THE HIGH COURT OF JUDICATURE AT MADRAS

DATE: 23.12.2020

Order Reserved on: *21.12.2020*	*Order delivered on:* *23.12.2020*

CORAM :

THE HONOURABLE MR.JUSTICE T.S.SIVAGNANAM
AND
THE HONOURABLE MRS.JUSTICE V.BHAVANI SUBBAROYAN

Tax Case Appeal No.388 of 2019

Mr.Anandkumar
(PAN: ABQPK0805N) ...Appellant

-vs-

The Assistant Commissioner of Income Tax,
Circle-2, Salem.....Respondent

PRAYER: Tax Case Appeal filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal Chennai 'A' Bench, dated 30.01.2019 in ITA No.573/CHNY/2018 for the Assessment year 2012-13.

For Appellant : Mr.R.Sivaraman

For Respondent : Mr.M.Swaminathan
Senior Standing Counsel
Assisted by Ms.V.Pushpa
Junior Standing Counsel

JUDGMENT

(Judgment was delivered by T.S.Sivagnanam, J.)

This appeal filed by the assessee under Section 260A of the Income Tax Act, 1961 ('the Act' for brevity) is directed against the order dated 30.01.2019 passed by the Income Tax Appellant Tribunal, 'A' Bench, Chennai (hereinafter referred to as 'the Tribunal') in I.T.A.No.573/CHNY/2018 for the assessment year 2012-13.

2.The present appeal has been filed raising the following substantial questions of law:

> *"A. Whether, on the facts and circumstances of the case, the Appellate Tribunal was right in law in holding that interest and salary received by the assessee from firms in which he was a partner cannot be construed as business income u/s. 28(v) and therefore not eligible for applying the presumptive interest rate of 8% under section 44AD of the Act?*
>
> *B. Whether on the facts and circumstances of the case, the Appellate Tribunal is right in law in holding that only remuneration and salary, received from a firm, to the extent of eligible under clause (b) of Section 40 of the Act, would be considered as profits and gains of business or profession of the recipient partner?*

3.The assessee is an individual, a partner in M/s.Kumbakonam

Jewellers, M/s.ANS Gupta & Sons and M/s.ANS Gupta Jewellers. The assessee filed his return of income for the assessment year under consideration admitting a total income of Rs.43,53,066/-. The assessment was selected for scrutiny and it was finalized under Section 143(3) of the Act by order dated 03.03.2015 disallowing the claim made by the assessee under Section 44AD of the Act. While filing the return of income, the assessee had applied the presumptive rate of tax at 8% under Section 44AD and returned Rs.4,68,240/- as income from the remuneration and interest received from the partnership firm. The Assessing Officer did not agree with the assessee and opined that Section 44AD is available only for an eligible assessee engaged in an eligible business and that the assessee was not carrying on business independently but only a partner in the firm. Further the assessee did not have any turnover and receipts of account of remuneration and interest from the firms cannot be construed as gross receipts mentioned in Section 44AD of the Act. Aggrieved by the assessment order dated 03.03.2015, the assessee filed an appeal before the Commissioner of Income Tax (Appeals), Salem [CIT(A)]. The said appeal was dismissed by order dated 22.12.2017. Aggrieved by the same, the

assessee preferred appeal before the Tribunal which was dismissed by the impugned order.

4.We have elaborately heard Mr.R.Sivaraman, learned counsel appearing for the appellant/assessee and Mr.M.Swaminathan, learned Senior Standing Counsel appearing for the respondent/revenue assisted by Ms.V.Pushpa, learned Junior Standing Counsel.

5.Section 44AD of the Act is a special provision for computing profits and gains of business on presumptive basis which was introduced in the Act with effect from 1993. Sub-section (1) of Section 44AD states that Notwithstanding anything to the contrary contained in sections 28 to 43C, in the case of an eligible assessee engaged in an eligible business, a sum equal to eight per cent of the total turnover or gross receipts of the assessee in the previous year on account of such business or, as the case may be, a sum higher than the aforesaid sum claimed to have been earned by the eligible assessee, shall be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or

profession". Sub-section (2) of Section 44AD states that any deduction allowable under the provisions of sections 30 to 38 shall, for the purposes of sub-section (1), be deemed to have been already given full effect to and no further deduction under those sections shall be allowed. The explanation found in section 44AD defines eligible assessee as well as the eligible business. Under Clause (a) of the explanation which defines eligible assessee to mean an individual, Hindu undivided family or a firm who is a resident but not a limited liability partnership firm. Eligible business has been defined in clause (b) to mean (i) any business except the business of plying, hiring or leasing goods carriages referred to in Section 44AE and (ii) whose total turnover or gross receipts in the previous year does not exceed an amount of Rs.2 Crores.

6. At the outset, it needs to be noted that Section 44AD is a special provision and it carves out an exception in respect of certain businesses and from Clause (b)(ii) of the explanation under Section 44AD which prescribes the limit of Rs.2 Crores as total turnover or gross receipts is a clear indication that this provision is meant for small businesses. Further Section

44AD(1) commences with a *non-obstante* clause and states that notwithstanding anything to the contrary containing in Section 28 to 43C in the case of an eligible assessee engaged in an eligible business a presumptive rate of tax at 8% can be adopted. One more important aspect is that 8% is computed on the basis of the total turnover or gross receipts of the assessee. Therefore, four important aspects to be noted in Section 44AD are that the assessee who claim such a benefit of the presumptive rate of tax should an eligible assessee as defined in Clause (a) of the explanation to Section 44AD, he should be engaged in an eligible business as defined in Clause (b) of Section 44AD and 8% of the presumptive rate of tax is computed on the total turnover or gross receipts. Therefore, to avail the benefit of such provision, the assessee has to necessarily satisfy the Assessing Officer that they come within the frame work of Section 44AD. The assessee's case is that he has received the remuneration and interest from the partnership firm and according to him this remuneration and interest received are gross receipts and they being less than Rs.1 Crore arising from an eligible business, he is entitled to claim the benefit of presumptive rate of tax. Further, the assessee's contention is that he is an

eligible assessee and the remuneration and interest received from the partnership firm being gross receipts from an eligible business, the Assessing Officer ought to have allowed the benefit under Section 44AD of the Act.

7.The learned counsel elaborated on the above submission and referred to the decision of the Hon'ble Supreme Court in the case of ***Commissioner of Income Tax vs. Ramniklal Kothari [(1969) 74 ITR 57(SC)]*** and the decision in the case of ***Munjal Sales Corporation vs. Commissioner of Income Tax, Ludhiana [(2008) 168 Taxman 43(SC)]***. The learned counsel also referred to the Budget Speech of Hon'ble Finance Minister delivered on 29.02.1992, Circular issued by the CBDT [Central Board of Direct Taxes] bearing Circular No.636 dated 31.08.1992, Copy of the Guidance note of Tax Audit under Section 44AB of the Act and the Copy of the Memorandum explaining the provisions of the Finance Bill, 1992. To buttress his submission that the assessee is an eligible assessee, the learned counsel referred to Section 44AD(6)(i), (ii) and (iii) of the Act.

8.The learned Senior Standing Counsel for the revenue would submit

that the assessee is not doing any business, but the firm is carrying on business in which the assessee is a partner and therefore, the condition that it should arise from an eligible business is not satisfied. In the Statement issued by the ICAI, it has been stated that the word "turnover" for the purpose of the clause may be interpreted to mean the aggregate amount for which sales are effected or services rendered by an enterprise, whereas in the case of the assessee, neither he has performed any sales nor rendered any services but merely receives remuneration and interest from the firm and the partnership firm has already debited the remuneration and interest in the their profit and loss account and therefore, it cannot be taken as turnover or gross receipts. Further, the revenue would contend that the remuneration and interest is not excessive, it is the total net income of the assessee because of the expenses to earn and this income has already been claimed in the hands of the firm's profit and loss account. Therefore, the claim of the assessee under Section 44AD is wholly incorrect and therefore, rightly negatived. Further, the CIT(A) also considered the facts and correctly held that the assessee has received the remuneration and interest from firms in which he is a partner and the provisions of Section 44AD will not be

applicable to the assessee. The Tribunal also re-considered the facts and held that Section 44AD was to help small businesses to comply with the taxation provisions and the partners remuneration and interest is not eligible business of the assessee and hence, Section 44AD will not be applicable.

9. Before we move on to consider the arguments of the learned counsel for the appellant/assessee, we need to point out that the decision in the case of ***Ramniklal Kothari*** was couched on a different set of facts and what was decided in this case is with regard to the share of the partner in the taxable profits of the registered firms whether is liable to be included under Section 23(5)(a)(ii) of the Income Tax Act, 1922 and whether when included in the share of the assessee would connote as income received from business carried on by him.

10. Section 23 of the 1922 Act is a provision which deals with assessment. Sub-Section (5) which was the subject matter of consideration dealt with assessees which were a firm and the facts were considered as to whether the assessee's case would stand attracted under clause (ii) of

Section 23(5) which states that the total income of each partner of the firm including therein his share of its income, profits and gains of the previous year, shall be assessed and the sum payable by him on the basis of such assessment shall be determined. The said provision is not in pari materia with Section 44AD which is a special provision intended to help small businesses. Therefore, the decision cannot be applied to the facts of this case.

11. As pointed out earlier, the assessee should be able to satisfy the four main criteria mentioned in sub-section (1) of Sectio 44AD r/w. explanation (a) and (b) in the said provision. Therefore, the assessee should establish that he is an eligible assessee engaged in an eligible business and such business should have a total turnover or a gross receipt. Admittedly, the assessee who is an individual in the instant case is not carrying on any business. Therefore, the remuneration and interest received by the assessee from the partnership firm cannot be termed to be a turnover of the assessee [individual]. Similarly, it will also not qualify for gross receipts. As rightly pointed out by the revenue, in the statement issued by the ICAI on the

Companies (Auditors report) Order 2003, the word 'turnover' has been defined under the term 'turnover' for the purpose of this clause may be interpreted to mean the aggregate amount for which sales are effected or services rendered by an enterprise. Admittedly, the assessee has not done any sales nor rendered any services but has been receiving remuneration and interest from the partnership firms which amount has already been debited in the profit and loss account of the firms. Therefore, the revenue was right in their contention that remuneration and interest cannot be treated as gross receipt. The CIT(A) also took note of the grounds raised by the assessee which are in fact identical to the grounds raised before us and also the decisions which were cited by the assessee before us arising under the 1922 Act and took note of the factual position and the nature of receipts received by the assessee and dismissed the appeal. The Tribunal once again tested the correctness of the order passed by the Assessing Officer and the CIT(A), it took note of section 28(v) which deals with profits and gains of business or profession and noted that clause (v) mentions about section 40(b) of the Act and rightly concluded that only remuneration and salary received from a firm to the extent eligible under Section 40(b) of the Act would be

considered as profits and gains of the business or profession of the recipient partner. Further, it took note of section 40(b) and observed that the language used in the said provision is in the negative as it states that certain amounts shall not be deducted while computing income under the head 'Profits and gains of business or profession'. However, it exempts from the rigors of such prohibition, payment of salary, bonus, commission and interest to the extent specified in sub-clause (iv) and (v) of sub-section (b) of section 40 of the Act.

12. The Tribunal observed that the intention of Section 40(b) is that the partner should not be disentitled for claiming reasonable remuneration where he is a working partner and should not be denied reasonable interest on the capital invested by him in a firm and these changes if not made in the accounts of the firm, then the pro-rata profits of the firm would be higher resulting in higher tax for the firm. Therefore, the payments have to be construed indirectly as type of distribution of profits of a firm or otherwise the firm would have been taxed. Therefore, the Tribunal observed that the legislature in its wisdom chose such remuneration and interest to be a part

of profits from business or profession and that can never translate into gross receipts or turnover of a business of being partners in a firm. The Tribunal took note of the position prior to substitution of Section 44AD by Finance (No.2) Act, 2009 with effect from 01.04.2011. Prior to the said substitution, this provision allowed the application of presumptive tax rate only for business of civil construction or supply of labour for civil construction. By virtue of the substitution, the applicability of presumptive rate of tax was expanded to include any business which had turnover or gross receipts of less than Rs.1 Crore. The Tribunal noted the explanatory notes to the provisions of the Finance (No.2) Act, 2009 vide Circular No.5/2010 dated 03.06.2010, wherein the CBDT had explained as to why the scope of the said provision was enlarged. The relevant portion of the Circular reads as follows:

> *"21.Special Provision for computing profits and gains of business on presumptive basis.*
>
> *21.1. The existing provisions of the Income Tax Act provide for taxation of income on presumptive basis .....*
>
> *There has been a substantial increase in small businesses with the growth of transport and communication and*

general growth of the economy. A large number of businesses and service providers in rural ad urban areas who earn substantial income are outside the tax-net. Introduction of presumptive tax provisions in respect of small businesses would help a number of small businesses to comply with the taxation provisions without consuming their time and resources. A presumptive income scheme for small taxpayers lowers the compliance cost for such taxpayers and also reduces the administrative burden on the tax machinery. In view of the above, to expand the scope of presumptive taxation to all businesses, the existing section 44AD has been substituted by a new section 44AD.

21.2. The salient features of the new presumptive taxation scheme are as under:

(a) The scheme is applicable to individuals, HUFs and partnership firms excluding Limited liability partnership firms. It is also not be applicable to an assessee who is availing deductions under sections 10A, 10AA, 10B, 10BA or deduction under any provisions of Chapter VIA under the heading "C.-Deductions in respect of certain incomes" in the relevant assessment year.

(b) The scheme is applicable for any business (excluding a business already covered under Section 44AE

which has a maximum gross turnover/gross receipts of 40 lakhs).

(c) The presumptive rate of income is prescribed at 8% of gross turnover/gross receipts.

(d) .....

(e) An assessee opting for the above scheme is exempted from maintenance of books of accounts related to such business as required under Section 44AA of the Income Tax Act.

(f) .....

(g).....

13. A reading of the circular will clearly show the intention behind the widening scope of Section 44AD and the intention is clear that it was made taking note of the fact that there has been substantial increase in small businesses who earns substantial income are outside the tax-net. Precisely for such reason, the assessee opting for presumptive rate of tax provision are exempted from maintenance of books of accounts related to such business as required under Section 44AA of the Act. The intention of the legislature also becomes clearer if we look into Section 44AF which is a special provision for computing profits and gains of retail business which is

computed based on the total turnover with the previous year on account of such business. Section 44ADA is a special provision for computing profits and gains of profession on presumptive basis uses the expression 'Total gross receipts'. As already seen in Section 44AD, the words used are 'total turnover' or 'gross receipts' and it pre-supposes that it pertains to a sales turnover and no other meaning can be given to the said words and if done so, the purpose of introducing Section 44AD would stand defeated. That apart, the position becomes much clearer if we take note of sub-Section (2) of Section 44AD which states that any deduction allowable under the provision of Section 30 to 38 for the purpose of sub-section (1) be deemed to have been already given full effect to and no further deduction under those sections shall be allowed. Thus, conspicuously section 28(v) has not been included in sub-section (2) of Section 44AD which deals with any interest, salary, bonus, commission or remuneration by whatever name called, due to or received by, a partner of a firm from such firm.

14. Thus, for all the above reasons, we find that the Tribunal rightly rejected the plea raised by the assessee and confirmed the order passed by

the CIT(A) and the Assessing Officer.

15. In the result, the tax case appeal is dismissed and the substantial questions of law are answered against the assessee and in favour of the revenue. No costs.

(T.S.S.,J.) (V.B.S.,J.)
23.12.2020

cse
Index: Yes/No
Internet: Yes/No
Speaking Order/Non-speaking Order

To

1. The Assistant Commissioner of Income Tax,
   Circle-2, Salem.

2. The Income-tax Appellate Tribunal,
   "A" Bench, Chennai.

T.S.SIVAGNANAM, J.
AND
V.BHAVANI SUBBAROYAN, J.

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Pre-delivery judgment made in

T.C.A.No.388 of 2019

23.12.2020