IN THE INCOME TAX APPELLATE TRIBUNAL AT AHMEDABAD,
"SPECIAL BENCH"

BEFORE S/SHRI G.E. VEERABHADRAPPA, PRESIDENT,

G.C. GUPTA, VICE-PRESIDENT AND

K.G. BANSAL, ACCOUNTANT MEMBER)

ITA No.3002/Ahd/2009
[Asstt.Year : 2006-2007]

Shri Vishnu Anant Mahajan Mahajan Lane Raopura, Vadodara.	बनाम/Vs.	ACIT, Cir.5 Baroda.
Appellant)		**Respondent)**

Assessee by	:	Shri Sunil H. Talati
Revenue by	:	Shri S.K. Gupta, CIT-DR with Shri Kartarsingh, CIT-DR
Date of Hearing	:	19th April, 2012
Date of Pronouncement	:	25th May, 2012

PER BENCH :

Vide order dated 18-01-2012, the Hon'ble President, Income Tax Appellate Tribunal, referred the following question to this Special Bench in the case of Shri Vishnu Anant Mahajan Vs. Asstt.Commissioner of Income-tax.

> *"Whether the ld.CIT(A) was justified in disallowing 76% of the depreciation and other related expenses by apportioning them in the ratio of exempt to taxable income by applying provisions of section 14A*

of the Act on the share income from the firm which is exempt from tax u/s.10(2A) of the Act ?"

2. The assessee is an individual and derives income by way of share of profit from the firm of M/s.Mahajan & Amar Doshi, capital gains, interest, dividend and house property. The findings of the AO are that the assessee is a separate and distinct legal entity from the partnership firm. Although, the assessee is the legal owner of the motor car, but that does mean that the expenditure so incurred is for earning the business income. The earning of other incomes apart from share in the partnership firm does not advance the case of the assessee regarding the claim of the expenditure. The assessee has also disallowed *suo motu* $1/10^{th}$ of depreciation allowance which indicates that the asset has been used for personal purpose.

2.1 The learned CIT(A) considered the facts of the case and rival submissions. His interpretation about the view of the AO is that the expenses and depreciation allowance do not pertain to the assessee as an individual, but pertain to the partnership firm in which he is a partner. The share income from the firm is not to be included in the total income of the assessee by dint of provision contained in Section 10(2A). Therefore, the provision contained in Section 14A regarding "expenditure incurred in relation to income not included in total income" becomes applicable. The assessee derives 76% of professional income as share from the firm and the balance amount by way of remuneration and interest income from the firm. He, therefore, allocated the expenses to the income not includible under Section 10(2A). Thus, the business income by way of remuneration and interest from the firm has been taxed in the hands of the assessee under section 28(v) after allowing 24% of the expenditure. Thus, 76% of the expenditure has been disallowed.

2.2 Before proceeding with determination of the main issue, it may be mentioned that the learned CIT-DR submitted that the basic finding of the AO is that the expenditure does not pertain to the assessee. The learned CIT-DR has not furnished any finding on this issue, but he has proceeded straight away to examine admissibility of the expenditure and its disallowance under section 14A. We are of the view that this question can be decided by the Division Bench. Therefore, we proceed to determine-whether, the expenditure incurred by the assessee, a partner in a firm, is entitled to claim expenditure incurred on motor car even if the whole or part of the income from the firm is not includible in his total income under section 10(2A) of the Act?

3. Before us, the learned counsel for the assessee submits that a firm is a compendium name of all the partners who join together for conducting a business or a profession, share its profits and act as agent of one another. This concept has been incorporated in the Act as "firm", "partners" and "partnership" have been assigned under Section 2(23) of the Act the same meaning as assigned to them under the Indian Partnership Act, 1932. Although the definition of the term "person" includes within its ambit an individual and a firm also under Section 2(31), but the provision contained in section 2(23) should not be lost sight of while interpreting section 14A.

3.1 He further submits that the issue of disallowance of the expenditure incurred by a partner has been discussed directly in a number of cases, which support the aforesaid contention. In this connection, reference is made to the decision on 'C' Bench of Mumbai Tribunal in the case of Shri Sudhir Kapadia, ITA No.7883/Mum/2003 for A.Y.2001-2002 dated 26-2-2007, a copy of which has been placed on record. The facts are that the assessee was a Chartered Accountant and a partner in a firm of Chartered Accountants. In his computation of income deduction of Rs.3,95,500/- was claimed in respect of expenditure incurred on motor car and depreciation allowance thereon. The AO applied the provision contained in Section 14A since the share was not includible in the total income under Section 10(2A). Consequently he disallowed certain amount from the overall expenditure which was attributed to the earning of share income. The Tribunal came to the conclusion that it will not be feasible to hold that share income in the hands of the partner is altogether tax free income. The share has suffered tax in the hands of the firm. Section 10(2A) has been introduced to avoid double taxation of the same income, once in the hands of the firm and then in the hands of the partner. This view is fortified by the fact that any partner in the firm is not allowed to claim any conveyance expenditure from the firm as provided in the partnership deed. Further, it is submitted that this case has been followed by 'H' Bench of the Mumbai Tribunal in the case of Hitesh D. Gajaria, in ITA No.983/Mum/2007 for A.Y.2003-2004 dated 14.11.2008, a copy of which has been placed on record. It is also submitted that there is a contrary decision rendered by the 'H' Bench of the Mumbai Tribunal in the case of Hoshang D. Nanavati Vs. ACIT, in ITA No.3567/Mum/2007 for A.Y.2003-2004 dated 18-3-2011, a copy of which has been placed on record. The learned counsel for the assessee in that case argued that there is a cleavage of opinion amongst co-ordinate Benches and looking to the smallness of the tax effect, he would not like to carry the matter to Special Bench, although, he is firmly of the view that the assessee deserves to succeed on this issue. It was further argued that in any case, the depreciation allowance is not an expenditure and therefore, this allowance is not covered at all under Section 14A. The Tribunal mentioned that what can be disallowed under Section 14A is only expenditure incurred and not any allowance admissible to an assessee. Therefore, the depreciation allowance cannot be made a subject matter of disallowance under Section 14A. The expenditure incurred by the assessee is in the nature of business expenditure, which requires to be apportioned between the income included in the total income and not included in the total income. Thus, a proportionate disallowance was upheld with a remark that the decision is rendered on peculiar facts of the case. The case of the ld.

counsel is that since the question has been decided on the basis of concession by the ld. counsel for the assessee, it may be ignored.

3.2. Similar issue also came before the Tribunal in the case of Dhamasingh M. Popat, Vs. ACIT, (2010) 127 TTJ 63 (Mum). The question before the Tribunal in that case was regarding the allowance of expenditure of Rs.10,70,864/- under Section 14A. The assessee was engaged in legal profession in the year under consideration. He received salary of Rs.13,26,000/- from the partnership firm and share of profit of Rs.40,25,000/. Against this income, he claimed expenditure of Rs.14,27,819/- leading to income of Rs.39,23,180/-. Out of this income, share of profit of Rs.40,25,600/- was excluded under Section 10(2A) and thus, the loss of Rs,1,01,819/- was computed. The major portion of the expenditure was incurred on conference, seminar and court assignment abroad. The salary income from the partnership firm was assessable as business income under Section 28(v). The Tribunal considered a number of decisions while deciding this case. We think it proper at this stage to discuss those cases which have been dealt with before us.

3.3 In the case of CIT Vs. A.W. Figgies & Co., (1953) 24 ITR 405 (SC), it is observed that change in the constitution of the firm does not amount to the succession of the business. Therefore, the technical view of the firm under the Partnership Act cannot be carried over to the I.T. Act. However, under the Partnership Act, a firm has not separate or distinct existence. Thus, it is argued before us that the business of the firm is the business of the partners. The income has been taxed in the hands of the firm. Therefore, it cannot be said that the share income received by the partner has not been subjected to tax or excluded from the total income under Section 10(2A). This provision is only a safeguard against double taxation of the same income in the hands of the firm and the assessee partners.

3.4 In the case of Dulichand Laxminarayan Vs. CIT, (1956) 29 ITR 535(SC), it has been, *inter alia*, held that section 4 of 1932 Act contemplates only the nature of the entity and whether such an entity can enter into another partnership with any firm, HUF or individual. The general concept is that the firm is not an entity or a person in law, but is merely an association of individuals. Therefore, the registration cannot be granted to a partnership purporting to be one between three firms, a Hindu undivided family and an individual as a firm under Section 26A of the 1922 Act. On the basis of this decision, it is urged before us that since a partnership firm is not a person under general law, it cannot enter into a partnership with any one else. The partnership is a compendium name of the partners. Therefore, income earned through its business by the partners gets taxed in the hands of the firm under the IT Act.

3.5 In the case of Malabar Fisheries Co. Vs. CIT, 120 ITR 49 (SC) , it has, *inter alia,* been held that it is not correct to say that distribution of assets of a partnership firm leads to transfer of assets so as to attract the provision contained in section 155(5) of the Act. What the partners get are their shares in surplus which they already owned in the assets of the firm.

3.6 In the case of DCIT Vs. K. Kelukutty, 155 ITR 158 (SC), it has, *inter alia*, been held that essentially a firm consists of three elements – (a) persons, (b) a business carried on by all of them or any of them acting for all, and (c) an agreement between these persons to carry on such business and share its profits. It is permissible to say that an agreement creates or defines relation of partnership and, therefore, identifies the firm. If that conclusion be right, it is only a further step to hold that each partnership agreement between same persons may constitute a distinct and separate partnership. The question may have to be decided on the basis of facts of each case taking into account commonality of management, interlacing of funds etc. But this does not mean that the firm is a distinct person, separate and apart from the partners.

3.7 In the case of Bist & Sons Vs. CIT, 116 ITR 131 (SC), the facts are that a HUF consisted of father and son. They were carrying on business of forest contractors. Due to total disruption of the family, the separated members constituted a firm and took over business as a running concern. The business of erstwhile HUF consisted of three trucks on which deprecation had been allowed and the WDV had come to NIL. The trucks were sold by the partnership firm. The court came to the conclusion that the depreciation allowed to the HUF was a step taken in the assessment of the HUF for determining its total income. That does not mean that the depreciation allowed to the HUF could be regarded as depreciation allowed to the partnership firm. Therefore, the sale proceeds realized by the firm was not taxable as balancing charge. It is urged before us that this case distinguishes between disrupted HUF and the firm subsequently constituted and not between a firm and its partners.

3.8 In the case of CIT Vs. Chase Trading Co., 236 ITR 665 (Bom), it has, i*nter alia,* been held that under the Act, the partnership firm is an assessable entity. In the course of its business, the firm may borrow or lend from or to its partners, sell or purchase goods and other assets. These are commercial transactions. Such transactions would not be amenable to the principle that one cannot trade with oneself. It is urged that this case recognizes the transaction of a firm with its partners, but in so far as the business of the firm itself is concerned, the same is jointly carried out by the partners and its profits belong to the partners.

3.9 On the basis of aforesaid discussion, it is argued that the Tribunal erred in coming to the conclusion in the case of Dharmasingh M. Popat that the scheme of assessment as applicable from A.Y.1993-1994 is not merely procedural, but also includes the computation of income of partnership firm as well as its partners. In this very connection, reliance is placed on Board circular no.636 dated 31-8-92, 198 ITR (St.) 1 wherein it is mentioned that change in the levy of tax on the firms has been undertaken to avoid double taxation, as it happened prior to the change. It is also urged that the decisions rendered in the case of limited companies regarding the applicability of section 14A, will not be applicable in respect of assessment of the partnership firm, as one cannot equate partners with shareholders and the firm does not have any legal *persona* as it is merely a compendium name of all the partners. Thus, the share income received by a partner from the firm cannot be said to be an income which has been excluded from the total income. It has also been submitted that irrespective of rates of tax, there will be no loss to the Revenue, if the expenditure is allowed in the case of the partner or in the case of firm.

4. In reply, the learned DR submits that motor car has not been used by the assessee for his business. It may have been used for the purpose of business of the firm. Therefore, as such, there is no question of allowing the expenditure in the hands of the assessee. It is further submitted that earlier a partnership firm was assessed at concessional rate of tax. The profit of the firm after deduction of tax payable by it was distributed amongst the partners as per the partnership deed, and the partners were liable to pay tax on such income allocated to them at normal rates. It was this double taxation, for which the scheme of taxation was changed. The Board Circular is relevant only in this context. Now, the firm is allowed to deduct salary and interest paid to the partners as provided under Section 40(b) of the Act and the balance amount is taxed in the hands of the firm at a flat rate. The salary and interest allocated to the partners are taxed as business income under Section 28(v) in the hands of the partners at normal rates applicable to them. This shows that under the Act, the firm and the partners are treated separately, which also flows from the definition of term "person" in section 2(31). Therefore, the

concepts under the Act and under the Partnership Act are different. Thus, in effect the arguments of the learned CIT-DR is that while a firm is a transparent vehicle under the Partnership Act, it is a translucent vehicle under the I.T. Act, the reason being that two are taxed on their separate incomes and what is taxed in the hands of the firm is not further taxed in the hands of the partners.

4.1 He referred to various decisions considered in the case of Dharmasingh M. Popat. The case of S.G.Investments & Industries Ltd., 89 ITD 44 (Kol) is distinguishable in the sense that it deals with a limited company. Such is also the case of Primer Conslidated Capital trust (I) Ltd., 4 SOT 793 (Mum).

4.2 In the case of Phiroze H. Kudianawala, 113 ITR 873 (Bom) the facts are that the assessee, a partner in a firm of architects, incurred certain expenses. The agreement provided that certain expenses will be incurred by partners. The Court held that if business expediency is proved, a partner could claim expenses incurred by him for earning share income. This decision has been distinguished on the ground that it relates to the period when share income was taxable in the hands of the partners and there was no provision corresponding to section 10(2A). The decision in the case of R.M. Chidambram Pillai, 106 ITR 292 (SC) is not really applicable to the facts of the case because it was held that the nature of income in the hands of the firm and partners remains the same. The decision in the case of A.W. Figgies & Co. (supra) lays down that the change in the constitution of the firm does not lead to succession to business. This decision goes against the assessee. It has been mentioned in the decision that this view to a certain extent is a compromise between strict doctrine of English Common Law which refuses to see anything in the firm but a collective name for individuals carrying on business in partnership and the mercantile usage which recognizes the firm as a distinct person. However, the firm may only be a quasi corporation. The decision in the cased of Dulichand Laxminarayan merely lays down that a firm cannot enter into an agreement of partnership with any one else, as it is not a legal entity under the Partnership Act. In the case of Malabar Fisheries Co., the question was regarding distribution of assets on extinguishment of partnership and it was held that there is no transfer. At the relevant point of time, there was no provision to deal with such a situation under the I.T.Act, although, now it is deemed to be a transfer. In the case of K. Kelukutty, it has been held that where the tax law is silent, one will have refer to law on partnerships. Thus, it is clear that where the field has been occupied by the tax law, there will be no necessity to refer to the law applicable to the partnership firms. This decision has been applied by the Tribunal in the case of Dharmasingh M. Popat . The question in the case of Bist & Sons was totally different, regarding the value of trucks in the hands of the partnership, which were earlier owned by the HUF and whose WDV had become NIL. In the case of CIT Vs. Kaluram Puranmal, 119 ITR 564 (Bom), the transactions between the partners and the firm are held to be transaction between two separate legal entities which supports the case of the Revenue. In the case of Chase Trading Co., similar proposition of law has been reiterated. The decision in the case of C.A. Abraham Vs. ITO and Another , (1961) 41 ITR 425 (SC) has been applied by the Hon'ble Tribunal in the case of Dharmasingh M. Popat (supra), in which it has been held that the word "assessment" includes both computation, imposition of tax liability and the machinery for enforcement thereof..

4.3 It has also been submitted that the case of ITO Vs. Daga Capital Management P. Ltd., (2009) 117 ITD 169 (Mum)(SB), Wimco Seedling Ltd. Vs. DCIT, 107 ITD 267 (Del)(TM) deal with the limited companies, and as such, are not applicable to the facts of the instant case. The decision in the case of Godrej & Boyce Mfg. Co. Ltd. Vs. DCIT, 328 ITR 81 (Bom) can be relevant to the extent that it has been held that even prior to insertion of Rule 8D, all circumstances can be considered and disallowance can be made on a reasonable basis.

4.4 Finally, it is argued that the scheme of taxation of a firm and its partners is that profit is taxed in the hands of the firm and, thus, the shares are excluded from the total income of the partners. A firm and its partners are two separate assessable entities and taxation of the profit of the firm in its hands does not lead to a conclusion that it has been taxed in the hands of the partners on the ground that the firm and its partners constitute only one entity. This field is occupied by the IT. Act under which profit is taxable in the hands of the firm and it is excluded from its total income of partners under Section 10(2A). The total income of the firm is different from total income of the partners. Accordingly, the learned CIT(A) rightly invoked the provisions contained in Section 14A and disallowed the expenses on proportionate basis.

5. In the rejoinder, it is submitted that the statutory changes made in the year 1993 do not really make a difference in the legal position that the firm is a compendium name of the partners. Therefore, when an income has been taxed in the hands of the firm, it automatically means that the partners have paid tax on the income because the profit allocated to them is from the amount left in the hands of the firm after payment of tax. Any other interpretation would lead to double taxation of the same income in the hands of the firm and partners.

6. We have considered facts of the case and submissions made before us. We find that difficulty in deciding the issue arises from the fact that while a firm is a transparent vehicle under the Partnership Act, it is considered to be a separate and distinct entity apart from its partners under the I.T. Act. Further, while share income is excluded from the total income of the partners under Section 10(2A), salary and interest are taxable in their hands as business income under Section 28(v) of the Act. At the same time, “firm”, “partner” and “partnership” have meaning respectively assigned to them in the Indian Partnership Act, 1932. The term “partner” also includes any person being a minor who has been admitted to

the benefit of the partnership. Thus, the firm is somewhat translucent vehicle under the Act. This requires a combined reading of the provisions contained in sections 2(23) and 2(31) of the Act. Obviously, a firm cannot be equated with a limited company, which has been granted a separate and distinct legal *persona* under the Companies Act and which has been recognized under the Income Tax Act as such.

7. We have given careful consideration to various cases relied upon by the contesting parties. These cases inter-alia show that a firm can validly enter into an agreement with a partner regarding purchase and sale of assets etc.[Kaluram Puranmal; Chase Trading Co.]. Further it has been held that whenever the field is occupied by the tax law, the provision contained therein will become applicable, but where the field is left vacant, we will have to take assistance from the provisions contained in the Partnership Act for filling the vacuum under the tax law. [K. Kulakutty]. In so far as the issue before us is concerned, a firm and its partners are assessable separately on their total income in their names, notwithstanding the position of law under the Partnership Act that a firm is a compendium or the collective name of the partners. Thus, in so far as the taxation is concerned, the firm is not a pass-through vehicle. It is a translucent vehicle, as only the salary and interest paid to the partners are taxable under Section 28(v) as business income. It has been so provided because there cannot be really be a relationship of employer and employee or debtor or creditor between the firm on one hand and the partners on the other hand. Even earlier, the salary and interest allocated to the partners were taxable as business income. The real change in the scheme of taxation is that the firm is taxed at a flat rate of income after deduction of interest and salary paid to the partners, and interest and salary are taxed in the hands of the partners as business income. Thus, it is clear that the amount taxed in the hands of the firm is not taxed again in the hands of the partners. This change has led to avoidance of double taxation because the firm does not have to pay tax on salary and interest income paid to the partners and the partners do not

have to pay tax on share income allocated to them. This is achieved by insertion of section 10(2A) and 28(v) in the Act. In so far as share income is concerned, the field is occupied by the tax law, as it is enacted that the share income shall not form part of total income of the partners. Therefore, in view of this specific provision and the fact that the firm and partners are separately assessable entities, it will be difficult to hold that the share income is not excluded from the total income of the partner because the firm has already been taxed thereon. When section 10(2A) speaks of its exclusion from the total income, it means, the total income of the person whose case is under consideration. The instant case is that of the partner and therefore what is to be examined is whether the share income is excluded from his total income. The answer is obviously in the affirmative. In such a situation, provision contained in section 14A will come into operation and any expenditure incurred in earning the share income will have to be disallowed. Thus, we agree with the learned CIT(A) that the provision contained in section 14A is applicable to the facts of the case. Further, it has been held in the case of Godrej & Boyce Mfg. Co. Ltd. (supra) that all facts may be taken into consideration for determining the quantum of disallowance to be made. This portion of the judgment is applicable only in respect of determination of quantum of disallowance. The learned CIT(A) has disallowed the expenditure in the ratio of income not included in the total income and the income received from the firm. In the absence of any argument regarding any error in this part of the decision, it is held that he was right in doing so.

8. Coming to the question regarding depreciation being an expenditure or not, it has been held in the case of Hoshang D. Nanavati (supra) that section 14A deals only with the expenditure and not any statutory allowance admissible to the assessee. The decision has been arrived at after considering the decision in the case of Nectar Bebverages Pvt. Ltd. Vs. DCIT (2009) 314 ITR 314. The ld. CIT (DR) has not been able to displace the ratio of these cases. Thus, on consideration, we find that section 14A uses the words “expenditure incurred by

the assessee in relation to income". A statutory allowance under section 32 is not an expenditure. Therefore, we are in agreement with the decision of the Division Bench in the case of Hoshang D. Nanavati.

9. Question referred to us is answered accordingly. The Division Bench shall dispose of the appeal in conformity with this decision.

Order pronounced in Open Court on the date mentioned hereinabove.

Sd/-	Sd/-	Sd/-
(G.E. EERABHADRAPPA)	**(G.C. GUPTA)**	**(K.G. BANSAL)**
PRESIDENT	**VICE-PRESIDENT**	**ACCOUNTANT MEMBER**

Copy of the order forwarded to:

1) : Appellant
2) : Respondent
3) : CIT(A)
4) : CIT concerned
5) : DR, ITAT.

BY ORDER

DR/AR, ITAT, AHMEDABAD