Commissioner Of Income Tax, Calcutta vs Prahaladrai Agarwala on 26 April, 1989

Equivalent citations: 1990 AIR 270, 1989 SCR (2) 737, AIR 1990 SUPREME COURT 270, 1990 TAX. L. R. 146, (1989) 177 ITR 398, 1989 SCC (SUPP) 2 279, 1990 SCC(TAX) 94

Author: R.S. Pathak

Bench: R.S. Pathak, M.H. Kania

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           PETITIONER:
COMMISSIONER OF INCOME TAX, CALCUTTA

        Vs.

RESPONDENT:
PRAHALADRAI AGARWALA

DATE OF JUDGMENT26/04/1989

BENCH:
PATHAK, R.S. (CJ)
BENCH:
PATHAK, R.S. (CJ)
KANIA, M.H.

CITATION:
 1990 AIR  270            1989 SCR  (2) 737
 1989 SCC  Supl.  (2) 279 JT 1989  Supl.    139


ACT:
    Income  Tax Act, 1961: Section 64(1)(iii)--Wife  partner
in  firm alongwith husband--Capital contributed by wife  out
of  amount gifted by the husband--Share of profit of  asses-
see's  wife--Whether includible in total income of the  hus-
band--There must be proximate connection between the accrual
of income and assets transferred.



HEADNOTE:
    The  respondent-assessee  was one of the partners  In  a
firm in which the five other partners were his wife, mother,
grand-father, brother, and a stranger. His wife had contrib-
uted Rs.51,000 as capital in the firm, which amount came out
of  two gifts made to her by the assessee. in the course  of
assessment  proceedings for the assessment year  1962-63  in
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respect of the assessee, the Income Tax Officer included the profits of the assessee's wife from the firm, under s. 64(1)(iii) of the Income Tax Act, 1961 . The.assessee's appeal was dismissed by the Appellate Assistant Commissioner who observed that the wife would not have become a partner of the firm unless he had contributed capital which was provided by the husband. The Appellate Tribunal, while dismissing the second appeal of the assessee, found that the admission of the assessee's wife as a partner in the firm was solely on account of her contribution of capital to the firm. It was conceded by the assessee before the Tribunal that the interest received by the assessee's wife on her capital contribution to the firm was includible in the total income of the assessee.

The High Court, while answering the question referred to it in favour of the assessee, took the view that the income arose from the share of profits only because the other partners agreed to take the assessee's wife as partner and she was allowed to contribute to the partnership firm, and that the admission of the assessee's wife to the partnership was not in consequence of the gift.

Dismissing the Revenue's appeal, it was

HELD: (1) The income may arise directly or indirectly, but for application of the provisions of section 64(1)(iii) of the Income Tax Act,

738

1961 there must be a proximate connection between the accrual of the income and the assets transferred by the assessee. [741D]

Commissioner of Income-tax, West Bengal 111 v. Prem Bhai Parekh, [1970] 77 ITR 27 followed.

(2) The mere contribution of the capital by the wife into the firm would not automatically have entitled her to partnership in the firm. The partnership was based on agreement, and it is the event of agreement between the partners that brought the assessee's wife into the firm as partner. [742E]

Commissioner of Income-tax, Bangalore v. J.H. Gotla, [1985] 156 ITR 323; Commissioner of Income-tax, Assam, Tripura and Manipur v. Jwalaprasad Agarwala, [1967] 66 ITR 154; V.D. Dhanwatey v. Commissioner of Income-tax, Madhya Pradesh, Nagpur and Bhandara, [1968] 68 ITR 365; Smt. Mohini Thapar v. Commissioner of Income-tax (Central), Calcutta, [1972] 83 ITR 208; Potti Veerayya Sresty v. Commissioner of Income-tax, A.P., [1972] 85 ITR I94 distinguished.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 575 (NT) of 1975.

From the Judgment and Order dated the 24.4.1973 of the Calcutta High Court in Income Tax Reference No. 202 of 1969. B. Ahuja and Ms. A. Subhashini for the Appellant. K.P. Bhatnagar, S.P. Mittal and B.P. Maheshwari for the Respondent.

The Judgment of the Court was delivered by PATHAK, CJ. This appeal by special leave is directed against the judgment of the High Court at Calcutta answering the following question in favour of the assessee and against the Revenue:

> "Whether, on the facts and in the circum- stances of the case, the share of profit of the assessee's wife was includable in the total income of the assessee under section 64(1)(iii) of the Income Tax Act, 1961?"

The assessee was assessed in the status of an individual for the assessement year 1962-63 corresponding to the previ- ous year 26 March, 1961 to 13 April, 1962. At the material time the assessee was a partner in a firm, Messrs Ramesh and Co., with a share of eight annas therein. The balance was shared by three other partners, the assessee's father, Kunjilal Agarwala, the assessee's brother, Hariram Agarwala and a stranger, Jagdish Prasad. On 10 November, 1960 and on 28 November, 1960 the assessee made two gifts of Rs.21,000 and Rs.30,000 respectively to his wife, Kaushalya Devi, from his account in the firm. On 28 November, 1960 he made anoth- er gift of Rs. 11,000 to his mother Chili Bai from that account. It may be observed that Chili Bai received another gift of Rs.20,000 from her husband, Kunjilal, effected by similarly drawing from his account with the firm. The assessee's wife, Kaushalya Devi, as well as his mother Chili Bai became partners with three other persons in a newly constituted firm, Messrs Kunjilal Hariram & Co. The three other partners were the assessee's grand father, Moharilal Agarwala, the assessee's brother, Hariram Agarwala and the stranger, Jagdish Prasad Gup. ta. The Partnership Deed dated 10 November, 1960 provided that the business was to commence from 12 November, 1960. The preamble to the deed stated:

> "Whereas the partner of the Fifth Part who has extensive experience and outstanding talent of organisation in Jagree and Grains Trade but little finance requested the partners of the First four Parts to enter into co-partnership with him on contributing the necessary finance to carry on business in Jagree and Grains and also act as Commission Agents in Jagree Grains and allied commodities to which request they acceded."

Clause 4 of the Partnership Deed stipulated:

> "That the partners of the First Four Parts shall initially contribute Rs.25,000 each to be put in within six months from the commence- ment of the partnership. The said contribu- tions augmented by further deposits and prof- its or depleted by withdrawals and tosses shall carry interest at the rate of 6% per annum. The amount if any, standing to the credit of the partner of the Fifth Part shall carry interest at the same rate."

On 12 November, 1960 Kaushalya Devi contributed Rs.21,000 as capital, which came out of the gift made by the assessee on 10 November, 1960. She also contributed Rs.30,000 as capital, which amount came out of the gift made on 28 November, 1960.

In the course of assessment proceedings for the assess- ment year 1962-63 in respect of the assessee the Income Tax Officer included the profits of the assessee's wife from the firm, Messrs. Kunjilal Hariram & Co., under s. 64(1)(iii) of the Income Tax Act, 1961.

An appeal by the assessee was dismissed by the Appellate Assistant Commissioner of Income Tax, who observed that the wife would not have become a partner of the firm unless she had contributed capital, and as the capital was provided by the husband the inclusion of the wife's share of income in the assessment of the assessee was justified. In second appeal, it was conceded by the assessee before the Income Tax Appellate Tribunal that the interest received by the assessee's wife on her capital contribution to the firm was includible in the total income of the assessee, but it was contended that the balance of the share of profit was not so includable as the assessee's wife had become a part- ner in the firm in her own right, and it was immaterial that the capital invested by her had been provided as a gift by the assessee. The Appellate Tribunal found that the admis- sion of the assessee's wife as partner in the firm was solely on account of her contribution of capital to the firm, that the assets in the form of cash were transferred directly by the assessee to his wife otherwise than for adequate consideration, and that the income must be said to have arisen indirectly from the assets transferred. The second appeal was dismissed. At the instance of the assessee the question of law set forth earlier was referred to the High Court at Calcutta for its opinion.

The High Court has taken the view that the share of profits arose to the assessee's wife primarily because the partnership made a profit and although it had connection with the gift it did not arise as a result of the gift, that the income arose from the share of profits only because the other partners agreed to take the assessee's wife as partner and was allowed to contribute to the partnership firm, that the admission of the assessee's wife to the partnership was not in consequence of the gift, and that, therefore, upon all those circumstances, the connection between the income of the share of profits and the gifts by the assessee to his wife was too remote to be included within the provisions of s. 64(1)(iii) of the Income Tax Act.

S.64(1)(iii) of the Income Tax Act, 1961, as it stood at the relevant time, provides:

> "64(1) In computing the total income of any individual, there shall be included all such income as arises directly or indirectly--
>
> (i) xx xx xx
>
> (ii) xx xx xx
>
> (iii) subject to the provisions of cl.

> (i) of s. 27, to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connec-

tion with an agreement to live apart."

The income may arise directly or indirectly, but there must be a proximate connection between the accrual of the income and the assets transferred by the assessee. In Commissioner of Income-tax, West Bengal 111 v. Prem Bhai Parekh and Others, [1970] 77 ITR 27 this Court held that the income of minor sons, who had invested capital in the firm out of moneys gifted to them by their father (the assessee) could not be included in the assessment of the assessee. The Court observed:

> "Before any income of a minor child can be brought within the scope of section 16(3)(a)
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> (iv), it must be established that the said income arose directly or indirectly from assets transferred directly or indirectly by his father. There is no dispute that the assessee had transferred to each of his minor sons, a sum of Rs.75,000. It may also be that the amount contributed by those minors as their share in the firm came from those amounts. But the question still remains wheth-

er it can be said that the income with which we are concerned in this case arises directly or indirectly from the assets transferred by the assessee to those minors. The connection between the gifts mentioned earlier and the income in question is a remote one. The income of the minors arose as a result of their admission to the benefits of the partnership. It is true that they were admitted to the benefits of the partnership because of the contribution made by them. But there is no nexus between the transfer of the assets and the income in question. It cannot be said that income arose directly or indirectly from the transferor the assets referred to earlier. Section 16(3) of the Act created an artificial income. That section must receive strict construction as observed by this court in Commissioner of Income-tax v. Keshavlal Lal- lubhai Patel, [1965] 55 ITR 637 (S.C.). In our judgment before an income can be held to come within the ambit of section 16(3), it must be proved to have arisen-directly or indirectly--from a transfer of assets made by the assessee in favour of his wife or minor children. The connection between the transfer of assets and the income must be proximate. The income in question must arise as a result of the transfer and not in some manner con- nected with it."

It seems to us that the observations of this Court in that case fully cover the case before us. There is no doubt that the wife became a partner because of the capital contributed by her in the firm, but, as observed by the High Court, in the judgment under appeal, it was upon agreement by the remaining partners that she became a member of the partner- ship. The mere contribution of the capital by the wife into the firm would not automatically have entitled her to part- nership in the firm. The partnership was based on agreement, and it is the event of agreement between the partners that brought the assessee's wife into the firm as partner. Learned counsel for the Revenue relies on Commissioner of Income-tax, Bangalore v. J.H. Gotla, [1985] 156 ITR 323; Commissioner of

Income-tax, Assam Tripurn and Manipur v. Jwalaprasad Agarwala, [1967] 66 ITR 154; V.D. Dhanwatey v. Commissioner of Income-tax, Madhya Pradesh, Nagpur and Bhandara, [1968] 68 ITR 365 and Smt. Mohini Thapar v. Com- missioner of' Income-tax (Central), Calcutta, and Others, [1972] 83 ITR 208 but we are not satisfied that those cases are of assistance to the Revenue. Reliance was placed on Potti Veerayya Sresty v. Commissioner of Income-Tax, A.P., [1972] 85 ITR 194 where the Andhra Pradesh High Court upheld the inclusion of the wife's income from cloth business carried on by her, into which cloth business she had invest- ed a portion of the assets transferred by the assessee. It is sufficient to observe that the cloth business was her own business and, as the High Court pointed out, there was no necessity to depend upon the agreement of others. It is on that basis that the High Court distinguished Prem Bhai Parekh's case (supra).

We are of the view that the High Court is right in answering. the . question referred to it in the negative, in favour of the assessee and against the Revenue.

In the result the appeal fails and is dismissed with costs.

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R.S.S.                                      Appeal dismissed.
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