IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 10.06.2025

CORAM :

THE HON'BLE MR.K.R.SHRIRAM, CHIEF JUSTICE

AND

THE HON'BLE MR.JUSTICE SUNDER MOHAN

TCA Nos.750 and 987 of 2013
and M.P.No.1 of 2013

TCA No.750 of 2013:

M/s.Deloitte Haskins & Sells,
ASVN Ramana Towers, 7th Floor,
No.52, Venkanarayana Road,
T. Nagar, Chennai-600 017. .. Appellant

Vs.

The Assistant Commissioner of Income tax,
Cirvle-XV,
Chennai-600 034. .. Respondent

TCA No.987 of 2013:

Commissioner of Income Tax,
Chennai. .. Appellant

Vs.

M/s.Deloitte Haskins & Sells,
ASVN Ramana Towers,
7th Floor, N.52, Venkatanarayana Road,
T.Nagar, Chennai-600 017. .. Respondent

Prayer: Appeals filed under Section 260A of the Income Tax Act, 1961 against the order of Income Tax Appellate Tribunal, "D" Bench, Chennai, dated 04.07.2023 passed in I.T.A No.1164/MDS/2012.

For Appellant in TCA No.750/2013 and Respondent in TCA No.987/2013:	Mr.J.D.Mistri Senior Counsel assisted by Mr.Niraj Sheth Mr.R.Venkatanarayanan and Mr.S.P.Chidambaram for M/s.Subbaraya Aiyar
For Respondent in TCA No.750/2013 and Appellant in TCA No.987/2013	Mr.T.Ravikumar Sr. Standing Counsel

COMMON JUDGMENT
(Delivered by the Hon'ble Chief Justice)

The appeals, one by department and the other by assesee, impugn the order dated 04.07.2013 passed by the Income Tax Appellate Tribunal (ITAT) "D"Bench, Chennai.

2. Appeals were admitted on 13.12.2024 on the following substantial questions of law:

T.C.A.No.987 of 2013:

"Whether on the facts and in the circumstances of the case, the Hon'ble Income Tax Appellate Tribunal was right in law in holding that the Commissioner of Income Tax had gone overboard by directing the Assessing Officer to modify the assessment order treating the status of assessee as AOP instead of setting-aside the order of the Assessing Officer, when the provisions of Sec 263(1) gives the power to enhance or modify the assessment or cancelling the assessment and directing a fresh assessment."

T.C.A.No.750 of 2013:

"1. Whether on the facts and circumstances of the case, the Tribunal was right in law in upholding the order of the Commissioner of Income-Tax passed u/s.263 without appreciating that the assessment order passed by the Assessing Officer was neither erroneous nor prejudicial to interest of revenue?

2. Whether on the facts and circumstances of the case, the Tribunal was right in holding that applying the ratio of the decision of the Apex Court cited when a person is a partner in a

firm in his individual capacity as well as a representative of another firm, he should be counted as a single partner qua the firm and hence the Appellant was a validly constituted firm?

3. Whether on the facts and circumstances of the case, the Tribunal ought to have appreciated that when neither the firm of Deloitte Mumbai nor its partners were partner in the Appellant firm as per the decisions of the Supreme Court and when the partners who were chargeable to tax at the maximum marginal rate had been assessed on the remuneration received by them from the Appellant firm, the order passed by the Assessing Officer cannot be considered as prejudicial to the interest of the revenue?

4. Whether on the facts and circumstances of the case, the Tribunal was right in law in observing that the effort of the Appellant was to indirectly bring in Deloitte Mumbai as a Partner, which in effect concludes the issue against the Appellant and will effectively bind the hands of the Assessing Officer while doing the assessment afresh?"

3. Assessee is a firm of Chartered Accountants in Chennai formed under the partnership deed dated 22.02.1998. The firm was reconstituted vide a partnership deed dated 01.04.2007 with a total number of 20 partners. So far as it is relevant for the present purpose, one Mr.Mukund Dharmadhikari, a partner, was entitled to a share of 20.0530% of the

profits of the firm. The reconstituted firm continued to carry on the business, *inter alia*, of Accountants, Auditors, Tax Practitioners, etc.

4. Assessee as well as one M/s.Deloittee Haskins and Sells at Mumbai (Deloitte Mumbai) are participating firms of the network of Deloitte Haskins and Sells which is referred to as the National firm. All policy decisions affecting the participating firms needed the approval of the partners of the National firm. This was only to ensure consistency and uniformity of operations of all the participating firms. It did not alter the status or the number of partners or their *inter-se* agreement under the partnership deed of the individual participating firms.

5. Assessee filed its return of income for assessment year 2008-2009 on 30.09.2008 declaring a total income of Rs.17,70,69,972/- after deducting payment of salary to some of the partners totalling to Rs.3,23,50,000/-. While computing its total income, assessee claimed deduction of a sum of Rs.3,23,50,000/-, being salary paid to its partners,

under Section 40(b) of the Income Tax Act, 1961 (the Act). Correspondingly, the partners, who received salary from assessee, had offered the same to tax in their individual assessment under the head "Profits and gains of business or profession" and have been assessed to tax on the said income at the maximum marginal rate of 33.99%, which is the same rate at which the firm is being taxed.

6. The return of income was processed under Section 143(1) of the Act and later was selected for scrutiny and notice under Section 143(2) of the Act was issued. Notice under Section 142(1) was also issued calling for details, which were furnished by assessee. In the course of assessment proceedings, assessee had filed various details before the Assessing Officer, including the partnership deed and the amendment deed. The Assessing Officer passed the assessment order under Section 143(3) of the Act on 31.12.2010 determining assessee's total income at Rs.17,70,69,972/-. The Assessing Officer accepted assessee's status as a partnership firm after verifying the partnership deeds.

7. Assessee, thereafter, received a notice dated 29.02.2012 from the

Commissioner of Income Tax-IV (CIT), Chennai, issued under Section 263 of the Act. In the notice it is alleged that by amending the partnership deed to include one more partner (Mr.Mukund Dharmadhikari), the number of partners was beyond the prescribed limit of 20 partners and, therefore, the status of appellant had changed from a partnership firm to an Association of Persons (AOP). Therefore, salary paid to the partners amounting to Rs.3,23,50,000/- was not allowable as a deduction under Section 40(b) of the Act. Thereafter, the CIT, after considering the detailed submissions dated 19.03.2012 filed by assessee, passed an order dated 26.03.2012, in which, the CIT held that in view of the amendment of the partnership deed on 01.05.2007, Deloittee Mumbai has become a partner in the assessee firm through its representative Mr.Mukund Dharmadhikari; sharing of profits to the extent of Rs.267 lakhs with Deloitte Mumbai meant that the membership of assessee firm exceeded 20, which is the maximum limit under the settled law. He, therefore, directed the Assessing Officer to assess appellant in the status of AOP and disallow the salary paid to the partners of Rs.3,23,50,000/- as the same cannot be allowed as deduction under Section 40(b) of the Act.

8. Assessee carried this order in appeal before the ITAT. The ITAT, vide its order dated 04.07.2013 which is impugned in these appeals, made various observations and remanded the matter to the Assessing Officer to pass fresh assessment order.

9. Various submissions were made by learned Senior Counsel Shri Mistri and Shri Ravikumar on the stand taken by the CIT as well as the ITAT. In our view, we need not deal with all those submissions in detail because the whole case hinges on whether notice issued under Section 263 of the Act by the CIT was a valid notice. The point that requires to be considered is whether the CIT could have exercised its jurisdiction under Section 263 of the Act. That is the fulcrum. If our answer is that he could not have, we do not need to look into the subsequent developments and the orders, and even for that matter deal with the substantial questions of law which were framed by this court on 13.12.2024.

10. Section 263 of the Act reads as under:

"263. (1) The Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may call for and examine the record of any proceeding under this Act, and if he considers that any order passed therein by the Assessing Officer or the Transfer Pricing Officer, as the case may be, is erroneous in so far as it is prejudicial to the interests of the revenue, he may, after giving the assessee an opportunity of being heard and after making or causing to be made such inquiry as he deems necessary, pass such order thereon as the circumstances of the case justify, including,—

(i) an order enhancing or modifying the assessment or cancelling the assessment and directing a fresh assessment; or

(ii) *an order modifying the order under section 92CA; or*

(iii) *an order cancelling the order under section 92CA and directing a fresh order under the said section.*

Explanation 1.—For the removal of doubts, it is hereby declared that, for the purposes of this sub-section,—

(a) an order passed on or before or after the 1st day of June, 1988 by the Assessing Officer or the Transfer Pricing Officer, as the case may be, shall include—

(i) an order of assessment made by the Assistant Commissioner or Deputy Commissioner or the Income-tax Officer on the basis of the directions issued by the Joint Commissioner under section 144A;
(ii) an order made by the Joint Commissioner in exercise of the powers or in the performance of the functions of an Assessing Officer or the Transfer Pricing Officer, as the case may be, conferred on, or assigned to, him under the orders or directions issued by the Board or by the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or Principal Commissioner or Commissioner authorised by the Board in this behalf under section 120;
(iii) an order under section 92CA by the Transfer Pricing Officer;

(b) "record" shall include and shall be deemed always to have included all records relating to any proceeding under this Act available at the time of examination by the Principal

Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner;

(c) where any order referred to in this sub-section and passed by the Assessing Officer or the Transfer Pricing Officer, as the case may be, had been the subject matter of any appeal filed on or before or after the 1st day of June, 1988, the powers of the Principal Commissioner or Commissioner under this sub-section shall extend and shall be deemed always to have extended to such matters as had not been considered and decided in such appeal.

Explanation 2.—For the purposes of this section, it is hereby declared that an order passed by the Assessing Officer or the Transfer Pricing Officer, as the case may be, shall be deemed to be erroneous in so far as it is prejudicial to the interests of the revenue, if, in the opinion of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner,—

(a) the order is passed without making inquiries or verification which should have been made;
(b) the order is passed allowing any relief without inquiring into the claim;
(c) *the order has not been made in accordance with any order, direction or instruction issued by the Board under section 119 ; or*
(d) the order has not been passed in accordance with any decision which is prejudicial to the assessee, rendered by the jurisdictional High Court or Supreme Court in the case of the assessee or any other person.

Explanation 3.—For the purposes of this section, "Transfer Pricing Officer" shall have the same meaning as assigned to it in the Explanation to section 92CA.

(2) No order shall be made under sub-section (1) after the expiry of two years from the end of the financial year in which the order sought to be revised was passed.

(3) Notwithstanding anything contained in sub-section (2), an order in revision under this section may be passed at any time in the case of an order which has been passed in consequence of, or to give effect

to, any finding or direction contained in an order of the Appellate Tribunal, the High Court or the Supreme Court.

Explanation.—In computing the period of limitation for the purposes of sub-section (2), the time taken in giving an opportunity to the assessee to be reheard under the proviso to section 129 and the period commencing on the date on which stay on any proceeding under this section was granted by an order or injunction of any court and ending on the date on which certified copy of the order vacating the stay was received by the jurisdictional Principal Commissioner or Commissioner shall be excluded."

11. Under Section 263 of the Act, the Commissioner is empowered to call for and examine the record of any proceeding under the Act and if he considers that any order passed therein by the Income Tax Officer (ITO) is erroneous in so far as it is prejudicial to the interests of the revenue, he may, after giving assessee an opportunity of being heard and after making or causing to be made such inquiry as he deems necessary, pass such order thereon as the circumstances of the case justify, including an order enhancing or modifying the assessment or cancelling the assessment and directing a fresh assessment. The Commissioner, in the present case, has purported to act in exercise of this power on the ground that the order of the Assessing Officer was in his view erroneous and prejudicial to the interests of the revenue.

12. Paragraph 5 of the notice dated 29.02.2012 issued under Section 263 of the Act reads as under:

> *"5. Since the scrutiny assessment order dated 31/12/2010 has been passed without treating you as the AOP and consequently disallowing the salary paid to partners of Rs.3,23,50,000/-, I am of the prima facie view that the said assessment is erroneous and prejudicial to the interest of revenue. ....."*

13. We agree with Shri Mistri that in the notice there is no explanation as to why the order of the Assessing Officer was prejudicial to the interests of the revenue. It does not suggest in what way there is any prejudice to the interests of the Revenue. Even if prejudice to the Revenue is to be reckoned in terms of the actual loss to the exchequer, no figures have been given. This is an indication that, as on that date, the CIT had no clear idea as to what the difference in tax effect would have been if instead of taxing the assessee as partnership firm, the assessee was taxed as AOP.

14. As held by a Co-ordinate Bench of this Court in ***Venkata Krishna***

Rice Company v. Commissioner of Income-tax[1], Section 263 is a special power which has no parallel in any other statute or legal system. It is an extraordinary revisional power. It is also *sui generis* in its nature and in the occasion for its exercise, it is to be employed not as a jurisdictional corrective or as a review of a subordinate's order in exercise of supervisory power. It is, on the contrary, to be invoked and employed only for the purpose of setting right distortions and prejudices to the revenue, which is a unique conception which has got to be understood in the context of and in the interests of the revenue administration. The power is intended to maintain the tone of the revenue administration and the morale of the officers manning it. Such a power cannot, in any manner, be equated to or regarded as approaching in any way the appellate jurisdiction or even the ordinary revisional power conferred on the Commissioner under Section 264 of the Act.

15. In *Venkata Krishna Rice Company* (supra), the Co-ordinate Bench of this Court held as under:

> *"11. Section 263 of the Act empowers the Commissioner to call for and examine the record of any proceeding under the Act and if he*

1[1987] 30 Taxman 528 (Madras)

considers that any order passed therein by the Income-tax Officer is erroneous in so far as it is prejudicial to the interests of the Revenue, he may, after giving the assessee an opportunity of being heard and after making or causing to be made such enquiry as he deems necessary, pass such order thereon as the circumstances of the case justify, including an order enhancing or modifying the assessment, or cancelling the assessment and directing a fresh assessment. The Commissioner of Income-tax, in the present case, had purported to act in exercise of this power on the ground that the order of the Income-tax Officer, although in accordance with the law, was, in his view, prejudicial to the interests of the Revenue. This view of the Commissioner of Income-tax that the order passed by the Income-tax Officer was erroneous and prejudicial to the interests of the Revenue, was endorsed by the Tribunal in their order. The question is whether the view expressed by the Commissioner of Income-tax and the Tribunal are based on a correct understanding of the enabling provisions of section 263 of the Income-tax Act and of the nature of the order of assessment passed by the Income-tax Officer.

12. Section 263 of the Income-tax Act is a provision in sub-chapter E of Chapter XX of the Income-tax Act. This Chapter deals with appeals and revision. Section 246 provides a right of appeal to an assessee, against orders passed by the Income-tax Officer, to the Appellate Assistant Commissioner. Section 252 provides a further appeal to the Tribunal against the orders passed by the Appellate Assistant Commissioner in appeal. In the sub-chapter of Chapter XX relating to revision by the Commissioner apart from section 263, there is yet another provision under section 264 which confers revisional power on the Commissioner of Income-tax. This latter revisional power under section 264 enables the Commissioner, either suo motu or on application by assessee, to interfere in revision with the orders passed by the authorities subordinate to him. The expression "authorities subordinate to him" would include not only the Income-tax Officer, but also the Appellate Assistant Commissioner and the Inspecting Assistant Commissioner. It is, however, specifically stated in section 264 that this power of revision under section 264 is available only against an order other than an order which is subject to revision under section 263.

13. In the context of the above provisions, the power of the Commissioner of Income-tax under section 263 has to be judged on the words employed therein. The language used by the Legislature in section 263 is to the effect that the Commissioner may interfere in revision if he considers that the order passed by the Income-tax

Officer is erroneous in so far as it is prejudicial to the interests of the Revenue. It is quite clear from the above phrasing that two things must co-exist in order to give jurisdiction to the Commissioner, to interfere in revision. The order of the Income-tax Officer in question must not only be erroneous but also the error in the Income-tax Officer's order must be of such a kind that it can be said of it that it is prejudicial to the interests of the Revenue. In other words, merely because the officer's order is erroneous, the Commissioner cannot interfere. Again, merely because the order of the officer is prejudicial to the interests of the Revenue, then again, that is not enough to confer jurisdiction on the Commissioner to interfere in revision. These two elements must co-exist. This construction of the section has been stated and evolved from the statutory language by a decision of the Karnataka High Court in CIT v. T. Narayana Pai, [1975] 98 ITR 422.

14. The learned counsel for the Department submitted that the order of the Income-tax Officer in the present case was prejudicial to the interests of the Revenue since by taxing first the share income of the assessee who was a member of the association, the officer thereby disabled the Department from getting at the total income of the association of persons as such for being taxed at the higher rate appropriate thereto, resulting thereby in loss of revenue. We find it hard to accept this argument for more than one reason. In the first place, there are no materials stated in the order of the Commissioner of Income-tax to suggest in what way there is any prejudice to the interests of the Revenue. Even if prejudice to the Revenue is to be reckoned in terms of the actual loss to the exchequer, no figures have been given in the order of the Commissioner of Income-tax to suggest that the average rate of income-tax on the total income of the association of persons would be far higher than the average rate of income-tax applied to the share income from the joint venture in this assessment year in so far as the present assessee is concerned and in so far as the other members of the association are concerned. Indeed, in one portion of the order, the Commissioner had dealt with the argument advanced on behalf of the assessee to the effect that even if the joint venture is to be assessed as such, the tax effect may not necessarily be more, While noticing this contention of the assessee, the Commissioner had observed that this question as to whether the tax effect would be more or less may be raised when the assessment of the association of persons is taken up. This is an indication that the Commissioner had not, as on that date, any clear idea as to what the difference in tax effect would have been if, instead of taxing the share income of all the members in their respective hands, the Department had first made an assessment on the total income of the association,

as such, in respect of the joint venture business. We cannot, therefore, readily accept the thesis that the Income-tax Officer's order has been shown to be prejudicial to the interests of the Revenue, by reference to any acceptable materials.

15. Even otherwise, the argument of the Department's learned counsel is unsound as a matter of construction of section 263. As we earlier observed, it is essential for the Commissioner to find not only that the order of the Income-tax Officer in question proposed to be revised is prejudicial to the interests of the Revenue but also that it is erroneous, and, therefore, prejudicial in that sense. We have earlier pointed out how the Commissioner himself had clearly conceded the position that the order of assessment made by the Income-tax Officer is in accordance with the law. We fail to understand how an assessment, which is in accordance with the law, can at all be regarded as erroneous, let alone prejudicial to the interests of the Revenue. We think it is axiomatic that any assessment, which is in accordance with the law cannot, at the same breath, be regarded as erroneous, and if the assessment is not erroneous, it cannot be prejudicial to the interests of the Revenue or for that matter to the interests of the assessee as well. This is on the principle that nothing can be prejudicial either to the Department or to the assessee if it is in accordance with the law, unless it be that the law itself is being questioned on some ground or other, which objection is available under some provision or other of the Constitution. In this case, when the Commissioner had accepted the position that the Income-tax Officer was at liberty to tax the share income from the joint venture in the hands of the assessee as a member of the association, then it follows that that can be regarded as prejudicial to the interests of the Revenue.

16. In our judgment, the expression "prejudicial to the interests of the Revenue" is not to be construed in a petty-fogging manner, but must be given a dignified construction. It may be noted that the use of the expression "Revenue", in our opinion, is significant It denotes some kind of abstraction or symbol in the same sense in which the expression "crown" is used to distinguish it from any person enthroned. The interests of the Revenue is not to be equated to rupees and paise, merely. There is a biblical saying that we do not live by bread alone. Varying this saying, it may be said that the Revenue does not live by tax alone. In this sense, therefore, the interests of the Revenue are not tied up merely with realising as much Revenue as

possible, willy nilly, merely looking to the productivity aspect of taxation. The jurisdiction of the Commissioner under section 263 is undoubtedly a supervisory jurisdiction. It is intended for interference in special cases to counteract orders which are erroneous as well as prejudicial to the interests of the Revenue. In this context, therefore, the expression "prejudicial to the interests of the Revenue" must be regarded as involving a conception of acts or orders which are subversive of the administration of revenue. There must be some grievous error in the order passed by the Income-tax Officer, which might set a bad trend or pattern for similar assessments, which on a broad reckoning, the Commissioner might think to be prejudicial to the interests of Revenue administration. There might be cases where the Commissioner might wish to interfere with an order of the Income-tax Officer in order to safeguard the fair name and reputation of the Income-tax Department without any thought of going into the particular aspects of the assessment Assessments which are mala fide, politically and communally motivated may be, however, set aside as being prejudicial to the interests of the Revenue. It is unnecessary, for us to illustrate the point any further. All that we wish to observe is that the scope of the interference under this section is not to set aside merely unfavourable orders and bring to tax some more money to the treasury. Nor is the section meant to get at sheer escapement of revenue which, as is well known, is taken care of by provisions elsewhere, in the Act such, for instance, as section 147 of the Act. The prejudice must be prejudice to the revenue administration.

17. The mainspring of action for the Commissioner of Income-tax in the present case would seem to be really to circumvent the position of law which has become well-settled in the matter of assessment of an association and/or the members thereof. Since the Income-tax Officer's order makes it difficult for the Department to get at the total income of the association of persons, it had to be removed out of the way. If it is removed out of the way, the resulting position would be as though there had been no such order even in the first instance, and the field may be clear for the exercise of option once more, as though the Department can begin from the very beginning. This intention to circumvent the clear consequence of the law, as laid down by the courts, is not definitely a purpose which could actuate the Commissioner of Income-tax under section 263 of the Act. This is because, far from the Income-tax Officer's order being prejudicial to the interests of the Revenue, the present action of the Commissioner in seeking to set aside that order is really prejudicial to the Revenue since it is prejudicial to the law laid down by the courts.

.....

20. The principle laid down in this judgment of the Supreme Court cannot, however, be adopted for the purpose of clothing the Commissioner of Income-tax with a power of interference with the exercise of the option made by the Income-tax Officer in the matter of assessment of the members of an association in preference to an assessment to be made on the association itself. In the first place, the basis of the Supreme Court's ruling was that an appeal was but a rehearing and the powers of the appellate authority are so equal with those of the assessing authority, in the first instance. In coming to this conclusion, the Supreme Court were only adopting the general law relating to the powers of the appellate authorities under the Civil Procedure Code, and other enactments dealing with the powers of appellate courts. The Commissioner of Income-tax acting under section 263 is not, however, an appellate authority, by any means. As we had earlier observed, the power conferred on him by this section is in the nature of a supervisory power. We have referred to another revisional power under section 264 which might be regarded as a regular revision. Section 263, however, is a special power, which, so far as we know, has no parallel in any other statute or legal system. It is an extraordinary revisional power. It is also sui generis, in its nature, and in the occasion for its exercise, it is to be employed not as a jurisdictional corrective or as a review of a subordinate's order in exercise of supervisory power. It is, on the contrary, to be invoked and employed only for the purpose of setting right distortions and prejudices to the Revenue, which, as we have endeavoured to point out earlier, is a unique conception which has got to be understood in the context of and in the interests of revenue administration. The power, as we conceive it, is intended to maintain the tone of the revenue administration and the morale of the Officers manning it. Such a power cannot, in any manner, be equated to, or regarded as approaching in any way the appellate jurisdiction or even the ordinary revisional power conferred on the Commissioner under section 264 of the Act.

21. For all the above reasons, we hold that the Commissioner of Income-tax, in this case, was not justified in interfering with the order of the Income-tax Officer, under section 263 of the Act. The Tribunal's order, confirming the Commissioner's decision, was based on a misconception of the provisions of section 263 and the nature and

finality of the order passed by the Income-tax Officer. On this basis, our answer to the question of law is in the negative and in favour of the assessee. The assessee will have its costs. Counsel's fee Rs. 500."

[emphasis supplied]

16. It is quite clear from Section 263 of the Act that two things must co-exist in order to give jurisdiction to the Commissioner to interfere, the order of the ITO in question must not only be erroneous, but the error in the ITO's order must be of such a kind that it can be said of it that it is prejudicial to the interests of the revenue.

17. In the instant case, there is nothing stated in the notice issued under Section 263 of the Act to suggest in what way there is any prejudice to the interests of the revenue. No figures have been given in the notice to suggest that the average rate of income tax on the total income of the AOP would be far higher than the average rate of income tax applied to the partnership firm. We agree with Shri Mistri's submission that even assuming for the moment it is accepted that the Assessing Officer could not have assessed assessee as a partnership firm, still he has not caused any prejudice to the interests of the revenue in passing the assessment order.

18. Two statements tendered by Shri Mistri, learned Senior Counsel appearing for assessee, which were not contradicted by Revenue, are reproduced below:

"If the Revenue's stand of disallowing remuneration paid by M/s.Deloitte Haskins & Sells, Chennai (Appellant) to its partners is upheld:

1. Tax payable by the Appellant if remuneration paid by it to its partners is disallowed:

Particulars	***Amount (in Rs.)***	***Amount (in Rs.)***
Income as assessed for tax purposes	17,70,69,972	
Add: Disallowance of remuneration to partners u/s.40(b)	3,23,50,000	
Total income		20,94,19,972
Tax on Rs.20,94,19,972 at 33.99% [A]		7,11,81,848

2.Tax on individual partners on the remuneration disallowed in computing the income of the Appellant:

Partner	**Remuneration (in Rs.)**
A.C. Gupta	29,99,000
B. Mala	19,86,000

Partner	**Remuneration (in Rs.)**
Ramaratnam	9,50,000
Bhavani Balasubramanian	14,38,000
C.R.Rajagopal	9,93,000
Ganesh Swaminathan	8,90,000
Geetha Suryanarayan	10,96,000
K. Sairam	21,50,000
K. Rajasekhar	16,80,000
K.R. Sekar	11,30,000
M.Lakshminarayan	26,03,000
M.K. Ananthanarayan	22,95,000
M. Ramachandran	13,78,000
Mukund Dharmadhikari	64,88,000
P.R. Ramesh	-
S. Thirumalai	-
Srikumar	21,50,000
S. Ravi Veeraraghavan	12,67,000
Sundaresan	-
V. Balaji	8,57,000
Total	3,23,50,000

No tax is payable by the partners on the remuneration disallowed in computing the income of the Appellant [B]	Nil

3. Total tax paid by the Appellant and the partners [A+B] = Rs.7,11,81,848/-."

"I. Stand as per M/s.Deloitte Haskins & Sells, Chennai

1. Income offered to tax, rate of tax and total tax paid by the Appellant.

Particulars	***Amount (in Rs.)***
Income assessed for tax purposes (after being allowed deduction of remuneration to partners u/s.40(b) of Rs.3,23,50,000/-	17,70,69,972
Rate of tax	33.99%
Total tax paid by the Firm [A]	6,01,86,083

2. Consequential tax paid by individual partners of the Appellant on remuneration paid to the partners.

Partner	***Remuneration (in Rs.)***
A.C. Gupta	29,99,000
B. Mala	19,86,000
Ramaratnam	9,50,000
Bhavani Balasubramanian	14,38,000
C.R.Rajagopal	9,93,000
Ganesh Swaminathan	8,90,000
Geetha Suryanarayan	10,96,000
K. Sairam	21,50,000
K. Rajasekhar	16,80,000
K.R. Sekar	11,30,000
M.Lakshminarayan	26,03,000
M.K. Ananthanarayan	22,95,000
M. Ramachandran	13,78,000
Mukund Dharmadhikari	64,88,000
P.R. Ramesh	-
S. Thirumalai	-
Srikumar	21,50,000

Partner	***Remuneration (in Rs.)***
S. Ravi Veeraraghavan	12,67,000
Sundaresan	-
V. Balaji	8,57,000
Total	3,23,50,000

The tax rate for partners would be maximum marginal rate i.e. 33.99% since income of all partners exceed Rs.2.50 lakhs. [3,23,50,000 * 33.99%] [B]	Rs.1,09,95,765

3. Total tax paid by the Appellant and the partners [A + B] = Rs.7,11,81,848/-."

Therefore, if revenue's stand of disallowing remuneration paid by assessee to its partners is upheld, then the total tax that would be paid by assessee and its partners would amount to Rs.7,11,81,848/-. If the stand of assessee is accepted, still the tax paid collectively by the firm and the partners in their individual assessment would amount to Rs.7,11,81,848/-. Therefore, there is absolutely no prejudice that could be stated to have been caused to the revenue, because, if it was so, the CIT in the notice issued under Section 263 of the Act would have articulated the figures.

19. The CIT stated that by amending the partnership deed to include

one more partner (Mr.Mukund Dharmadhikari) would take the number of partners beyond 20 partners and the status of appellant would change from a partnership firm to an AOP. According to CIT, Mr.Mukund Dharmadhikari was acting in two capacities, i.e., on his own behalf and as a partner in a representative capacity of Deloitte Mumbai and, therefore, should be counted as two in numbers thereby adding one more partner to the existing strength of 20 partners. The said stand taken by the CIT is erroneous.

20. As held by the Apex Court in ***Rashik Lal and Company v. Commissioner of Income-tax***[2], a firm is a compendious way of describing the individuals constituting the firm. The Court held that Section 4 of the Indian Partnership Act spoke of persons who had entered into partnership with one another and it could only be individuals and not a body of persons and a body of persons like a firm could not enter into partnership with other individuals.

21. In *Rashik Lal and Company* (supra), assessee was a partnership

2 [1998] 96 Taxman 16 (SC)

firm carrying on a number of businesses, including sale and purchase of various commodities as well as mining. The partners of the firm were (1) Popatlal Devram; (2) Jayantilal Jagmal; (3) Pragji Devram; (4) Ratilal Odhavji; (5) Rashiklal P. Rahor. Popatlal is Rashiklal's father. On 01.04.1967, there was an oral partition of the share of Popatlal in the firm amongst Popatlal, his wife and his two sons, including Rashiklal. The assets of Rashiklal continued to be invested in the partnership firm. Rashiklal was karta of a small Hindu Undivided Family (HUF). On 17.10.1978, there was an agreement between Rashiklal and the firm Rashik Lal and Company that Rashiklal will receive 37 paise per tonne of mineral sold by the firm. In the assessment year 1980-81 Rashiklal received a sum of Rs.28,579/- as commission. The firm claimed deduction of this amount from its income. The claim was negatived by the ITO. The AAC allowed the appeal holding that commission was paid to Rashiklal in his individual capacity and not as karta of the smaller HUF, which is the partner of the firm. Since payment was not made to the partner, Section 40(b) of the Act was not attracted. The amount of commission paid to Rashiklal could not be included in the income of the firm. On further appeal by the revenue, the Tribunal held that Section 40(b) clearly applied in this case. Payment

to Rashiklal will be payment to a partner. The partnership firm could not claim any deduction for this payment from its income. The High Court on reference held that there was clear material that Rashiklal had invested his joint family funds to enter into the partnership. Payment was made to Rashiklal who was a partner. Accordingly, the Tribunal was correct in coming to the conclusion that Section 40(b) will be applicable in this case. The firm was not entitled to claim any deduction on account of payment of commission to one of its partners.

Assessee took the stand that remuneration was paid of Rs.28,579/- as commission to Rashiklal in his individual capacity and not while representing the HUF and the real partner of the firm was the HUF. Therefore, the payment to Rashiklal did not amount to payment of commission to the HUF which was the real partner and, therefore, will not fall within the mischief of Section 40(b) of the Act, which at the material time provided that 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 shall not be deducted in computing the income chargeable under the profits and gains of business or profession. The Apex Court dismissed the

stand of assessee and held that the firm is a compendious way of describing the individuals constituting the firm and an HUF directly or indirectly cannot become a partner of a firm, because the firm is an association of individuals.

22. Paragraphs 2 to 6 of *Rashik Lal and Company* (supra) read as under:

> *"2. The assessee is a partnership firm carrying on a number of businesses including sale and purchase of various commodities as well as mining. The partners of the firm were:*
>
> *(1) Popatlal Devram*
> *(2) Jayantilal Jagmal*
> *(3) Pragji Devram*
> *(4) Ratilal Odhavji*
> *(5) Rashiklal P. Rathor*
>
> *Popatlal is Rashiklal's father. On 1-4-1967, there was an oral partition of the share of Popatlal in the firm amongst Popatlal, his wife and his two sons including Rashiklal. The assets of Rashiklal continued to be invested in the partnership firm. Rashiklal was the Karta of a smaller HUF. On 17-10-1978, there was an agreement between Rashiklal and the firm Rashiklal and Company that Rashiklal will receive 37 paise per tonne of mineral sold by the firm. In the Assessment Year 1980-81 Rashiklal received a sum of Rs 28,579 as commission. The firm claimed deduction of this amount from its income. The claim was negatived by the Income Tax Officer. The Appellate Assistant Commissioner allowed the appeal holding that the commission was paid to Rashiklal in his individual capacity and not as Karta of the smaller HUF which is the partner of the firm. Since the payment was not made to the partner, Section 40(b) of the Income Tax Act was not attracted. The amount of commission paid to Rashiklal could not be included in the income of the firm. On further appeal by the Revenue, the Tribunal held that Section 40(b) of the Income Tax Act clearly applied in this case. Payment to Rashiklal will be payment to a*

partner. The partnership firm could not claim any deduction for this payment from its income. The High Court on reference held that there was clear material that Rashiklal had invested his joint family funds to enter into the partnership. Payment was made to Rashiklal who was a partner. Accordingly, the Tribunal was correct in coming to the conclusion that Section 40(b) will be applicable in this case. The firm was not entitled to claim any deduction on account of payment of commission to one of its partners.

3. The firm has come up in appeal against the judgment of the High Court. Section 40(b) of the Income Tax Act, at the material time, stood as under:

> *"Amounts not deductible.- Notwithstanding anything to the contrary in Sections 30 to 39, the following amounts shall not be deducted in computing the income chargeable under the head 'profits and gains of business or profession',-*
>
> *(a)****
>
> *(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."*

In our view the answer to the question raised in this case is self-evident. There is no dispute that Rashiklal was a partner of the assessee-firm. For assessment of the firm under the head profits and gains of business and profession any payment of commission by the firm to any partner of the firm will not be allowed as deduction. The firm has paid a commission of Rs 28,579 to Rashiklal and has claimed that amount as deduction. Such deduction is not permissible in clear terms of Section 40(b).

The language of the section is simple and clear. But to complicate the matter an argument was sought to be made that Rashiklal had not joined the firm as an individual but was really representing an HUF. The real partner of the firm was the HUF. The payment of Rashiklal did not amount to payment of commission to the HUF which was the real partner. Therefore, the amount of commission paid by the firm to a non-partner or a partner who had joined the firm in a representative capacity, will not fall within the mischief of Section 40(b).

4. We are unable to uphold this contention for a number of reasons. A firm is a compendious way of describing the individuals constituting the firm. An HUF directly or indirectly cannot become a partner of a

firm because the firm is an association of individuals.

5. In the case of Dulichand Laxminarayan v. CIT [(1956) 29 ITR 535 : AIR 1956 SC 354] it was held by a Bench of three Judges of this Court that a firm is not a "person" and as such was not entitled to enter into a partnership with another firm or an HUF or an individual. In that case, an individual, a joint family and three firms purported to enter into a partnership. The agreement of partnership was signed by the individual partner, the Karta of the joint family and one partner each of the three firms. The firm applied for registration under Section 26-A of the Income Tax Act. The application was signed by the aforesaid five individuals. This Court held that there could be no question of granting registration to a partnership purporting to be one between three firms, an HUF and an individual. In coming to this conclusion, this Court relied on the provisions of the Indian Partnership Act wherein, "partnership", "partner", "firm" and "firm name" were defined in the following manner:

> *"4. Definition of 'partnership', 'partner', 'firm' and 'firm name'.— 'Partnership' is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.*

Persons who have entered into partnership with one another are called individually 'partners' and collectively 'a firm', and the name under which their business is carried on is called the 'firm name'."

S.R. Das, C.J. speaking for the Court observed:

> *"This section clearly requires the presence of three elements, namely, (1) that there must be an agreement entered into by two or more persons; (2) that the agreement must be to share the profits of a business; and (3) that the business must be carried on by all or any of those persons acting for all. According to this definition 'persons' who have entered into partnership with one another are collectively called a 'firm' and the name under which their business is carried on is called the 'firm name'. The first question that arises is as to whether a firm as such can enter into an agreement with another firm or individual. The answer to the question would depend on whether a firm can be called a 'person'."*

Das, C.J., thereafter, went on to examine the meaning of the word "person" in the Partnership Act. It noted that "person" had not been defined in the Partnership Act. However, the General Clauses Act, 1897, had defined 'person' in Section 3(42) as under:

> *"(42) person' shall include any company or association or body of individuals, whether incorporated or not;"*

After referring to the definition of 'person' in the General Clauses Act, Das, C.J. observed that the firm was not a company but was certainly an association or body of individuals.

6. The Court, however, after examining the scheme of the Partnership Act and the corresponding provisions of the English law on the subject, held that the definition given to "person" by the General Clauses Act could not be extended to the Partnership Act having regard to the various provisions of that Act. The Court concluded:

> *"It is clear from the foregoing discussion that the law, English as well as Indian, has, for some specific purposes, some of which are referred to above, relaxed its rigid notions and extended a limited personality to a firm. Nevertheless, the general concept of partnership, firmly established in both systems of law, still is that a firm is not an entity or 'person' in law but is merely an association of individuals and a firm name is only a collective name of those individuals who constitute the firm."*
>
> *(emphasis supplied)*

The view of this Court was that when Section 4 of the Partnership Act spoke of "persons" who had entered into partnership with one another it could only be individuals and not a body of persons. A body of persons like a firm could not enter into partnership with other individuals."

23. In the circumstances, by no stretch of imagination can Deloitte Mumbai be added as a partner of assessee firm.

24. In such view of the matter, the questions of law, as framed in both the appeals, are answered accordingly.

Appeal of revenue (TCA No.987 of 2013) is dismissed and the appeal of assessee (TCA No.750 of 2013) is allowed. There shall be no order as to costs. Consequently, interim application stands closed.

(K.R.SHRIRAM, CJ.) (SUNDER MOHAN, J.)
10.06.2025

Index : Yes
Neutral Citation : Yes
bbr

To:

1. The Assistant Registrar
   Income Tax Appellate Tribunal
   "D" Bench, Chennai.

2. The Commissioner of Income Tax-IV,
   Chennai.

3. The Deputy Commissioner of Income Tax,
   Circle-I, Chennai-600 034.

4. The Assistant Commissioner of Income Tax,
   Circle-XV,
   Chennai-600 034.

THE HON'BLE CHIEF JUSTICE
AND
SUNDER MOHAN,J.

bbr

TCA Nos.750 and 987 of 2013

10.06.2025