

**INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "SMC-2": NEW DELHI
(Through Video Conferencing)**

BEFORE

SHRI R.K. PANDA, ACCOUNTANT MEMBER

ITA No. 2815/Del/2019
Asstt. Year 2015-16

M/s. Quality Traders, 1698/122, Shanti Nagar, Tri Nagar, Delhi 110 035 PAN AAFAQ1139J	Vs.	ITO Ward 63-2, New Delhi.
(Appellant)		(Respondent)

Assessee by:	Shri Ashwani Kumar, Advocate
Department by :	Shri Rabin Rawal, Add. CIT(DR)
Date of Hearing	21/01/2021
Date of pronouncement	23/03/2021

ORDER

PER R.K. PANDA, AM

This appeal filed by the assessee is directed against the order dated 25th January, 2019 of the Ld. CIT(A)-38, New Delhi relating to assessment year 2015-16.

2. Facts of the case, in brief, are that the assessee is a partnership firm engaged in the business of trading in soaps and

detergents under the name & style of M/s. Quality Traders. It filed its return of income on 28th September 2015 declaring taxable income of Rs. 9,420/-. During the course of assessment proceedings the AO noted that the assessee has debited Rs. 2,88,000/- as remuneration to partners. To verify the allowability of the same, the AO asked the assessee to produce the copy of partnership deed. From the partnership deed so submitted the AO noted at page 2 on point No. 5 where it is mentioned as under :-

“That the parties hereto shall be entitled for interest on their capital investment and is entitled to a salary as per mutual consent which shall be deducted from the profit or losses of the firm before dividing the same in accordance with the proceeding but under Income Tax Act, 1961.”

3. He, therefore, asked the assessee to explain as to why the remuneration to partners debited to the P & L account should not be disallowed as per the provisions of section 40(b) of the Income Tax Act 1961. It was explained by the assessee that the partnership deed mentioned that salary be paid as per Income Tax Act, 1961 which covers everything. However, the AO rejected the explanation of the assessee by observing as under :-

“Section 40(b) of the Act places some restrictions and conditions on the deductions of expenses available to an assessee assessable as a partnership firm in relation to remuneration payable to partners of such firm. The deductions regarding salary to partners cannot exceed the monetary limits specified u/s 40(b) and are available subject to fulfillment of conditions mentioned therein.

The following conditions must be satisfied before claiming any deduction in respect of salary/remuneration to partner by a partnership firm:

- Partner to be paid must be a working partner*
- Remuneration must be authorized by the partnership deed*
- Remuneration will be allowed as deduction only for that period onwards wherefrom the partnership deed authorizes such remuneration*
- Quantification of remuneration is must &*
- Remuneration exceeding the limit prescribed u/s 40(b) is to be disallowed*

Also as per CBDT circular No. 739, dated 25-3-1996 point no 3&4 it is stated as under:

3. *“In cases where neither the amount has been quantified nor even the limit of total remuneration has been specified but the same has been left to be determined by the partners at the end of the accounting period, in such cases payment of remuneration to partners cannot be allowed as deduction in the computation of the firm’s income. ”*

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. ”*

Since the partnership deed provided by AR of the assessee neither specifies the amount of remuneration payable to each individual working partner nor lays down the manner of quantifying such remuneration which is one of the conditions prescribed by section 40(b) of the Act.”

4. Rejecting the various explanations given by the assessee and following the decision of Hon’ble Delhi High Court in the case of

Sood Brij & Associates vs. CIT reported in 15 taxmann.com 76, the AO disallowed the salary of Rs. 2,88,000/- and added the same to the total income of the assessee.

5. Before Ld. CIT(A), it was explained that the partnership deed was written on 1.4.1992 and the CBDT circular No. 739 was issued on 25.3.1996. It was explained that the salary paid to the partners is within the permissible limit as prescribed under Income Tax Act. So far as the decision of Delhi High Court in the case of Sood Brij & Associates vs. CIT (supra) relied on by the AO is concerned, it was submitted that the said decision is not applicable to the facts of the present case since in that case both the partners were not working partners whereas in the present case both the partners are working partners.

6. However, the Ld. CIT(A) was also not satisfied with the arguments advanced by the assessee and sustained the addition made by the AO by observing as under :-

“4.2 Ground no. 2- This ground of appeal relates to disallowance of partner’s salary of Rs.2,88,000/- u/s 40(b). The appellant’s submission that the partnership deed was dated 01.04.1992 and the CBDT circular No.739 was issued on 25.03.1996, clearly does not hold water. The Assessment

Order in dated which was much after the issuance of the said circular. The payment of salary u/s 40(b) would be governed by the circular no.739. Also, the appellant's contention to restrict the disallowance as per the circular is not correct. This step could have been taken at the assessment stage itself which was not done. Irrespective of this fact, the disallowance itself is correct by made by the Assessing Officer. Therefore, the addition made by the Assessing Officer is sustained."

7. Aggrieved with such order of the Ld. CIT(A), the assessee is in appeal before the Tribunal by raising the following grounds :-

1. *" That Ld. CIT (A) erred on the facts and circumstances of the case and in law in upholding reasoning assumed by the AO for passing the assessment order under section 143(3) of the Income Tax Act, 1961, is bad in law and void ab initio.*
2. *That the Assessing officer issued notice under section 143(2) and 142(1) without application of mind as it talks about assessment year 2010-11 and CIT(A) upheld the same.*
3. *That Ld. Assessing officer erred in disallowing the sum of Rs. 2,97,420/- despite accepting the fact that allowable remuneration was Rs. 2,67,676/- in the show cause dated 16.10.2017 and CIT(A) erred in confirming the disallowance.*
4. *The appellant craves leave to add, alter, amend or vary any of the above grounds during the pendency of the appeal."*

8. Ld. Counsel for the assessee strongly challenged the order of the Ld. CIT(A) in confirming the disallowance of salary to partners made by the AO. Referring to the copy of the partnership deed, the Ld. Counsel for the assessee drew the attention of the bench to clause 5 of the partnership deed and submitted that the said clause provides salary to partners in accordance with the proceeding under Income Tax Act 1961. He submitted that the salary paid to the partners is within the limit as prescribed u/s 40(b) of the Income Tax Act.

8.1. Referring to the decision of the Mumbai Bench of the Tribunal in the case of Unitec Marketing Services vs. ACIT reported in 101 taxman.com 397, he submitted that the Tribunal after considering the provisions of section 40(b)(v) and the conditions laid down in CBDT circular No. 739 dated 25th March 1996 has held that claim of remuneration paid to the partners despite the quantum being not prescribed in the partnership deed was to be allowed.

8.2. Referring to the decision of Hon'ble Delhi High Court in the case of CIT vs Vaish Associates (2015) 63 taxman.com 90, he submitted that under somewhat similar circumstances the decision of the Tribunal allowing salary to two partners was

upheld by the Hon'ble Delhi High Court. He submitted that merely because the partnership deed did not specify the amount of salary to be paid to each of the partners or had not laid down a specific method of computation thereof cannot be a ground to disallow the remuneration to partners. He accordingly submitted that the order of the Ld. CIT(A) be reversed and the grounds raised by the assessee be allowed.

9. Ld. DR on the other hand while supporting the order of the Ld. CIT(A) submitted that the partnership deed does not specify the amount of salary to be paid to the working partners. Therefore, in view of the decision of Hon'ble Delhi High Court cited (supra) and CBDT Circular No. 739 dated 25th March, 1996 the remuneration can not be allowed to the working partners. Therefore, the order of the Ld. CIT(A) be upheld and the grounds raised by the assessee should be dismissed.

10. I have considered the rival arguments made by both the sides, perused the orders of the AO and the Ld. CIT(A) and the paper book filed on behalf of the assessee. I have also considered the various decisions cited before me. I find the AO in the instant case, has disallowed an amount of Rs. 2,88,000/- claimed by the assessee as remuneration to the partners on the ground that the

partnership deed does not specify the quantification of remuneration to the partners. Therefore, relying on CBDT circular No. 739 dated 25th March, 1996 and the decision of Hon'ble Delhi High Court in the case of Sood Brij & Associates vs. CIT (supra), the AO disallowed the salary to working partners which has been upheld by the Ld. CIT(A). I do not find any infirmity in the order of the Ld. CIT(A). A perusal of clause (5) of the partnership deed which has been reproduced at page 2 of this order clearly shows that there is no mention of the quantum or manner of calculation of such remuneration.

11. I find the AO while disallowing the salary has followed the decision of Hon'ble Delhi High Court in the case of Sood Brij & Associates vs. CIT reported in (2011) 15 taxman.com 76 where it has been mentioned as under :- (Head notes)

*“Section 40(b) of the Income Tax Act, 1961-
Business disallowance – interest, salary, etc. paid
by firm to partners – Assessment year 2007-08 –
Whether requirement of allowing deduction under
section 40(b) is that remuneration paid to partners
should be authorised and in terms of partnership
deed – Held, yes – Whether expression ‘ in*

accordance with terms of partnership deed' read with sub-clause (iii) of section 40(b), requires and mandates that quantum of remuneration or manner of computation of quantum of remuneration should be stated in partnership deed and should not be left undetermined, undecided or to be determined or decided on a future date – Held, yes- Whether where quantum or amount of remuneration and manner of computing is not specified or stipulated in partnership deed but was left undecided, unstipulated and left to discretion of partners to be decided at a future point in time requirements of section 40(b)(v) were not satisfied and, therefore, remuneration paid to partners could not be allowed as deduction under section 40(b)(v) – Held, yes [in favour of revenue]"

12. Since in the instant case, the partnership deed does not specify the manner of computation of quantum of remuneration to partners and the same has been left undetermined, undecided and left to the discretion of partners, therefore, I do not find any

infirmity in the order of the Ld. CIT(A) in confirming the addition made by the AO.

13. So far as the decision of Mumbai Bench of the Tribunal relied on by the Ld. Counsel for the assessee is concerned, the same is not applicable to the facts of the present case in view of the binding decision of Hon'ble Jurisdictional High Court cited (supra). Further in the said case, the provision of salary or remuneration to partners was excluded in the original partnership deed. However, the same was inserted in the deed of rectification of partnership deed. In any case, since the Hon'ble Jurisdictional High Court has decided identical issue, the decision of the Mumbai Bench of the Tribunal relied on by the Ld. Counsel for the assessee will not be applicable.

14. So far as the decision of Hon'ble Delhi High Court in the case of CIT vs Vaish Associates (2015) (supra) is concerned, in that case clause 6A of the partnership deed clearly indicates the methodology and the manner of computing the remuneration of the partners and the remuneration of the partners was computed in terms thereof. However, in the instant case there is no such clause at all regarding the methodology and the manner of computing the remuneration of partners. Therefore, this decision

also is of no help to the assessee . In this view of the matter and respectfully following the decision of Hon'ble Jurisdictional High Court in the case of Sood Brij & Associates vs CIT (supra) relied on by the AO, I do not find any infirmity in the order of the Ld. CIT(A) in confirming the disallowance of salary to the working partners. I, therefore, uphold the same and the grounds raised by the assessee are dismissed.

In the result, the appeal filed by the assessee is dismissed.

Order pronounced on 23rd March, 2021.

sd/-
(R.K. PANDA)
ACCOUNTANT MEMBER

Dated: 23rd March, 2021

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Copy forwarded to

1. Applicant
2. Respondent
3. CIT
4. CIT (A)
5. DR:ITAT

ASSISTANT REGISTRAR
ITAT, New Delhi