

(1973) 03 AHC CK 0015

In the Allahabad High Court

Case No : Income-tax Reference No. 738 of 1969

Bimal Kumar Jain

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 29-03-1973

Acts Referred:

Income Tax Act, 1961 — Section 256(1)

Citation : (1974) 93 ITR 225

Hon'ble Judges : R.L. Gulati, J;C.S.P. Singh, J

Bench : Division Bench

Advocate : C.S. Agarwal and V.K. Verma, for the Appellant; Deokinandan and R.R. Misra, for the Respondent

Judgement

Gulati, J.—This is a reference u/s 256(1) of the Income Tax Act, 1961 (hereinafter referred to as "the Act").

2. The assessee, Bimal Kumar Jain, was a director and the general manager of a company, known as Jain Glass Works Private Ltd., Firozabad. For the assessment year 1964-65 he filed two returns, one in the status of a Hindu undivided family showing an income of Rs. 29,398 and the other in his individual capacity showing an income of Rs. 26,048. This amount of Rs. 26,048 was received by him from the company by way of remuneration. Thus, the assessee put forward the claim that the income which he had received from the company by way of remuneration should not be included in the income received by his family from dividends on shares held in the company. This claim of the assessee was rejected by the Income Tax Officer holding that the entire income was to be assessed in the hands of the Hindu undivided family. His appeals to the Appellate Assistant Commissioner of Income Tax and to the Income Tax Appellate Tribunal failed. At his request the Income Tax Appellate Tribunal has referred the following question for our opinion ;

" Whether the sum of Rs. 26,048 received by the assessee as general manager's remuneration is assessable as the income of the Hindu undivided family of which

Sri Bimal Kumar Jain is the karta ? "

The facts as appearing from the statement of the case and from the appellate order of the Tribunal are these.

3. Formerly, there was a joint family of the name and style of M/s. Motilal Chhadami Lal, which owned a business styled Jain Glass Works. The assessee and his father were the two coparceners of the family. There was a partial partition in the family from the beginning of the assessment year 1955-56, when the business of the family was converted into a partnership firm in which the assessee and his father were the partners. On May 3, 1960, the firm transferred its machineries and other assets to a limited company named Jain Glass Works Private Ltd. and the assessee and his father were allotted shares in the company in lieu of the assets of the firm so transferred. Previously, the assessee's income from the aforesaid business used to be assessed in his individual status presumably because he had no male issue. On May 5, 1962, a son was born to him and thereafter his status was changed to that of a Hindu undivided family and the income arising to him was assessed in his hands as the karta of a Hindu undivided family. The total share capital of the company consisted of 2204 equity shares of Rs. 100 each and 100 preference shares. Bimal Kumar Jain and his father held 1,051 equity shares each, while the remaining 102 shares were held by Bimal Kumar's wife and his brother-in-law. Out of 100 preference shares the assessee and his father held 50 shares each. Under article 35 of the articles of association of the company, the assessee's father, Seth Chhadami Lal, became its permanent managing director with an option to nominate any other person in his place and, in the absence of such nomination, the assessee was automatically to become the managing director with the same powers of nomination, etc., as his father had after the latter's death or resignation. Article 37 provided that the remuneration of Seth Chhadami Lal, as managing director, and that of Bimal Kumar Jain, director, as the manager and technical adviser, shall be as may be settled by agreement and/or by resolution. On May 23, 1960, a resolution was passed by the directors of the company in which the remuneration of Seth Chhadami Lal was fixed at Rs. 3,000 per month " keeping in view his past experience and ability in the trade ". By another resolution the board of directors resolved " that Sri Bimal Kumar Jain, director of the company be appointed general manager on a remuneration of Rs. 2,000 per month till the board of directors decide otherwise ". For the year 1964-65, which is the year in dispute, the income from salary was credited to the account of the Hindu undivided family. Later on, however, the assessee claimed that his income from salary should be assessed separately in his individual capacity. On these facts the Income Tax Officer, the Appellate Assistant Commissioner of Income Tax and the Income Tax Appellate Tribunal have held that the income derived by the assessee by way of remuneration from the company was the income of the Hindu undivided family.

4. Admittedly, the shares which qualified the assessee to become a director of

the company were purchased with the funds of the joint Hindu family and, as such, any income earned by him in his capacity as the director of the company would belong to the Hindu undivided family. But it is argued that the salary received by the assessee from the company was by virtue of his holding the post of the general manager and not on account of his being the director. The Tribunal has not accepted this contention and the only question that arises for consideration is as to whether the Tribunal was right in doing so.

5. A question of this nature has received the attention of the Supreme Court in a number of cases; The first case is that of *The Commissioner of Income Tax, West Bengal Vs. Kalu Babu Lal Chand*, . In that case, R, a karta of a Hindu undivided family, was one of the promoters of a company which took over a business as a going concern. The articles of association of the company provided that R would be its first managing director. It was found by the Appellate Tribunal that the shares held in the name of R and his brother were acquired with the funds belonging to the Hindu undivided family and the family was in enjoyment of the dividends paid on those shares. Further, the company was floated with the funds provided by the family and R made no contribution in this respect. The company had all along been financed by the family. Prior to the accounting year relevant to the assessment year 1943-44, the managing director's remuneration received by R was credited in the account of the family. On these facts the Supreme Court held that the managing director's remuneration received by R was, as between him and the Hindu undivided family, the income of the family and should be assessed in its hands. This is what has been observed by their Lordships at page 128 :

" Whether in entering into a partnership with outsiders, the karta acted in his individual capacity and for his own benefit or he did so as representing his joint family and for its benefit is a question of fact. If for the purpose of contribution of his share of the capital in the firm the karta brought in monies out of the till of the Hindu undivided family, then he must be regarded as having entered into the partnership for the benefit of the Hindu undivided family and as between him and the other members of his family he would be accountable for all profits received by him as his share out of the partnership profits and such profits would be assessable as income in the hands of the Hindu undivided family."

To the same effect is the case of *V.D. Dhanwatey Vs. The Commissioner of Income Tax, M.P. Nagpur*, . There a karta of a Hindu undivided family became a partner of a firm. His contribution to the capital of the firm belonged to the family. Under one of the clauses of the deed of partnership the general management and supervision of the partnership business was to be in his hands and he was to be paid a monthly remuneration out of the gross earnings of the partnership business. A question arose as to whether the salary, received by him was assessable in the hands of the Hindu undivided family. The Supreme Court held that he was in the partnership as representing the family and he became a partner on account of investment of the joint family funds in the capital of the

partnership and that the remuneration received by him was only an increased share paid to him as representing the family. The principle underlying this decision is to be found at page 369 in the following words :

" The general doctrine of Hindu law is that property acquired by a karta or a coparcener with the aid or assistance of joint family assets is impressed with the character of joint family property. To put it differently, it is an essential feature of self-acquired property that it should have been acquired without assistance or aid of the joint family property."

The same principle has been more clearly stated by the Supreme Court in the case of P.N. Krishna Iyer Vs. Commissioner of Income Tax, Kerala, . In that case the karta of a Hindu undivided family received salary, commission and sitting fees as governing director of a private company. The shares which qualified him to become a member of the company were purchased with the aid of the joint family funds. The entire capital assets of the company originally belonged to the joint family and were made available to the company in consideration of a mere promise to pay the amount for which the assets were valued. The Supreme Court held that the entire income earned by way of salary, commission and sitting fees along with the dividends were assessable in the hands of the Hindu undivided family. At page 546 the Supreme Court observed :

" The income was primarily earned by utilising the joint family assets or funds and the mere fact that in the process of gaining the advantage an element of personal service or skill or labour was involved did not alter the character of the income. "

The principle enunciated in the aforesaid decisions is clearly applicable to the facts of the present case. The entire shareholding of the assessee is in lieu of the assets of the Hindu undivided family which was previously invested in the partnership business. He became a director because of his shareholding. It is, however, contended that he received remuneration as the general manager of the company and not as a director. In the resolution, no doubt, he has been described as the general manager and the technical adviser, but there is nothing on the record to show as to what services he rendered in that capacity. Mere label of a general manager and technical adviser cannot help him. It has to be remembered that the company has already a permanent managing director who is being paid a salary of Rs. 3,000 per month and further that the resolution by which the remuneration of the assessee was sanctioned was passed by himself and his father as the directors of the company. In these circumstances a very heavy onus lay upon him to show that the remuneration was paid to him by the company purely for his personal services. It may be that some element of personal services was involved, but, as has been pointed out by the Supreme Court in the case of P. N. Krishna Iyer, that circumstance is not sufficient to alter the character of the income. Another significant fact, which cannot be lost sight of, is that the remuneration received by the assessee had been credited to the account of the family along with the dividend income. If the remuneration had

belonged to him in his individual capacity, there was no occasion for the same being credited to the account of the joint Hindu family. It should have been credited to his personal account. This circumstance may not create an estopped, but this shows the conduct of the assessee and is a relevant circumstance. It is clear that the assessed himself had at one time considered this income as belonging to the joint Hindu family and it was an after-thought on his part to claim it as his individual income obviously to escape proper taxation. The view that we are taking on this aspect of the matter is supported by the following observation of the Supreme Court in the case of Commissioner of Income Tax v. Kalu Babu Lal Chand at page 130 :

" It is also significant that right up to the accounting year relevant to the assessment year 1943-44, the income was treated as the income of the Hindu undivided family. It is true that there is no question of res judicata but the fact that the remuneration was credited to the family is certainly a fact to be taken into consideration. "

The case of S. RM. CT. PL. Palani Appa Chettiar Vs. The Commissioner of Income Tax, Madras, strongly relied upon by the learned counsel for the assessee is clearly distinguishable. There the family held only 90 out of 300 shares. The karta of the family was not a director to begin with. He became a director after 8 years when one of the directors died and a year later, on the death of another director, who was managing the business, he became the managing director. First, the company granted him an honorarium of Rs. 3,000 per year and gradually increased the remuneration to Rs. 1,000 per month with 131/2 per cent. commission on the net profits. On those facts the Supreme Court held that there was no direct connection between the shareholdings and the appointment of the karta as the managing director of the company. The Supreme Court has itself distinguished the case of Kalu Babu Lal Chand in this case at page 225,

6. In Shri Raj Kumar Singh Hukam Chandji Vs. Commissioner of Income Tax, Madhya Pradesh, the Supreme Court has reviewed the entire case law on the point and has at page 43 formulated the following tests for resolving the question like the present one :

" In our opinion, from these subsidiary principles, the broader principle that emerges is whether the remuneration received by the coparcener in substance though not in form was but one of the modes of return made to the family because of the investment of the family funds in the business or whether it was a compensation made for the services rendered by the individual coparcener. If it is the former, it is an income of the Hindu undivided family, but if it is the latter then it is the income of the individual coparcener. If the income was essentially earned as a result of the funds invested the fact that a coparcener has rendered some service would not change the character of the receipt. But, if on the other hand, it is essentially a remuneration for the services rendered by a coparcener, the circumstance that his services were availed of because of the reason that he was a member of the family which had invested funds in that business or that he

had obtained the qualification shares from out of the family funds would not make the receipt, the income of the Hindu undivided family. "

Applying this test to the facts found by the Tribunal the Supreme Court in that case held that the remuneration received by the assessee in that case did not belong to the Hindu undivided family. Following are the facts which have been relied upon by the Supreme Court:

" He (assessee in that case) did not become the managing director of the firm for the mere reason that his family had purchased considerable shares in the firm. He was elected as a managing director by the board of directors. The Tribunal has found that he received his salary for his personal services. There is no material to hold that he was elected managing director on behalf of the family. In the past the salary received by him was assessed as his individual income. The same was the case as regards the salary received by the other managing directors. The Tribunal has found that he was not appointed as managing director as a result of any outlay or expenditure of or detriment to the family property. It has been further found that the managing directorship was an employment of personal responsibility and ability. "

Clearly, the facts of the present case are materially different. Here the family owns almost half of the company. The company was floated with the funds of the family. He himself contributed nothing. The assessee was appointed a director under the articles of association of the company and not by the board of directors subsequent to the formation of the company. No contract of service between the company and the assessee has been produced to show the nature of the work entrusted to him. There is no evidence, much less a finding, of any personal services rendered by him to the company. The remuneration payable to him was fixed by the board of directors consisting of himself and his father. The assessee was automatically to become the managing director after his father in case the latter did not make any other nomination before his death or resignation and, lastly, the remuneration received by him had been credited to the account of the family and not to his personal account. On these facts an irresistible conclusion emerges that the assessee became the general manager because of the shares held by his family and not on account of any personal qualification and that the remuneration paid to him was only an increased share of the income of the company paid to him as representing the family. Even if there was some element of personal service that would not change the character of the income.

7. We, accordingly, answer the question in the affirmative, in favour of the department and against the assessee. The department is entitled to costs, which we assess at Rs. 200.