IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

SPECIAL CIVIL APPLICATION No. 22407 of 2017
With
SPECIAL CIVIL APPLICATION No. 22408 of 2017

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DELOITTE HASKINS AND SELLS....Petitioner(s)
Versus
DEPUTY COMMISSIONER OF INCOME TAX....Respondent(s)

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Appearance :
Mr JP SHAH, Sr Advocate with Mr MANISH J SHAH, Advocate for the Petitioner
Mrs MAUNA M BHATT, Advocate the Respondent

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CORAM: HONOURABLE Mr. JUSTICE AKIL KURESHI
and
HONOURABLE Mr. JUSTICE B.N. KARIA
6th February 2018

COMMON ORDER (PER : HONOURABLE Mr. JUSTICE AKIL KURESHI)

Petitioner has challenged Notices dated 20th February 2017 and 24th March 2017 issued by the respondent-Assessing Officer to reopen the petitioner's assessment for the Assessment Years 2010-2011 and 2011-2012 respectively.

These two petitions arise in common factual background. We refer to the facts from Special Civil Application No. 22407 of 2017, which are as under :

The petitioner is a partnership firm of Chartered Accountants. For the Assessment Year 2010-11, the petitioner had filed return of income declaring total income of Rs. 7.45 Crores [rounded off]. The return of the assessee was taken in scrutiny. During such scrutiny assessment, the Assessing Officer issued Notice dated 22nd August 2012 and called upon the petitioner to supply various details. Such details were supplied by the petitioner alongwith a covering letter dated 5th October 2012. The documents annexed with the said letter dated 5th October 2012 included a copy of Partnership Deed of the petitioner-partnership firm.

The Assessing Officer passed a scrutiny assessment order on 12th March 2013 in which he made certain additions and disallowances to the income declared by the assessee.

To reopen the assessment, the Assessing Officer issued *impugned* notices. In order to reopen the assessment, he recorded the following reasons :-

> "The assessee M/s. Deloittee Haskins & Sells, a partnership firm engaged in practicing as a firm of Chartered Accountant, filed its original return of income for A.Y. 2010-11 on 13.10.2010 declaring total income of Rs. 7,45,82,670/-. The case was selected for scrutiny and the assessment was finalized u/s. 143(3) on 12.03.2013 determining income of Rs. 9,04,96,640/-.
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> Subsequently, on verification of Schedule-9 of profit & loss account regarding professional fees it revealed that the assessee has directly deducted an amount of Rs. 48,10,682/- from Gross Professional receipts and thereby reduce its income to the above extent. As per Clause-10 of partnership deed there is provision for payment for pension to the retiring partners. As the payment was made to the retired partners, cannot be considered for current business or profession. Further, the partners is not employee of the firm but owner of the firm. Therefore, the partners are not entitled to receive pension because, pension is payable only to the employee.

The partners are entitled to receive only the capital balance as on date of retirement. The payment made to the partner is of capital nature and hence it cannot be allowable as expenditure u/s. 37 of the IT Act.

Further, the payments were stated to be made in view of Clause-10 of partnership deed. However, by making provision in partnership deed, the entitlement of income cannot be proved because any provision made in partnership deed should have legal entitlement as per the provision of Income Tax Act. For example, provision of Section 40(b) provides the allowability of payments remuneration and interest on capital to the partners to certain extent. Therefore, any excess provisions made in this regard in partnership deed are not allowed in view of provision of section 40(b). Therefore, the entitlement of deducting certain amount for payment to retiring partners cannot be proved by making provision in partnership deed.

Moreover, the payment made for service rendered in past to build the income of the firm is nature of goodwill which is of capital nature. Further, the payment of goodwill is required to be made to retiring partners by the incoming partners who are the real beneficiaries of that income build by the retiring partners.

In view of the above, I have reason to believe that the assessee failed to disclose the fully and truly all materials facts necessary for the A.Y. 2010-11. However, also reason to believe that income chargeable to tax has escaped assessment within the meaning of Section 147 of the IT Act by an amount more than Rs. 1,00,000/-. Therefore, it is a fit case, for reopening the assessment u/s. 147 of the IT Act."

From the reasons, it could be gathered that the Assessing Officer has objection to a sum of Rs. 48.10 lakhs [rounded off] deducted from the assessee's gross professional receipts which amount was paid by the firm to its retired partner. According to the Assessing Officer, this was not an allowable deduction since a partner is not an employee of the firm and is therefore, not entitled to pension after retirement. The payment to the retiring partner, therefore, was capital in nature.

The assessee raised objections to the notice of reopening under communication dated 5th March 2017 in which the assessee took mainly two grounds – one was that there was no failure on the part of the assessee to disclose truly and fully, all material facts. It was highlighted that all facts necessary for assessment were already on record and the notice for reopening, which was issued beyond the period of four years was therefore not valid. The second ground elaborately raised by the petitioner was that even on merits, the objection was not sustainable. The partnership deed had a clause for paying pension to the retiring partners. The payment would depend on nature of work already done by the retiring partner for which payments may not have been received from the clients. It was pointed out that such practice is being followed in similar other firms; including one C.C Chokshi & Associates, which was one of the firms taken over by the petitioner-partnership firm. The decisions of several High Courts were cited in support of the contention that the payment was a recognized expenditure and in fact, it could be argued that there was diversion of income at source.

The Assessing Officer, however, rejected the objections by order dated 6th November 2017. Thereupon, the petitioner has filed these petitions.

Having heard learned advocates for the respective parties and having perused the documents on record, what emerges is that in the reasons recorded, the Assessing Officer has not referred to any material outside the assessment proceedings on the basis of which it can be said that income chargeable to tax has escaped assessment. In fact, in the reasons itself, he has stated, "..*Subsequently, on verification of Schedule-9 of Profit & Loss account regarding professional fees, it revealed that the assessee has directly deducted an amount of Rs. 48,10,682/= from Gross Professional receipts and thereby reduce its income to the above extent. As per Clause 10 of* *partnership deed, there is provision for payment of pension to the retiring partners*..” Thus, the information on which the Assessing Officer proceeded to form a belief that the said payment was not a recognized deduction, the said payment could not have been allowed to be deduced from the income, was already on the record. This would be relevant in the context of the fact that the *impugned* notice came to be issued beyond the period of four years from the end of relevant assessment year and the element of true and full disclosure on the part of the assessee would be important.

The Assessing Officer has referred to Schedule-9 which is a Profit and Loss account, filed along with return of income. He has also referred to Clause 10 of the partnership deed which refers to payments to the retiring partners. In response to certain queries raised by the Assessing Officer, the petitioner had produced documents which include a copy of partnership deed. Clause 10 of the partnership deed pertains to

Admission, Retirement, Death and Insolvency of partners. This clause contains various clauses regarding admission, retirement; including compulsory retirement and expulsion of partners. Sub-clauses [m] and [n] of Clause 10 pertain to right to receive payment on retirement or death of a partner and computation thereof. These clauses read as under :

> "**m**. In addition to the amounts, if any, payable, as provided in the Clauses 10.k and 10.l above, a retired/retiring Partner of the Firm or the Legacy Firm in respect of which the liability thereof has been taken over by this Firm or the spouse or nominee of a deceased Partner, as the case may be, shall be entitled to receive further sums determined on the basis specified in Clause 10.n in respect of the following:
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> i. amounts billed, but not received, work completed, but not billed, and work partly completed and not billed as at the date of death or retirement, as the case may be, having regard to the fact that the Partnership follows the cash system of accounting;
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> ii. in consideration of the Retiring Partner or the spouse or nominee of the deceased partner, as the case may, permitting the continuing Partners the use of the Firm name of Deloittee Haskins & Sells, to carry on the profession, along with the clientele and the attendant rights of the Firm;

iii. the contribution made by the surviving partner or the deceased Partner as the case may be, during his association with the Firm, in increasing the future income earning potential of the Firm, the benefits whereof are likely to be reflected in the receipts of the Firm for a reasonable number of years immediately following the retirement or death of the partner; and/or

iv. in consideration of the assuming of the liability of the retired partners of the Legacy firms consequent to the acquisition of the clientele and employees together with the substantial business of the Legacy Firms.

n. The further sum payable to Retiring Partners or the spouse or nominees of deceased partners referred to in the preceding Clause shall be determined in accordance with Clause (I) to clause (v) below as may be applicable.

i. Any Partner retiring after “Qualifying Period” of 20 years with the participating Firm, shall be entitled to receive payments, at the rate of 25 percent of his average annual Amount received in the previous year from all the Participating Firms for best three years out of the last five years prior to retirement (even if it is related to the period prior to 1st April 2007) in absolute terms, for a period of ten yeas from the date of retirement. If the Partner retires in between the end of two accounting years than the average annual Amount received in the previous year shall be computed with reference to completed financial years before the date of retirement as a Partner. The absolute amount referred to above will be indexed as per the Cost Inflation Index specified in Section 48 of the Income Tax Act, 1961 or will be increased every year at the simple rate of 5% per annum, whichever is higher. The payments will be made on a monthly basis. The payments under this clause will be restricted to Rs. 60 lacks per annual and this limit will be indexed as per the Cost Inflation Index specified in Section 48 of the Income Tax Act 1961, the base year for the indexation being 2007-2008 or increased every year at the simple rate of 5% per annum, whichever is higher.

Payments as per this clause shall be made in case any Partner retires on becoming permanently incapacitated from continuing as Partner for or dies. In such case the qualifying period will not be considered. In case of death of a partner or retirement of a Partner due to incapacity before completion of three years as a Partner, then the average annual Amount received in the previous year would be worked out with reference to the Amount received in the previous years in absolute terms for the period he served as a Partner.

Provided that a Partner who retires on attainment of the normal Retirement Age after completing at least five continuous years as a partner but without completing the Qualifying period of 20 years shall be entitled to the payments of Rs. 6,00,000/- per annum for a period of 10 years from the date of the retirement. The absolute amount referred to above will be indexed as per the Cost Inflation Index specified in Section 48 of the Income Tax Act, 1961, the base year for the indexation being 2007-08 or increased every year at the simple rate of 5% per annum, whichever is higher.

ii. Notwithstanding anything contained above the amounts payable under Clause

10.n.i to a Retiring Partner in any financial year (on or after 1st April, 2007) shall not be less than Rs. 6,00,000/- per annum provided the said partner has completed the qualifying period of 20 years. The minimum amount of Rs. 6,00,000/- shall be adjusted by Cost Inflation Index specified in Section 48 of the Income Tax Act, 1961, the base year for the Indexation being 2007-2008 or increased every year at the simple rate of 5% per annum whichever is higher.

iii. Notwithstanding anything contained in clause 10.n.i and Clause 10.n.ii the amounts payable to a Retiring Partner or the widow or nominees of a deceased Partner under this Clause shall cease at the end of the financial year in which the Partner concerned attains the age of 75 years, or would have attained the said age if alive.

iv. The payments under this clause and in any other clause of this agreement are subject to deduction of tax at source, as may be applicable from time to time.

v. On the basis of i. to iv, above, the payment of pension to Partners under clauses 10.m and 10.n will be made as per Annexure III."

It could be thus seen that the partnership deed itself contained elaborate provisions for payment to a retiring partner, or to the representatives of the deceased partner. The objective of such payment was based on the amounts billed, but not received; work completed, but not billed and work partly completed and not billed, as at the time of death or retirement of a partner. The computation was on the basis of the format provided under sub-clause [n] of the partnership deed. The said sub-clause [n] also provides that such payment of pension to the partners will be made as per Annexure-III. Such Annexure-III for Assessment Year 2010-2011 contained the following details:-

Name of the Retired Partner	Pension payment for 2009-10	Pension Payable up to
A. G. PALKAR	Apr 09 to Sep 09 Rs. 23,06,274	2017-18
	Oct 09 to Mar 20 Rs. 25,04,408	
	Total- Rs. 48,10,682	

> **Note**: In terms of Clause 10.n.I., the above payments will be indexed as per the Cost Inflation Index specified in Section 48 of the Income Tax Act 1961 or increased every year at the simple rate of 5% *per annum*, whichever is higher.

Thus, the partnership deed which was on record contains detailed clauses for pension to the retiring partners. Annexure III to the deed contains precise details of payments made to one of the retiring partners Shri A.G Palkar. The total pension payment during the year under consideration comes to Rs. 48.10 lakhs. Note below Annexure III also provides for escalation in such payment which would be made till the year 2017-2018. The escalation would be indexed at the Cost Inflation Index specified in Section 48 of the Income-tax Act, 1961 or at the rate of 5% *per annum*; whichever is higher.

All these details were on record before Assessing Officer, when the original assessment proceedings were being made. There was nothing outside of the record which could have thrown any light on the nature of payment and its deductibility in terms of provisions of the Income-tax Act. We are not called upon to judge the Assessing Officer's assertion that though such payments were recognized in partnership deed, as per the Income-tax law, the payments were not allowable deductions, being the nature of payments made to the outgoing partner and therefore were in the nature of capital expenditure. We are presently concerned with the limited issue of reopening of the assessment beyond period of four years from the end of relevant assessment year. In this respect, the Revenue has completely failed in satisfying us that there was any failure on the part of the assessee in disclosing truly and fully, all material facts. From the reasons recorded by the Assessing Officer as well as material produced before us, it is completely visible that all necessary facts were already on record, duly disclosing and that there was no failure on the part of the assessee in this regard. If the Assessing Officer had any dispute about deduction of the said sum from the profit of the firm, he could have and ought to have raised such objection during the original assessment. At any rate, on such ground, the assessment framed after scrutiny cannot be reopened beyond the period of four years from the end of relevant assessment year.

In the result, the *impugned* Notices are set-aside. Petitions are allowed and disposed of.

[AKIL KURESHI, J.]

[B.N. KARIA, J.]

Prakash