Commissioner of Income-tax, Central Provinces*, it was held by the Nagpur High Court that remuneration paid to a partner doing business in his individual capacity for services rendered to the firm would be a legitimate deduction from the assessable income of the firm; but sums paid to a partner as such styled commission, paid (bonus or present) or by any other name would be simply the profits of the firm appropriated among the owners after they had been earned. Again it was held by the Lahore High Court in *Electric and Dental Stores v. Commissioner of Income-tax, Punjab*, that salary charged by working partners in a firm would be admissible as a deduction in the computation of the profits of the firm under Section 10 (2) (ix) if those partners were true employees and the payment of salary to them was bona fide and not a device to escape income-tax. The learned Judges who decided the case went on to say that whether the particular partners were in fact true employees or whether the payments of salary were a device to escape income-tax was a question of fact to be decided by the Commissioner. These decisions, in my opinion, lay down the general principle in correct terms though they are now more or less of an academic interest only in so far as partnership governed by the Indian Partnership Act are concerned inasmuch as provision has been inserted in the present Act disallowing "any allowance in respect of any payment by way of interest, salary, commission or remuneration made by a firm to any partner of the firm" [See section 10, clause (4), sub-clause (b)]. It was contended by the learned counsel for the Income-tax department that in view of this provision the question referred to us must be answered in the negative; but I do not agree with this contention. The new provision must be read with Section 2, sub-clause (6B), which states that "firm" "Partner" and "partnership" have the same meanings respectively as in the Indian Partnership Act of 1932. No distinct provision has yet been made about Hindu joint family trading firms to which the Partnership Act does not apply and in my judgment, the principles underlying the decisions to which I have referred are still applicable to them. In my opinion the true position has been correctly stated by the Tribunal in these words : "In a Hindu undivided family no member is bound to work in the business of the Hindu undivided family and if an allowance has been made to a junior member on contractual basis for actual work done and the amount is not excessive and is reasonable, the amount paid is allowable as a deduction." A member of a joint family might conceivably do business in his individual capacity and in that capacity might of which the firm might pay him such remuneration as it would pay to an outsider. If such remuneration is not excessive and is reasonable and is not a device to escape income-tax, then it will be legitimate deduction. If, on the other hand, the amount paid to an individual member of a family, is unreasonably high and disproportionate to the services rendered by him, then it may be treated as part of the profits of the firm distributed in a particular manner. In my opinion, in view of the findings arrived at by the Tribunal, the sum in question must be held to have been legitimately deducted, but as the question which has been formulated by the Tribunal is in general terms, I

would answer it by saying that the exact reply to the question will very largely depend upon the facts of each case but the amount paid can be legitimately deducted if it is found to be a bona fide payment to a bona fide employee for services actually rendered and is not excessive or unreasonable and is not a device to escape the income-tax.

The costs of the reference will be borne by the department. The assessee will be entitled to his costs which we assessee at Rs. 250.

Manohar Lall, J. - I Agree

Reference answered accordingly.