

applicable to the assessment years prior to 1st April, 1985. However, the Madras High Court in *O.M.S.S. Sankaralinga Nadar and Co's case (supra)*, took a different view. On this matter, we have held in I.T. Ref. No. 43 of 1981 (*Hindustan Steel Forging Rajpura v. C.I.T. Patiala* (6)), that the aforesaid decision of the Board is of clarificatory nature and what was hidden was made apparent. There we were considering the effect of Explanation 2.

(4) The circulars issued by the Board are not binding on Courts because if assessee wants to challenge its correctness, it is open to him to do so. But at the same time, the Supreme Court has held in numerous cases that the circulars issued by the Board are binding on the department, and the department cannot be allowed to raise argument opposed to the decision of the Board. In this case, we have to give effect to the circular referred to above, as it favours the assessee and would bind the department.

(5) In view of our earlier decision and the decision of the three High Courts in favour of the assessee on the circular point, we agree with the judgments referred to on behalf of the assessee and dissent from the decision rendered by the Madras High Court, and hold that only the net amount paid by the firm to its partners after adjusting the interest paid by the partners to the firm, can be disallowed under section 40(b) of the Act. Since in this case the partners had paid more interest to the firm, the interest paid by the firm to the partners was rightly not disallowed by the Tribunal and the Tribunal was right in deleting the addition and we answer the referred question in favour of the assessee, in the affirmative, with no order as to costs.

S.C.K.

Before : G. C. Mital and S. S. Sodhi, JJ.
GANESH FACTORY, RAJPURA,—Appellant.
versus

COMMISSIONER OF INCOME TAX, PATIALA,—Respondent.

Income Tax Reference No. 12 of 1981

May 18, 1989.

Income Tax Act (XLIII of 1961) Ss. 40(b), 40A(2)—Partnership concern paying salary to its partners—Firm claiming deductions as

(6) I.T.R. No. 43 of 1981 decided on 2nd March, 1980.

**Ganesh Factory, Rajpura v. Commissioner of Income Tax, Patiala
(G. C. Mital, J.)**

business expenditure—Deduction disallowed by Income Tax Officer in view of S. 40(b)—Payment of salary to partners—Whether can be claimed as deductions.

Held, that we are of the opinion that such a matter is not covered by S. 40 A of the Income Tax Act, 1961 and would be covered only under S. 40. Since salary has been paid by the assessee firm to its partners, the same has to be disallowed by virtue of sub-sec. (b) of S. 40 of the Act and the Tribunal and the officers below were right in disallowing the entire salary paid to the partners of the firm. (Para 3).

Reference under Section 256(1) of the Income Tax Act, 1961 by the Income Tax Appellate Tribunal, Chandigarh Bench, Chandigarh, to the Hon'ble High Court of Punjab and Haryana for opinion of the following questions of law arising out of the Tribunal's order dated 7th August, 1980 in R.A. No. 114/Chd./80. In I.T.A. No. 110/Chd./79. Asstt. year 1974-75:—

1. *Whether, the Tribunal has been in error in holding that the provisions of section 40(b) and 40A(2) of the Income-tax Act, 1961 operate in different fields.*
2. *Whether the Tribunal has been right in law in holding that though the income-tax authorities may restrict or modify a claim of payment of salary to a partner but even such restricted or modified payment is disallowable u/s. 40(b) of the Income-tax Act, 1961 and thereby upholding the disallowance of Rs. 18,000 in the appellant's case in respect of assessment year 1974-75.*

Balwant Singh Gupta, Sr. Advocate, with Sanjay Bansal, Advocate, for the Appellant.

Ashok Bhan, Sr. Advocate with Ajay Mittal, Advocate, for the Respondent.

(1) During the period relevant to the assessment year 1974-75, the assessee, a partnership concern, paid Rs. 18,000 as salary to three of its partners and during the assessment proceedings, claimed deduction as business expenditure. The Income Tax Officer disallowed the deduction as the payment of salary to partners was not allowable in view of section 40(b) of the Income Tax Act, 1961 (hereinafter called the Act). The contention of the assessee before the Appellate Assistant Commissioner, that the provisions of section 40 A of the Act were applicable and had overriding effect

on section 40(b), did not prevail and the assessee remained unsuccessful. Their further appeal before the Income Tax Appellate Tribunal Chandigarh also remained unsuccessful. The Tribunal came to the conclusion that section 40(b) and section 40 A of the Act operate in different fields and there was no conflict as was attempted to be made on behalf of the assessee. At the instance of the assessee, the Tribunal has referred the following questions for the opinion of this Court :—

1. Whether the Tribunal has been in error in holding that the provisions of section 40(b) and 40 A(2) of the Income Tax Act, 1961 operate in different fields ?
2. Whether the Tribunal has been right in law in holding that though the Income Tax authorities may restrict or modify a claim of payment of salary to a partner but even such restricted or modified payment is disallowable under section 40 (b) of the Income Tax Act, 1961 and thereby upholding the disallowance of Rs. 18,000 in the appellants' case in respect of assessment year 1974-75 ?

(2) By virtue of section 40, the amounts detailed in various clauses of sub-sections (a) to (d) shall not be deducted in computing the income chargeable under the head "Profits and Gains of business or profession" notwithstanding anything to the contrary contained in sections 30 to 39 of the Act. The relevant provisions for our consideration in this section would be sub-section (b), the relevant portion of which is as follows :—

"(b) in the case of any firm, any payment of interest, salary, bonus, commission or remuneration made by the firm to any partner of the firm."

(3) By virtue of sub-section (b) if a firm pays interest, salary, bonus, commission or remuneration to any of the partners of the firm, the same has to be disallowed. Here we are concerned with payment of salary to partners and by virtue of the aforesaid provision, the salary would be disallowed from the deductions as section 40, by virtue of the non obstante clause, has an over-riding effect over the provisions of section 30 to 39, under which possibly deduction could be allowed.

Ganesh Factory, Rajpura v. Commissioner of Income Tax, Patiala
(G. C. Mital, J.)

(4) The argument on behalf of the assessee is that after the enactment of section 40A with effect from 1st April, 1958, it contains non obstante clause saying that this section shall have effect notwithstanding anything to the contrary contained in any other provisions of the Act relating to the computation of income under the heading "Profits and gains of business or profession" and, therefore, section 40A will have over-riding effect even on section 40 including clause (b) thereof. Hence, section 40(b) is not to be considered in the wake of section 40 A.

(5) The argument raised on behalf of the assessee would be correct only to the extent that whatever amounts are covered by section 40 A, to that extent it will over-ride the provisions of section 40, but the matters which are not dealt with in section 40A and are dealt with in section 40, in that case, section 40A will not stand in the way of applying section 40. Therefore, the crucial point is whether the questions of allowing or disallowing salary or part thereof to a partner, is covered by section 40A or not? For this matter, reference may be made to section 40 A(2) (a), the relevant portion of which is as follows :—

"40A(2) (a) Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause (b) of this sub-section and the Income Tax Officer is of opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction."

(6) The aforesaid provision relates to the expenditure in relation to any person referred to in clause (b) of the sub-section and the expenditure has to be considered in relation to the fair market value of the goods, services or facilities for which payment is made or the legitimate need of the business or profession of the assessee or the benefit derived by or accruing to the assessee therefrom. Only so much of expenses, if paid to a person referred to in clause

(b), are allowable which are found to be not excessive and unreasonable and the excessive or unreasonable payment has to be disallowed. Further we have to consider as to what kind of expenditure is dealt with in clause (a) of sub-section (2) of section 40A of the Act. It has to be in regard to the fair market value of the goods, services or facilities for business purposes. Section 40 A(2) (a) came up for consideration before the Karnataka High Court in *T.T. Pvt. Ltd. v. Income Tax Officer, Company Circle-III, Bangalore* (1), and Venkataramaiah J. at pages 567 to 570 of the reported judgment considered the scope of the aforesaid provision in view of section 40 and gave the following verdict :—

“The goods, services and facilities referred to in section 40A(2) (a) are those which have a market value and which are commercial in character. Many of the services and facilities referred to above are those which are now a days provided by independent organisations. They take diverse forms, such as packing and forwarding, transport service, advertisement service, warehousing facilities, processing, collection of price, insurance of goods, etc. which involve investment of large finance and employment of number of persons. The cost of post-manufacture operations in some cases will be in the order of 30 per cent of the price paid by the consumers. Marketing and distribution of goods have become important branches of modern industrial and commercial operations, which have now become highly standardised.”

(7) A reading of the aforesaid shows that payment of salary to a partner of the firm, who may be working whole time for the assessee firm, would not come within the ambit of services as the services provided under section 40A are as noticed in the aforesaid quotation and not as an employee, i.e., relationship of master and servant.

(8) Moreover, the Legislature was aware of the meaning of the salary in contradistinction to the services which may be rendered for carrying of business by a person. Here, in the statement of the case it is mentioned that total salary of Rs. 18,000 was paid to three of the partners of the firm and the word salary is clearly

Ganesh Factory, Rajpura *v.* Commissioner of Income Tax. Patiala
(G. C. Mital, J.)

covered by section 40(b) and does not come within the ambit of section 40A. Therefore, we are of the opinion that such a matter is not covered by section 40 A and would be covered only under section 40. Since salary has been paid by the assessee firm to its partners, the same has to be disallowed by virtue of sub-section (b) of section 40 of the Act and the Tribunal and the officers below were right in disallowing the entire salary paid to the partners of the firm.

(9) The Tribunal in its order made the observations that by virtue of section 40A, the Income Tax Officer may restrict or modify a claim of payment of salary to a partner depending upon the extent and nature of his services but in spite of such modified payment, the same has to be disallowed keeping in view the provisions of section 40(b) of the Act. In this respect there was some misunderstanding with the Tribunal. If section 40 A applies, then section 40 would stand excluded but if section 40A does not apply and the matter is covered by section 40, then the matter of payment of salary to a partner of the firm, has to be decided under section 40 alone. Otherwise, the Tribunal was right in coming to the conclusion that section 40 (b) and section 40 A of the Act operate in different fields.

(10) Accordingly, both the questions are answered in favour of the revenue as indicated above. However, there will be no order as to costs.

P.C.G.

Before : G. C. Mital and S. S. Sodhi, JJ.

RAM KUMAR,—Petitioner.

versus

STATE OF PUNJAB,—Respondent.

Criminal Misc. No. 7251-M of 1988

July 31, 1989.

Indian Penal Code (XLV of 1860)—Ss. 420, 408, 109—Petitioner approaching members of general public to become members of Club and to make contribution—Money to be repaid turn by turn on the