[1964] 51 ITR 467 (MAD.)

HIGH COURT OF MADRAS

Mathew Abraham

v.

Commissioner of Income-tax

JAGADISAN AND SRINIVASAN, JJ.

Tax Case No. 92 of 1960

November 19, 1962

T.V. Balakrishnan and C.V. Mahalingam *for the Appelant.* S. Ranganathan *for the Respondent.*

JUDGMENT

Jagadisan, J. — A firm of partnership of five persons called Mahendragiri Tea Estate was constituted by a deed dated February 28, 1955. Each of the partners had an one fifth-share in the profits or losses of the firm. The managing partner was one Mathew Abraham, who will hereinafter be referred to as the assessee. Under the terms of the partnership, the assessee was entitled as managing partner to a monthly allowance of Rs. 250 and also a commission at the rate of twelve per cent, on the net profits available for distribution amongst the partners after meeting all the expenses relating to the business of the partnership and charging the monthly allowance of Rs. 250. The assessee received allowance and commission for the assessment years 1956-57, 1957-58 and 1958-59 as per particulars given below :

Previous year	Assessment year	Allowance	Commission
Year ended		Rs.	Rs.
31-3-1956	1956-57	3,000	8,811
31-3-1957	1957-58	3,000	4,332
31-3-1958	1958-59	3.000	5,930

Besides the said allowance and commission he also received the share income of Rs. 10,087, Rs-6,612 and Rs. 14,825 for the three assessment years respectively. The Income-tax Officer assessed forty per cent, of the share income on the footing that such forty per cent, was subject to tax under rule 24 of the Income-tax Rules, but brought to tax the whole of the allowance and commission. The view of the Income-tax Officer was that the allowance and commission was not agricultural income and was also not income of the assessee derived by sale of tea grown or manufactured by him in accordance with rule 24. There was an appeal to the Appellate Assistant Commissioner, who gave relief to the assessee excluding the allowance and commission from the taxable assessment by reason of the decision of the Tribunal in an appeal preferred by the assessee in relation to a prior year, though personally he was of the view that the decision of the officer was right. The department preferred an appeal to the Tribunal, and this time the Tribunal agreed with the contention of the department and allowed the appeal. The view of the Tribunal was that even though sixty per cent, of the share income of the assessee from the firm might be exempt from taxation under rule 24 of the Income-tax Rules, yet the amounts which he received by way of allowance and commission under the terms of the partnership agreement were of a different character and were in full subject to levy of tax. The assessee having preferred an application under section 66(1) of the Act before the Tribunal, the following question of law has been referred to this court:

> "Whether the allowance and commission received by the assessee as the managing partner of Mahendragiri Tea Estate is assessable in his hands to the full hundred per cent, thereof as an item of income distinct and separate from his share of profits therefrom ? "

2. The answer to the question does not present any difficulty as the relevant provisions of the Act are fairly clear. Learned counsel for the assessee addressed a very interesting argument but failed to convince us. In our opinion the assessee cannot successfully contend against the plain meaning and effect of the provisions of the Act, which we shall refer to a little later.

Now the assessee claims exemption from assessment to tax to the extent of 60 per cent, of the allowance and commission. What is relied on primarily is rule 24 of the Income-tax Rules and that is :

> "Income derived from the sale of tea grown and manufactured by the seller in the taxable territories shall be computed as if it were income derived from business, and 40 per cent, of such income shall be deemed to be income, profits and gains liable to tax ………… "

Can it be said that the allowance and commission earned by the assessee was income derived from sale of tea grown and manufactured by him ? In our opinion the answer must be in the negative. The tea estate is owned by the firm and the activities of growing, manufacturing and selling tea are those of the firm. The assessee's contention is that the firm is not a legal entity and what is done in the name of a firm is really done by the partners individually and collectively. But this general proposition which is essentially sound under the law governing partnership cannot be unreservedly imported into the income-tax law which treats the firm as a unit of assessment. If the assessee is a firm, "the seller" in rule 24 can only refer to the firm as such and not to each and every partner of the firm. In computing the income of a firm growing, manufacturing and selling tea, 40 per cent, of its total income is alone taxable as income, profits or gains of a business. The distribution of the share income of the partners amongst the partners is no doubt an appropriation of the profits or losses of the firm in proportion to their respective shares. But the receipt by a partner of any amount over and above his share income from the firm, though warranted by the special terms of the articles of partnership, would not stamp such receipt with the same character as that possessed by the total income of the firm which is divided in accordance with the shares. The fact that the extra allowance and commission received by a partner also emanate from the business income cannot justify the inference that the character of the receipt is not different from the character of the business income of the firm as such. In support of this position we may refer to the decision of the Patna High Court in *E.C. Danby* v. *Commissioner of Income-tax* [1944] 12 ITR 351. In that case a partnership consisting of the assessee and his brother owned agricultural properties. Under an arrangement between them the assessee received in the course of the accounting year a sum of Rs. 5,805 as remuneration for managing the agricultural properties. The question was whether that remuneration was exempt from income-tax as agricultural income. It was held that the remuneration was in the nature of salary and it was not exempt from taxation under section 4(3)(*viii*). Fazl Ali C.J. observed thus at page 353 :

> "The mere fact that its ultimate source was agricultural property will not make it agricultural income because the payment was received not as part of his profit from the agricultural

property, but as remuneration due to him for work done as manager of the property. This view is supported by the decision of the Judicial Committee of the Privy Council in *Hon. Nawab B. Habibidlah* v. *Commissioner of Income-tax* [1943] 11 ITR 295 (P.C.)."

With respect we agree with this decision, and, in our opinion, the principle laid down therein would clearly apply to the present case. The assessee cannot therefore bring himself within rule 24 of the Income-tax Rules and claim exemption to the extent of 60 per cent, of the allowance and commission.

3. We shall now refer to the other provisions of the Income-tax Act which have been relied upon by learned counsel for the assessee to substantiate his contention that the whole of the allowance and commission cannot be brought to tax. In computing the business income of a firm any allowance in respect of any payment by way of interest, salary, commission or remuneration made by the firm to any partner of the firm is not permissible under section 10(4)(*b*). When the partner is a partner of a firm, irrespective of the fact, whether the firm has made a profit or a loss, the share income of the assessee has to be taken to be any salary, interest, commission or other remuneration payable to him by the firm in respect of the previous year, increased or decreased respectively by his share in the balance of the profit or loss of the firm, after the deduction of any interest, salary, commission or other remuneration payable to any partner. This is section 16(*i*)(*b*). This clause prescribes the mode of computing the partner's share in the profit or loss of the firm. The salary, interest, commission or other remuneration payable to the partner by the firm is added on to the partner's share of the profits, if any, or is set off against the partner's share of liability if the firm had incurred a loss. Section 23(5) of the Act deals with the assessment of a firm. Section 23(5)(*a*) deals with a registered firm and section 23(5)(*b*) with an unregistered firm. In the case of a registered firm the income-tax payable by the firm itself shall be determined and the total income of each partner of the firm including therein his share of its income, profits and gains of the previous year shall be assessed. If such share of any partner is a loss, it shall be set off against his other income or carried forward and set off in accordance with the provisions of section 24.

4. The scheme of the Act is to tax an unregistered firm as a distinct entity and to tax a registered firm by assessing the partners individually in regard to their share income including also their other income. Under section 10 (4)(*b*) payment of interest, salary, commission or remuneration by a firm to any of the partners are not allowed as deductions and if these payments are again included in the taxable income of the partners, the result would be double taxation. In order to remove this inequity, section 14(2) provides that the tax shall not be payable by an assessee if a partner of an unregistered firm in respect of any portion of his share in the profits and gains of the firm computed in the manner laid down in clause (*b*) of sub-section (1) of section 16 on which the tax has already been paid by the firm. These are the main incidents of taxation of a firm registered or unregistered.

5. In our opinion, whatever may be the mode of assessment of a partner of a firm, an assessee partner can claim exemption only under one or other of the provisions of the Act or the Rules, if any. It is also equally clear that double taxation should be avoided, which in essence means that the same amount of receipt (income, profits or gains) shall not be taxed twice in the hands of the same assessee. In the present case the only ground on which the assessee seeks relief is on the basis of rule 24. We have already stated that the said rule would not enable him to obtain the exemption. Though for purposes of computation of income his share income of the firm is clubbed along with the allowance and commission, it is obvious that the character of the receipt of the latter amounts, though related to the business, cannot be said to partake of the same character of their receipt by the firm. The assessee who is a managing partner was entitled to receive the amount not by virtue of the relationship between him and the other members of the firm as partners but by virtue of the special agreement between the partners by which his services to the partnership were agreed to be remunerated.

6. Learned counsel for the assessee relied upon the decision in *Ellis* v. *Joseph Ellis & Co.* [1905] 1 K.B. 324 and contended that a partner engaged to do services for the firm is not an employee or servant of the firm. In that case a member of a partnership firm for the purpose of working a mine worked in the mine under an arrangement with his co-partners. For such work he received weekly wages out of the profits of the business. While working in the mine he met with an accident which caused his death, and his widow thereupon claimed compensation under the Workmen's Compensation Act, 1897, from the surviving partners. It was held that the deceased having been himself one of the partners in the firm for which he was working could not be said to have been employed by them and, therefore, the Workmen's Compensation Act was not applicable. At page 328, Collins M.R. observed thus:

> "The supposition that the deceased man was 'employed' within the meaning of that term as used in the Act would appear to involve that he, as one of the partners, must be looked upon as occupying the position of being one of his own employers. It seems to me that, when one comes to analyse an arrangement of this kind, namely, one by which a partner himself works, and receives sums, which are called wages, it really does not create the relation of employers and employed, but is, in truth, a mode of adjusting the amount that must be taken to have been contributed to the partnership assets by a partner who has made what is really a contribution in kind, and does not affect his relation to the other partners which is that of co-adventurer and not employee. Such a partner cannot put himself in the position of not being a partner when he is one, or of being a workman employed when that position would involve that he would be both 'employer and employee'."

7. This decision turned upon the construction of the provisions of the Workmen's Compensation Act, 1897, and the sole question for determination was whether a partner who received remuneration from the other copartners was an employee of the firm or not. The question now before us is certainly not whether the assessee was an employee. The question is what is the character of the income of the firm, whether it is really income derived from the sale of tea grown and manufactured by him within the meaning of rule 24 of the Income-tax Rules. In our opinion, the assessee has failed to make out that the receipt of the allowance and commission is exempt from taxation under the Act.

8. The Tribunal has reached the correct conclusion in the matter. The question is answered against the assessee, who will pay the costs of the department.