

(1989) 01 AP CK 0027

In the Andhra Pradesh High Court

Case No : Referred Case No. 93 of 1984

Commissioner of Income Tax

APPELLANT

Vs

Bajrang Lal

RESPONDENT

Date of Decision : 24-01-1989

Acts Referred:

Income Tax Act, 1961 — Section 64, 64(1)

Citation : (1989) 176 ITR 334

Hon'ble Judges : V. Neeladri Rao, J;B.P. Jeevan Reddy, J

Bench : Division Bench

Advocate : M. Suryanarayana Murthy, for the Appellant; Y. Ratnakar, for the Respondent

Judgement

B.P. Jeevan Reddy, J.—The Income Tax Tribunal, Hyderabad, has stated the following questions for our opinion u/s 256(1) of the Income Tax Act :

"Whether, on the facts and in the circumstances of the case, the interest amounts received by the minors, Master Sanjay Kumar and Master Manoj Kumar, are not includible u/s 64(1)(iii) in the income of the assessee, Sri Bajranglal (father of the minors), for the assessment year 1976-77 ?"

2. Jagdish Prasad and his brother, Musaddilal, constituted a partnership firm, Jagdish Prasad Co. One Bajranglal is the assessee herein. In 1970, his elder son by name, Sanjay Kumar brought in a sum of Rs. 10,000 into the partnership. Four years later, the other son of Bajranglal, Master Manoj Kumar, was also admitted to the benefits of the partnership. A similar Sum of Rs. 10,000 was brought in by Master Manoj Kumar on the occasion of his admission. When Sanjay Kumar was admitted, a deed of partnership was executed. For the assessment year 1976-77, the Income Tax Officer included the share income of the above two minors in the assessment of the father, Bajranglal. The income so included was Rs. 21,881 in the case of Sanjay Kumar and Rs. 18,359 in the case of Manoj Kumar. These amounts included interest amounts in sums of Rs. 4,272 and Rs. 750 respectively, that is, interest paid on the amounts to the credit of

each of the minors at the time of their admission to the benefits of the partnership and also on the accumulated profits of Sanjay Kumar. The assessee appealed to the Appellate Assistant Commissioner against the inclusion of interest amounts of the minors in his income. The Appellate Assistant Commissioner dismissed the appeal relying upon clause 3 of the deed of the partnership which provided that the partners shall contribute the capital required by the firm and that such capital shall carry interest at 7.5%. The Appellate Assistant Commissioner observed that interest was paid to the minors at the rate of 7.5% only which indicated that the amount contributed by the minors was in the nature of capital. On further appeal, however, the two Members of the Tribunal differed. The Accountant Member agreed with the assessee's contention. He was of the opinion that clause 3 of the partnership deed refers treated as partners. He observed that the said amounts represent deposits by the minors and not contribution to capital. On the other hand, the Judicial Member opined that the definition of partner in the Income Tax Act takes in a minor further that there was no express agreement or arrangement with the firm to keep the accumulated profits of the minors as deposits. He was of the opinion that in the circumstances on record, it is also not possible to spell out an oral contract or agreement to the effect that the said amounts shall be treated as deposits. He was, therefore, of the opinion that the interest income earned by the minors was includible in the assessee's total income. In view of the difference of opinion between the two Members, the matter was referred to a third Member.

3. The third Member, by his order dated April 7, 1982, agreed with the view taken by the Accountant Member of the Tribunal. He was of the opinion that there was no obligation cast on the minors to contribute any capital. He was, therefore, of the opinion that the amounts brought in by the minors and also the accumulated profits in the case of Sanjay Kumar represent only deposits. On this basis, he held that the interest paid to the minors cannot be included in the assessee's income. With respect to the accumulated profits, the said Member declined to apply the ratio of the decision of the Supreme Court in *S. Srinivasan Vs. Commissioner of Income Tax, Madras*, on the ground that the facts of the case before the Supreme Court are distinguishable from the facts of the present case. Thereupon, the Revenue applied for and obtained this reference.

4. Section 64 of the Income Tax Act, 1961, provides for inclusion of the income of spouse or minor child in the income of the assessee in certain circumstances. In this case, we are concerned with clause (iii) in subsection (1) of section 64 which reads thus :

"In computing the total income of any individual, there shall be included all such income as arises directly or indirectly -

(iii) to a minor child of such individual from the admission of the minor to the benefits of the partnership in a firm."

5. The question, therefore, is whether the interest amount was paid to the

minors on account of their admission to the benefits of the partnership firm. If it can be said on the facts before us that there is a definite connection or nexus between such interest amount and the admission of the minors to the benefits of the partnership, then such interest amount can be included in the father's income but not otherwise. In short, the question arising before us is not a pure question of law but is a mixed question of fact and law. It is, therefore, necessary to briefly refer to the relevant facts.

6. The deed of partnership dated November 21, 1974, executed at the time of admitting Manoj Kumar to the benefits of the partnership contains the following relevant recitals. The elder son of Bajranglal, Master Sanjay Kumar, was admitted to the benefits of the partnership under the partnership deed dated December 17, 1970. The second son of Sri Bajranglal, Master Manoj Kumar, aged five years, was also admitted to the benefits of the partnership with effect from November 13, 1974. Clause 3 stated :

"The capital shall be invested by all the partners as and when required which shall carry interest at 7 1/2%."

7. Clause 6 provided that the profits of the partnership firm shall be divided equally among the two partners, namely, Jagdish Prasad and Musaddilal, and the two minors admitted to the benefits of the partnership, while the losses were to be shared only by Jagdish Prasad and Musaddilal in equal proportion. The other circumstances relevant is that on the occasion of admission of both Sanjay Kumar and Manoj Kumar, they brought in a sum of Rs. 10,000 each. Master Sanjay Kumar further allowed his profits earned over the years to be accumulated with the partnership firm, upon which he was paid interest at the same rate, namely, 7 1/2% per annum.

8. It is true that the partnership deed does not say that there is an obligation upon the minors to contribute capital. It also does not say that the minors were admitted to the benefits of the partnership because of their contribution of Rs. 10,000 each. But one has to take a realistic view of the facts. No one, for that matter a minor, would be admitted to the benefits of a partnership for nothing. Normally, minors are admitted to the benefits of the partnership either by accommodating in the share of their father-partner or if they bring in some capital or at least provide some funds by way of deposit with the firm or provide some other benefit. It would be evident that the minor admitted to the benefits of the partnership because they contributed Rs. 10,000 each at the time of their admission. It should also be noticed that clause 3 of the partnership deed provided that capital shall be invested by all the partners as and when required and that such capital shall carry interest at 7 1/2% per annum. Now, the minors were being paid interest at the rate of 7 1/2%. It is well known that the market rate of interest was much higher than 7 1/2% even at that time. In other words, the minors were keeping this amount with the firm not by choice but as a matter of obligation though such an obligation is not specifically referred to in the deed of partnership. This aspect has been rightly stressed by the Appellate Assistant

Commissioner and also the Judicial Member of the Tribunal. The fact that the expression "partner" is defined in the Income Tax Act, as including a minor is also not without relevance. We are, therefore, of the opinion that the contribution of Rs. 10,000 by each of the minors and the accumulation of profits by Sanjay Kumar is indivisibly connected with the fact of their admission to the benefits of the partnership. The said amounts cannot be treated as deposits, for, as said above, if there was really no obligation upon the minors to keep those amounts with the partnership, as prudent persons (i.e. their guardian and father) would have invested the said amounts elsewhere earning far higher interest.

9. So far as the accumulated profits are concerned, the decision of the Supreme Court in *S. Srinivasan Vs. Commissioner of Income Tax, Madras*, , in our opinion, is clearly applicable to the facts of the case. In the case before the Supreme Court, the shares of profits of the wife and the minor sons of the senior partner were allowed to be accumulated profits. The deed of partnership provided, *inter alia*, that (at page 274) :

"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 on such at the rate of 12 annas per cent. per mensem."

10. The question was whether the interest allowed on the accumulated profits was assessable in the hands of the senior partner (husband/father) u/s 16(3)(a) (i) and (ii) of the Indian Income Tax Act, 1922. It was held that the interest accrued to the wife and the minor sons at least indirectly because of their capacity mentioned in section 16(3)(a)(i) and (ii) and was, therefore, assessable in the appellant's hands. At the same time, the Supreme Court pointed out the distinction between a deposit or loan and accumulated profits. They said that the interest earned on a deposit or loan differs from the interest earned on accumulated profits arising from the firm itself. In short, the question to be answered in each case would be whether the amount which is earning interest is in essence and in truth a deposit or a loan or whether it is contribution to capital or accumulated profits arising from the firm itself. Since we have held that the sums of Rs. 10,000 each brought in by the minors was in the nature of contribution to capital and also because the accumulated profits arose from the very firm, they cannot be treated as deposits or loans, in the facts and circumstances of this case. They arose to the minors because of their character, namely, as members admitted to the benefits of partnership. It should also be noted that just as in the case before the Supreme Court, the accumulated profits were permitted by the minors to be used by the firm.

11. For the above reasons, we answer the question referred to us in the negative, that is, in favour of the Revenue and against the assessee.