

IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "B", MUMBAI

BEFORE SHRI G.S. PANNU, VICE PRESIDENT
AND
SHRI AMARJIT SINGH, JUDICIAL MEMBER

ITA No	A.Y.	Appellant	Respondent
5217/Mum/13	2005-06	Mulla & Mulla & Craigie Blunt & Caroe, Mulla House, 51, M.G.Road, Fort, MUMBAI [PAN: AABFM1563D]	Joint Commissioner of Income Tax-11(3), MUMBAI
4451/Mum/12	2008-09		Addl. Commissioner of Income Tax-11(3), MUMBAI
248/Mum/14	2009-10		Asst. Commissioner of Income Tax-11(3), MUMBAI
249/Mum/14	2010-11		

Appellant by	:	Shri P.J. Pardiwala & Shri Nishant Thakkar,
Respondent by	:	Shri Rajeev Gubgotra, Sr.AR

Date of Hearing : 18-06-2019	Date of Pronouncement : 19-06-2019
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ORDER

PER G.S. PANNU, VICE PRESIDENT:

The captioned are four appeals filed by the assessee pertaining to assessment years 2005-06, 2008-09, 2009-10 and 2010-11. Since the appeals pertain to the same assessee and involve a common issue, they have been clubbed and heard together and a consolidated order is being passed for the sake of convenience and brevity.

2. The facts being same in all the years, we take up the appeal for assessment year 2008-09 (ITA No.4451/Mum/2012) as the lead case. The said appeal is directed against an order passed by the Commissioner of Income Tax(Appeals)-2, Mumbai dated 30.04.2012, which in turn, arises out of an order passed by the Assessing Officer, dated 31.12.2010 under section 143(3)(ii) of the Income Tax Act, 1961 (in short 'the Act').

3. The Grounds of appeal raised by the assessee for assessment year 2008-09 read as under:

"1. On the facts and in the circumstance of the case and in law, the CIT(A) erred in holding that the amount of Rs. 19,58,337/- paid to the retired partners and the legal heirs of the deceased partners as per the provision of the partnership deed, as income of the Appellant.

2. On the facts and in the circumstances of the case and in law, the CIT(A) erred in holding that the amount of Rs. 19,58,337/- is not a diversion of income by overriding title.

3. Without prejudice to the aforesaid grounds, the CIT(A) erred in holding that the amount of Rs. 19,58,337 is not allowable as an expenditure under section 37 of the Act as incurred for the business of the Appellant .

4. On the facts and in the circumstance of the case and in law the CIT (A) ought to have allowed the amount of Rs. 19,58,337/- as a loss.

5. On the facts and in the circumstances of the case and in law, the CIT(A) erred in charging interest u/s.234A, 234B and 234C of the Income Tax Act.

6. On the facts and in the circumstances of the case the CIT(A) erred in permitting penalty proceedings u/s.271(1)(c) of the Act to continue.

The Appellant craves leave to add any further grounds on or before the date of hearing".

4. Briefly put, the relevant facts are that the assessee is a partnership firm of practicing Advocates, Solicitors and Notaries.

It filed its return of income for Assessment Year 2008-09 on 27.09.2008 wherein, *inter alia*, it claimed deduction of Rs. 19,58,337/- on account of payment made to retiring partners and legal heirs of the deceased partners. In the course of assessment proceedings, the Assessing Officer noticed the above fact and accordingly, assessee was shown as to why these payments should not be disallowed. In response, assessee pointed out that the said payment was made in terms of a Partnership Deed entered dated 01.04.2001. It was further pointed out that the said payment was in the nature of diversion of income by overriding title as income to that extent never accrued to the assessee firm but always belonged to the retiring partners and legal heirs of the deceased partners. It was also pointed out that this issue arose in earlier years in assessee's own case for assessment year 1969-70 and the Hon'ble Bombay High Court vide order dated 20.09.1990 reported in [1991] 190 ITR 0198 decided the issue in favour of the assessee holding that this payment is in the nature of diversion of income by overriding title and thus cannot form part of income of the assessee-firm. After considering the issue in detail, the Assessing Officer held that main issue to be decided in this case was whether the payments made to the retired partners was an application of income or a diversion by an overriding title. The Assessing Officer further took a view that the decision of the Hon'ble Bombay High Court in the assessee's own case for Assessment Year 1967-70 in 190 ITR 198 was decided much before the amendment made in the Act w.e.f 01.04.1993. The Assessing Officer held that overriding title has been created voluntarily by the assessee firm itself and an overriding title cannot be created suo-moto or

voluntarily as per law, therefore, he rejected the argument of the assessee and disallowed a sum of Rs. 19,58,337/- paid to retiring partners and the legal heirs of the demised partners. On appeal, CIT(A) affirmed the order of Assessing Officer. Aggrieved by the same, assessee is in further appeal before us.

5. Before us, the ld. Representative for the assessee submitted that three partners retired from the firm w.e.f. 31.03.2001, vide a Deed of Partnership dated 01.04.2001. The three partners were to be paid the following amounts in 48 equal monthly instalments:

Mr. J. P. Thacker	Rs. 40,00,000/-
Mr. S. K. Wadia	Rs. 30,00,000/-
Mr. K.F. Mehta	Rs. 30,00,000/-

5.1. The aforesaid payments were made under clause 4 read with clause 5(b) of the aforesaid Partnership Deed. Apart from above, as per clause 13 read with clause 14 of the Partnership Deed, legal heirs of Mr. S. D. Colabawala were also to be paid Rs. 20,00,000/- in 48 equal monthly instalments. During the year under consideration, last 12 instalments were paid in respect to the retirement / death of the aforesaid four partners amounting to Rs. 19,58,337/-. The instalments paid in the earlier years to the very same partners were allowed and accepted by the Assessing Officer to be not chargeable to tax in the hands of the assessee. Thus, the ld. Representative submitted that as the earlier instalments of the payments made under the same Deed of Partnership has been accepted by the department to be not taxable in the hands of the assessee firm, the same view should be followed in this year as well.

6. The Id.Representative for the assessee pointed out that the above issue is covered in favour of the assessee by the decision of Hon'ble Bombay High Court in assessee's own case for Assessment Year 1969-70 reported in [1991] 190 ITR 0198 wherein the Hon'ble High Court has examined the above issue and held that payments made to retiring partner or legal heirs of deceased partners as per terms of Partnership Deed for the work done by the firm upto the date of partner's death or retirement did not reach the assess-firm as its income but it has been diverted at source.

7. The Id.Representative further submitted a chart depicting the year-wise status of allowance/ disallowance of the said payment and submitted that in assessment year 1969-70, the appeal of the assessee on this issue was allowed by the Hon'ble High Court; for assessment years 1970-71 to 1972-73 the said issue was allowed in favour of the assessee by CIT(A), and the Department had not preferred further appeal before Tribunal; and, from assessment year 1975-76 to 2004-05 the said payment was allowed by the Assessing Officer himself. Further, in assessment years 2006-07, 2007-08, 2013-14 and 2014-15, the Assessing Officer himself allowed the claim. It was thus submitted that in earlier years and even in later years the Assessing Officer himself has allowed this payment and thus, the same should also be allowed in current year.

8. The Id.Representative relied on the decision of the Hon'ble Bombay High Court in the case of *CIT vs. C. C. Chokshi & Co. in ITA No. 193 of 2008* wherein on identical facts, the High Court

dismissed the appeal of the Revenue relying on its decision in the case of assessee discussed above. Our attention was drawn to the decision rendered by the Tribunal in that case and pointed out that after detailed analysis of various clauses of the Partnership Deed, the Tribunal arrived at the conclusion that when the payment was obligated by the Partnership Deed, it cannot be said to be an application of income by the assessee firm. The assessee is, in fact, in the position of a collector of income on behalf of the persons to whom it is payable and is only paying the amount subsequently.

9. The Id.Representative relied on the decision of the Hon'ble Bombay High Court in the case of *CIT vs. M/s. Kanga & Co. in ITA No. 2277 of 2013* wherein on identical facts the High Court dismissed the appeal of the Revenue stating that the Tribunal has correctly placed reliance on the decision of *Mulla and Mulla and Craigie Blunt and Caroe 190 ITR 198 (supra)*.

10. The Id.Representative for the assessee further pointed to the contents of Partnership Deed of earlier year for which the Hon'ble High Court has decided the issue in favour of the assessee; the payment made to retiring partner and legal heirs of the deceased was covered by the Clause No. 16 of the Partnership Deed and the corresponding clause in the present Deed is Clause No. 14. It was further pointed out that even in earlier year's Partnership Deed there was scope for determination of amount which needs to be quantified in future whereas in the present Partnership Deed, the amount is already quantified in

the Partnership Deed itself. Apart from this, there is no difference in the old Partnership Deed and new Partnership Deed. As such, ratio laid by the Hon'ble Bombay High in assessee's own case still holds good and the issue is squarely covered by the said decision.

11. On the other hand ld. DR relied on the decision of Coordinate bench in the case of S. B. Billimoria & Co. Vs. ACIT [2010] 125 ITD 122 (Mum.), to say that payment made by the assessee was gratuitous in nature and therefore not allowable. The ld. DR further relied on the decision of Hon'ble Bombay High Court in the case of CIT vs. V. G. Bhuta reported in 203 ITR 249 (Bom).

12. We have carefully considered the rival submissions and considered the material placed before us. The limited controversy before us is whether the payment made by the assessee-firm to retiring partners and legal heirs of the deceased partners in terms of the Partnership Deed amounts to diversion of income by over riding title and thus, excludible from total income in the hands of the firm or not. At the outset, we shall make it clear that the question sought here is not with respect to the deduction claimed by the assessee under any provision of the Act and, therefore, the same is not required to be analysed from the perspective of any particular section under the Act. The question here is whether the amount claimed as deduction by the assessee-firm can at all be said to be income of the assessee in view of the fact that same was diversion of income by over riding

title as claimed by the assessee. In this regard, as pointed out by the assessee, the issue stands covered by the decision of the Hon'ble Bombay High Court in the case of assessee's own case for earlier year. However, the Assessing Officer in the assessment order has stated that the decision of the Hon'ble Bombay High Court pertains to assessment year 1969-70 which was much before the amendment in the Act w.e.f. 01.04.1993 to the effect that only payment made to working partners to the extent provided for under the Act is deductible and no other payment made to partners is deductible in the hands of the assessee-firm. As discussed earlier, we are deciding the issue of whether payment made by the firm amounts to diversion of income or not and, therefore, the reason assigned by the Assessing Officer that there was amendment in the Act and, therefore, the decision of earlier year cannot be applied to the facts of the current year, is quite irrelevant.

12.1. We shall now analyse the clauses of the Partnership Deed that was in operation during the year for which the issue has been decided by the Hon'ble Bombay High Court and the clauses of the Partnership Deed in operation during the current year. It was pointed out by the ld. Counsel of the assessee that the relevant clause in the earlier agreement was clause No. 16. For sake of brevity, we reproduce the clause 16 of the earlier Partnership Deed which reads as under:

"16. In the event of the retirement or death of any of them the parties hereto the retiring partner or the estate of the deceased partners, as the case may be, shall be entitled to the share of profits of the firm (in cases where the share is quantified, the

quantified share) for all the work done by the Firm upto the date of his retirement or death, as the case may be, and all necessary apportionment shall be made for the purpose PROVIDED ALWAYS and it has been hereby expressly agreed between the parties hereto that notwithstanding any-thing otherwise contained in these presents.

(a) it shall be lawful for the surviving or continuing agreement partners of the first to the eighth parts in agreement with the retiring partner or partners or the heirs, executors or administrators of any deceased partner or partners to quantify the share of the profits of the partner who has retired or died in respect of the work done upto the date of his retirement or death and also to arrive at any agreement for paying such share of profits of the retired or deceased partner or the quantified amount, as the case may be, in one or more lump sums /or by periodical instalments with or without interest but so that all such amount should be paid within a period of five years from the date of retirement or death it being agreed that the amount that may be so agreed upon as the share of profits in the firm payable to a retiring partner or a deceased partner for all the work done by the firm up to the date of death or retirement as the case maybe, or any quantification of the share of profits of a partner who has retired or died and any agreement to pay the said share of profits or the Quantified amount thereof in lump sum or by periodical instalments with or without interest shall be final and binding on any retiring partner and on the heirs, executors and administrators of any deceased partner as the case may be and the surviving or remaining partners and shall not be questioned by any of them in any Court of Law or otherwise howsoever;

(b) in the case of the said Engineer, the said Kavasha the said Bharucha and the said Nanavati, their respective shares being quantified at the respective amounts per month provided for in clause 5 hereof, they shall be titled respectively only to be paid their respective quantified shares upto their respective dates of retirement or death.

(Underlined for emphasis by us)

12.2. We shall now advert to the clause Nos. 13 and 14 of the Partnership Deed dated 01.04.2001 which is relevant for the year under consideration and pursuant to which assessee claims to

have made payment to retiring partner and legal heirs of the deceased partners during the year. The clause Nos. 13 and 14 of the Partnership Deed dated 01.04.2001 read as under:

“13. In the event of the death, retirement or insolvency of any Partner or determination of the share of any Partner as hereinafter provided, the Deceased Partner of his legal representative, the retiring Partner, the insolvent Partner, or the Partner whose share shall have been determined, as the case may be (hereinafter for brevity’s sake referred to as “the Outgoing Partner”) shall, subject to the other provisions hereof, have no share, right, title or interest in any receipts of the firm after the date of his death, retirement or insolvency or termination of the share even though such receipts may relate to work done prior to the date of death retirement, insolvency or determination of the share, as the case may be. On such death, retirement or insolvency of any Partner or determination of the share of any Partner, the Outgoing Partner shall be entitled to such amount as may be payable to such Partner as per the Books of Account of the firm upto the date of death, retirement, insolvency, or termination of share of such Partner, as the case may be, after taking into consideration the profits of the firm upto the date of his death, retirement, insolvency, or termination of share, as the case may be. Such profits shall be determined on proportionate time basis hereto of the First to the Ninth Parts or of the survivors of them. The amount so found shall be payable in one or more lumpsum or by periodical instalments as may be decided by the majority of the Parties hereto of the First to the Ninth Parts or the survivors of them, but so that the same shall be paid within a period of not more than three years from the date of his death, retirement, insolvency or termination of share as the case may be. If, on the other hand, on making accounts as aforesaid any amount is found to be due and payable by such Partner to the firm, such amount shall be recovered from him or his estate, as the case may be, in such manner as the majority of the Parties hereto of the First to the Ninth Parts, or of the survivors of them, may from time to time decide or may be set off or adjust against any amount that may be due by the Firm to such Partner or his estate or his assigns in insolvency.

14(a) In the event of the death of any of the Parties hereto of the First to Nineteenth Parties or in the event of his retirement consequent upon illness or accident incapacitating him from

carrying on the profession of Solicitor, Attorney or Advocate, there shall be paid to the person or persons nominated by him in his lifetime by a writing attested by two Partners of the Firm and left or filed in the Office of the Firm, and failing any such nomination, to the estate of such deceased Partner, or to such retiring Partner, as the case may be, the respective amounts mentioned hereinafter in this sub-clause against the name of each such Partner, in 48 equal monthly instalments that is to say:-

.....

....

(b) The amounts to be paid under this Clause shall be paid out of the receipts of the firm for the period subsequent to the death or retirement as the case may be, of the Partner concerned, to the intent that the same shall be paid in first instance out of such receipts of the firm, and charged on the receipts of the firm, before the balance thereof is distributed between the Partners of the Firm entitled to the profits of the firm. IT IS HEREBY ALSO EXPRESSLY AGREED AND DECLARED that there shall be no personal liability of the Partners of the Firm for the time being or any of them or their respective heirs, executors or administrators estate and effects to pay the instalments or any of them or any part thereof. IT IS HEREBY ALSO EXPRESSLY AGREED AND DECLARED that the person receiving such payment shall bear and pay Income-tax or any other tax or duty which may become payable in respect of such payment as if the same were the income of the beneficiary or beneficiaries receiving such payment and the Partners of the Firm shall be indemnified in respect thereof as hereafter provided in Clause 18 hereof.

(c) Nothing contained in this Clause 14 of this Agreement shall be construed as obliging any Partner to retire as a Partner of the said Firm, it being clearly understood that this clause is intended only to provide an option to any such Partner to retire should he so think fit.

(Underlined for emphasis by us)

From a perusal of clause No.16 of the old agreement and clause nos. 13 and 14 of the new agreement, it is amply clear that in sum and substance the only difference is that in old agreement amounts payable to the retiring partners and legal heirs were not

quantified and it only prescribed a method for quantification of amount, whereas in the new agreement the amount to be paid to the partners on retirement and otherwise is duly quantified. Apart from the aforesaid, we do not find difference in the terms and conditions prescribed in the two agreements.

12.3. The Hon'ble Bombay High Court, after carefully considering the terms of the old agreement, decided the issue in favour of the assessee in [1991] 190 ITR 0198, and the relevant extract of the said judgment is reproduced hereunder:

"6. We have already referred to the Tribunal's findings in detail in the third paragraph of the judgment. We are in agreement with the Tribunal that in view of clauses 11 and 16 of the deed of partnership dated 1-9-1967 to which both late Shri N.K. Petigara and Shri Khambata were parties and in view of clauses 3, 4 and 6 of the two partnership deeds dated 20-3-1968 and 17-3-1969, the assessee-firm was under a legal obligation to pay the share of the deceased partners in the income of the firm for the work done by the firm up to the date of the death of the aforesaid two partners to their legal heirs. As held by the Tribunal, these amounts were collected by the assessee-firm merely as agents of the predecessor firms and not in their own rights. They collected the income belonging to the predecessor firms for the sake of convenience and as except for these two partners all other partners were common. They included the amount receivable on behalf of the continuing partners in the income of the firm.

7. We have no difficulty in holding that in the facts of the case the Calcutta High Court decision in G. Basu & Co.'s case (supra) is squarely applicable. In the Calcutta High Court case two firms were carrying on practice as chartered accountants. They were facing certain troubles on account of disputes and differences among the partners. The dispute was referred to arbitrator for settlement. Pursuant to the award of arbitration and in consequence of the deed of retirement three partners of one of the firms retired in December 1969. As per the terms of the deed of retirement certain specific items of outstanding fees were directly assigned to the retiring partners. The

question arose whether those outstanding fees which were directly assigned to the retiring partners represented the income of the firm. Observing that there was a legal obligation in terms of the deed of retirement to pay in a particular manner the erstwhile partners in respect of realisation of fees after their retirement, it was held to be an instance of the source of income being subject to an obligation. The outstanding fees paid to the retiring partners as per the terms of the deed of retirement were held not assessable as income of the firm. Incidentally the Calcutta High Court had in this regard referred to and relied upon the Supreme Court decision in the case of CIT v. SitaldasTirathdas [1961] 41 ITR 367 and the Madras High Court decision in the case of V.N.V. Devarajulu Chetty& Co. (supra).

8. In the present case also the assessee-firm was under a legal obligation in terms of the deed of partnership dated 1-9-1967 and the clauses in the two subsequent partnership deeds to pay outstanding fees for the work done up to and during the period when the deceased partners were partners. This was also an instance of the source of income being subject to an obligation. We are in agreement with the Calcutta High Court decision and hold that the amounts so paid by the assessee-firm to the heirs of the deceased partners cannot be assessed as the income of the firm.

(Underlined for emphasis by us)

12.4. In our view, the terms of the Partnership Deed dated 01.04.2001 are also in line with the old agreement except that the amount to be paid to the retiring partners and legal heirs have been quantified in the new agreement. Thus, when the fact situation remains the same, we do not find any reason for not following the decision of the Hon'ble Bombay High Court in assessee's own case. The Assessing Officer has not followed the order of the Hon'ble High Court because as per him, there was amendment in the Act w.e.f. 01.04.1993 and thereafter, only payment made to the working partners of the firm is allowable. We do not agree with the reason cited by the Assessing Officer as

the issue herein is on a different footing, and the amendment made by the Act does not affect the case of the assessee as assessee is not claiming any deduction u/s 40 of the Act, rather the case of the assessee is that the impugned sum does not enter the computation of income at all. As per the assessee, the aforesaid amount is excludible from total income at the threshold itself. It is also important to note here that the Hon'ble High Court in above case, while deciding the issue in favour of the assessee, considered the decision of in the case of *CIT v. Sitaldas Tirathdas [1961] 41 ITR 367*, which has been relied upon by the Assessing Officer in the instant year while disallowing the claim of the assessee. Since the Hon'ble High Court has already considered the said decision, we are not discussing the applicability of the said case to the facts of the present case; and, it would suffice to note that the Assessing Officer has erred in placing reliance on the aforesaid decision.

12.5. We further state that the new agreement clearly spells out that the liability to pay income tax on amount received by the retiring partners or beneficiary will be on them and not on the assessee-firm. Thus, liability to pay tax, if at all, in terms of the agreement also, is upon the partner or the beneficiary receiving such payment. As such, it is the partners or beneficiaries receiving such payment who should be taxed and not the assessee. Further, it is also observed from the terms of the agreement that the above payment were to be set-aside at the threshold from the receipts of the firm and will, thus, not reach the hands of the other partners of the firm and, therefore, cannot be treated as income of the assessee-firm who has merely acted

as a pass through entity for this payment. We, accordingly, set-aside the order of CIT(A) and direct the Assessing Officer to allow the exclusion of Rs.19,58,337/-on account of payment made to retiring partners and legal heirs of the deceased partners.

13. In the result, appeal of the assessee is allowed, as above.

14. Insofar as appeals of assessee for assessment years 2005-06, 2009-10 and 2010-11 in ITA No. 5217/Mum/2013, ITA No. 248/Mum/2014 and ITA No. 249/Mum/2014 are concerned, the issue involved and the facts and circumstances therein stand on identical footing to that in appeal of assessee for assessment year 2008-09, therefore, our decision therein shall apply *mutatis mutandis* to the said appeals also.

15. Resultantly, all the appeals of the assessee are allowed, as above.

Order pronounced in the open court on 19th June, 2019

Sd/-
(AMARJIT SINGH)
JUDICIAL MEMBER

Sd/-
(G.S. PANNU)
VICE PRESIDENT

मुंबई/Mumbai; दिनांक/Dated : 19-06-2019

TNMM

आदेश की प्रतिलिपि अग्रेषित / Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent
3. आयकर आयुक्त(अपील) / The CIT(A), Mumbai
4. आयकर आयुक्त / CIT, Mumbai
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई /
DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार (Dy./Asst. Registrar)
आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai