S. Srinivasan vs Commissioner Of Income-Tax, Madras on 4 October, 1966

Equivalent citations: 1967 AIR 517, 1967 SCR (1) 727, AIR 1967 SUPREME COURT 517, 1967 (1) MADLJ(CRI) 45, 1967 (1) SCJ 174, 1967 (1) ITJ 138, 63 ITR 273, 1967 (1) SCR 727

Author: Vishishtha Bhargava

Bench: Vishishtha Bhargava, J.C. Shah, V. Ramaswami

PETITIONER:
S. SRINIVASAN

Vs.

RESPONDENT:
COMMISSIONER OF INCOME-TAX, MADRAS

DATE OF JUDGMENT:
04/10/1966

BENCH:
BHARGAVA, VISHISHTHA
BENCH:
BHARGAVA, VISHISHTHA
SHAH, J.C.
RAMASWAMI, V.

CITATION:
1967 AIR 517 1967 SCR (1) 727

ACT:
Income-tax Act (11 of 1922), s. 16(3) (a) (i) and (ii)-Assessee and his wife partners in a firm-Minor sons entitled to benefits-Profits of wife and minor sons allowed to accumulate with firm-Payment of interest by firm-Whether can be included in income of the assessee.

HEADNOTE:
The appellant was a partner in a firm in which the other two partners were his wife and a stranger. Two, minor sons of the appellant were also admitted to the benefits of the partnership. Under the partnership deed, the shares of the five persons in the profits were defined and it was also provided that a partner may advance a loan for meeting the

expenses of the firm and receive interest on such loan upto 12%. The amounts of profits falling to the shares of the wife and sons were allowed to accumulate in the accounts of the firm. Till the beginning of the accounting year 1956-57, the profits that were accumulating were kept without any interest, but thereafter the firm allowed interest at 9% per annum. On the question whether the interest could be added to the income of the appellant for purposes of assessment, under s. 16 (3) (a) (i) and (ii) of the Income-tax Act, 1922.

HELD : The interest indirectly arose and accrued to the wife and the minor sons because of their capacity mentioned in s. 16 (3) (a) (i) and (ii) and could therefore be included for assessment in the income of the assessee, under the section. [730 F-G]

The accumulated profits remaining in the hands of the firm could not be equated with deposits made with or loans advanced to the firm. The wife and minor sons earned the profits because of their membership of the firm or because of their admission to the benefits of the firm., and having earned them in that capacity, they allowed the use of the profits to the firm without any specific arrangement as would have been entered into if the funds belonged to a stranger. They let the firm use the funds because they were interested in the profits of the firm, and interest was allowed on the accumulation simply because the funds belonged either to a partner or to minors admitted to the benefits of the partnership. [730 B, C-D, F]

Case law referred to.

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 556 of 1965. Appeal by special leave from the judgment and order dated' August 27, 1962 of the High Court of Madras in T.C. No. 82 of' 1960.

A. K. Sen and R. Gopalakrishnan, for the appellant. S. T. Desai, A. N. Kripal and R. N. Sachthey, for the respondents.

The Judgment of the Court was delivered by Bhargava, J. The appellant is a senior partner in a firm 'in which the two other partners are his wife and a stranger. in addition, two minor sons of the appellant were admitted to the -benefits of the partnership. Under the deed of agreement constituting the partnership, the shares in the profits of all the five persons were defined. There was also specification of the shares in which losses were to be shared by the three partners. There was a clause in the deed of partnership that "if the firm requires any sum for meeting the expenses for its management and if any of the partners -has and is willing to give such amount, he may advance (such ,amount) as loan. He may receive interest for such sum at the rate ,of 12 annas per cent per mensem." The firm earned profits which were distributed in accordance with their shares between the three partners and the two minors who were admitted to the benefits of the partnership. The

amounts of profit falling to the share of the wife of the appellant and his two minor sons were allowed -to accumulate in the accounts of the partnership for a number of -years. Up to the beginning of the previous year relevant to the assessment year 1957-58, the profits that were accumulating in the accounts to the credit of the wife and the two minor sons of the appellant were kept without any interest. With effect from the previous year in question, the partnership decided to allow interest at 9 % per annum on these accumulated profits, so that, during this previous year, the amounts to the credit of these three persons increased on account of two additions in each case. There was addition of further profit falling to their share and there was added interest on the opening balance of the accumulated profits 'in the a(-,counts of each one of these three persons. All these amounts added to the accounts during the previous year in respect of share of profits as well as interest on accumulated profits were ,added to the income of the appellant for purposes of assessment under section 16(3) (a) (i) and (ii) of the Income-tax Act. These additions were challenged by the appellant on two different grounds. The first ground was that the provisions of s. 16(3) (a) (i) & (ii) were ultra vires as being beyond the legislative powers of the Parliament. The second ground was that, even on the application of these provisions, at least the amount added to the income of the appellant in respect of the interest credited in the accounts of his wife and minor sons was not justified in law. Both these objections were over-ruled by the Income-tax Officer. On appeal, the Appellate Assistant Commissioner upheld the decision of the Income-tax Officer on the first point, but decided the second point in favour of the appellant and held that the interest earned by his wife and minor sons from the firm could not be included in the income of the appellant for purposes of charging it with income-tax. The Income-tax Appellate Tribunal, on further appeal, again upheld the decision on the first question, but, on the second question, partly rejected the claim of the appellant. The Tribunal held that the amount of interest credited to the amount of the minors in respect of capital provided by their grand-father and grand-mother had to be excluded from the total income of the assessee, while the interest earned on the accumulated profits was rightly included in the income of the appellant. Thereupon, at the request of the appellant, the following two questions were referred by the Tribunal for the opinion of the Madras High Court:-

> "(i) Whether the provisions of section 16(3) (a) (i) and
>
> (ii) offend clauses (f) and (g) of Article 19(1) of the Constitution of India ?
>
> (ii)Whether interest credited by the aforesaid firm to the assessee's wife and minor children attributable to past profit accumulations only is includible in the assessment of the assessee under Section 16(3)(a)(i) and (ii) The High Court answered both the questions against the appellant, and consequently, he has come up to this Court by special leave.

So far as the first question is concerned, learned counsel appearing for the appellant himself did not press it before us in view of the decision of this Court in Balaji v. Income-tax Officer, Special Investigation Circle, Akola, and Others('). That point was earlier decided by the Madras High Court in B. N. Amina Umma v. Income-tax Officer, Kozhikode(2). It has been held by this Court in Balaji's case(') that the provisions of s. 16(3)(a)(i) and (ii) did not impose any unreasonable restriction on the fundamental rights of the assessee under Article 19(1)(f) and (g) of the Constitution, and were,

consequently, valid. The first question has, therefore, been clearly answered correctly by the High Court against the appellant.

Learned counsel appearing for the appellant mainly argued before us the second question and urged that though the profits earned from the partnership by the wife and the minor sons of the appellant were undoubtedly income arising to them directly from the partnership of the wife in the firm or the admission of the minors to the benefits of the partnership in the firm, the interest accruing on the accumulated profits should not be held to arise either directly or indirectly from the same source. The argument was that the accumulated profits belonging to the wife and the minor sons should be held to be in the nature of deposits made (1) [1962] 2 S.C.R. 983 :43 I.T.R. 393.

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by them with the firm, or in the nature of loans advanced by them to the firm, and interest earned on such deposits or loans can have no relationship with the membership in the firm of the wife or the admission to the benefits of the partnership of the minor sons. It appears to us that these accumulated profits remaining in the hands of the firm cannot, on any principle, be equated with deposits made or loans advanced. The profits accumulated to the credit of the wife and the minor sons, because they did not draw their share of profits when distribution of profits took place, and allowed those profits to remain with the firm; but there is no suggestion at all that, at that stage, either the wife or the minor sons, or anyone on their behalf, purported to enter into an arrangement with the firm to keep these accumulated profits as deposits. Similarly, there was no such contract which could convert those accumulations into loans advanced to. the firm by these persons. The facts and circumstances indicate that the wife and the minor sons had earned these profits because of their membership of the firm or because of their admission to the benefits of the firm, and having earned these profits in that capacity, they allowed the use of their profits to the firm without any specific arrangement as would naturally have been entered into if these funds had belonged to a stranger., They let the firm use these funds of theirs, because they had in- terest in the profits of the firm. The facts also show that the use of these moneys was allowed to the firm without asking for any interest, and it was only at a later stage that the three partners of the firm decided to give interest on these amounts. When the decision was taken to give interest, the nature of the funds did not change. They did not get converted into deposits or loans. They still remained accumulations belonging to a partner or persons admitted to the benefits of the partnership and allowed to be used by the firm. The interest also appears to have been allowed by the firm simply because these funds belonged either to a partner or to the minors who had been admitted to the benefits of the partnership. It is thus clear that the interest at least indirectly arose and accrued to the wife and the minor sons because of their capacity mentioned in s. 16(3)(a)(i) and (ii) of the Income-tax Act. In this connection, learned counsel for the appellant relied on a decision of the Bombay High Court in Bhogilal Laherchand v. Commissioner of Income-Tax, Bombay City(). It was held in that case that interest earned by minors on deposits maintained in the firm could not be held to be a benefit which the minors received from their admission to the partnership of the firm. The case is inapplicable, because, as we have indicated above, in this case the interest arising to the wife and the minor sons of the (1)25 I.T.R. 523.

appellant was not the result of any deposits made by them with the firm.

Chouthmal Kejriwal v. Commissioner of Income-tax, Assam,(') and Akula Venkatasubbaiah v. Commissioner of Income-tax(2) were cases where interest was paid to the minors on the capital provided by them for the business of the partnership. In those cases, it was held that the interest on the capital contributed by the minor sons was benefit arising from the admission of the minors to the benefits of the partnership, and consequently, that interest had to be included in the total income of the father in his assess- ment. These two cases are of no assistance, because the nature of the amount on which interest has accrued to the wife and the minor sons of the appellant is different and is not on capital advanced by them or on their behalf. Reference was also made by learned counsel to a decision of the Allahabad High Court in L. Rain Narain Garg v. Commissioner of Income-tax, U.P.(3), in which case also it was held that interest paid to a minor son admitted to the benefits of a partnership on his capital investment is income derived directly or indirectly by him from the admission and is includible in the income of the father under s. 16(3)(a)(ii) of the Income-tax Act. It was further held that it cannot be stated as a matter of law that interest paid by a partnership to a minor admitted to its benefits can never be said to be connected even indirectly with the fact of his admission. It is connected with the fact if the interest paid is on capital investment by the minor or on a loan advanced to the partnership by the minor and the partnership deed forbids the raising of a loan from any person other than a partner or a person admitted to its benefits. It is not connected with the fact if the interest is paid on a deposit made, or loan advanced by the minor, and, the partnership was free to accept a deposit or a loan from any person even if not connected with it. The principle enunciated by the Allahabad High Court does not envisage all circumstances in which interest may be earned by a minor on his moneys with the firm. The cases when interest is earned on a deposit or a loan differ from a case of the type before us where interest was earned on amounts of which the minors permitted the use by the firm, because they were their accumulated profits arising from the firm itself and because of their interest in the firm as persons admitted to the benefits of the partnership. In the circumstances, the answer returned by the High Court to the second question was also correct. Appeal dismissed. The appeal fails and is dismissed with costs. V.P.S. (1)41 I.T.R. 570.

(2)47 I.T.R. 458.

(3)55 I.T.R. 435.