

(1989) 05 CAL CK 0047

In the Calcutta High Court

Case No : Income-tax Reference No. 432 of 1980

Commissioner of Income Tax

APPELLANT

Vs

Ramesh Chandra Sogani

RESPONDENT

Date of Decision : 16-05-1989

Acts Referred:

Income Tax Act, 1961 — Section 64(1)

Citation : (1990) 183 ITR 312 : (1990) 52 TAXMAN 244

Hon'ble Judges : Bhagabati Prasad Banerjee, J;Ajit K. Sengupta, J

Bench : Division Bench

Advocate : Bagchi, for the Appellant;Bhattacharjee, for the Respondent

Judgement

Ajit K. Sengupta, J.—In this reference u/s 256(1) of the Income Tax Act, 1961, relating to the assessment year 1976-77, the following question of law has been referred to this court:

"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the interest of Rs. 11,480 payable to the minor son, Master Rajesh Sogani, by the firm, Messrs. Anil Kumar Mahendra Kumar, cannot be included in the income of the assessee-father u/s 64(1)(iii) of the Income Tax Act, 1961 ?"

2. The facts shortly stated are that the assessee's minor son, Master Rajesh Sogani, was admitted to the benefits of partnership in the firm, Messrs. Anil Kumar Mahendra Kumar. During the year under appeal, the said minor's share in the firm was determined at Rs. 8,599 and interest payable by the firm to the minor on the loans advanced by him was worked out at Rs. 11,480. The Income Tax Officer, while computing the assessee's total income, included both the amounts, i.e., share from firm and the interest under the provisions of Section 64(1)(iii).

3. On appeal, the Appellate Assistant Commissioner confirmed the inclusion of the share income but he excluded the interest income of Rs. 11,480 from the

assessed total income of the assessee as the interest income was considered by him to have accrued on the loans advanced by the minor out of his own funds.

4. Against that order of the Appellate Assistant Commissioner, the Department preferred an appeal before the Tribunal and it was contended on behalf of the Revenue that the amount standing as loan to the credit of the minor was his accumulated share of profit from the firm and so the Income Tax Officer rightly included the same in the assessee's total income u/s 64(1)(iii) of the Act. It was urged that the interest became payable to the minor as a result of his admission to the benefits of the partnership and not as an independent creditor. It was further urged that even the funds on which interest was paid to the minor belonged to him and the interest was includible in the income of the parents u/s 64(1)(iii) as the same was traceable to the admission of the minor to the benefits of the partnership.

5. It was, however, contended on behalf of the assessee that the provisions of Section 64(1)(iii) had no application in this case. It was further urged that Section 64(1)(iii) envisages income and not the benefit arising to a minor from the admission of such minor to the benefits of partnership. It was claimed that Section 64 creates an artificial income and, therefore, the provisions of that section should be construed strictly. Reference was made to Clause 10 of the partnership deed wherein it has been stated that the amounts standing to the credit of the partners shall be regarded as their capital and all further contributions made for the purpose of the firm's business by the partners, including the minor admitted to the benefits of the partnership, shall be deemed as loans to the firm as also the undrawn share of profit and interest lying credited in the partners' accounts including the minor's account shall also be treated as loans which will carry interest at 12% per annum.

6. The Tribunal, after hearing the submissions made before it by both the parties as also considering the cases relied on by them, held that interest payable by the firm on independent loans made by the minor to the firm or on the credit balance in the current account in the name of the minor was not includible in the income of the parents u/s 64(1)(iii) of the Income Tax Act, 1961. The Tribunal, therefore, upheld the order of the Appellate Assistant Commissioner.

7. The same contentions have been reiterated before us.

8. The question which calls for determination in this case is as to the treatment of interest paid by the firm to the minor admitted to the benefits of the partnership. It is now well-settled that the interest allowed to a minor admitted to the benefits of partnership by the firm on the capital supplied on behalf of the minor is liable to be included in the hands of the parent as income arising from the benefits of the partnership. Similarly, interest allowed by the firm on the accumulated share of profits of the minor is includible in the income of the parent. Interest payable by the firm on the amounts standing to the credit of the minor in excess of capital contributed or on profit accumulation is includible in

the income of the parent. But interest on independent loans made to the firm is not includible, since the income is not related to the admission to the benefits of partnership. It is, therefore, necessary to consider how the interest was payable to the minor in this case.

9. Clause 10 of the partnership deed provides that the amount standing to the credit of the partners shall be regarded as their capital and all further contributions made for the purpose of the firm's business by the partners, including the minor admitted to the benefits of partnership, shall be deemed as loans to the firm as also the undrawn share of profit and interest lying credited in the partners' accounts including the minor's share shall also be considered as loan which will carry interest at 12% per annum.

10. A similar case came up for consideration before the Madras High Court in Addl. Commissioner of Income Tax Vs. Misrimul Sowcar, . In that case the relevant clause of the partnership deed provided as follows (at page 125) :

"If, at any time, additional funds be considered by the parties hereto as necessary or expedient for efficiently carrying on or extending the business, the same shall be contributed by the parties hereto or raised from outsiders and, in either case, the monies so advanced to the business of partnership shall be treated as loan on which interest shall be paid at market rate or rates agreed upon by the parties and the same shall be treated as business expenses. Any amount other than the abovesaid capital standing to the credit of partners including share of profit that may be adjusted shall be treated as loan deposits which shall bear interest as may be mutually agreed upon having regard to the rate prevailing in the market."

11. In that case, the Income Tax Officer included the interest paid to the minors on the loan deposits in the hands of the assessee as arising to the minors on account of their admission to the benefits of partnership by invoking Section 64 of the Act. The assessee appealed to the Appellate Assistant Commissioner who allowed the appeal. In the further appeal preferred by the Revenue before the Tribunal, the Tribunal held that there were separate accounts for the capital contributed by the minors and for their deposits and accumulations of profits, that Clause 3 of the partnership deed operated as a special agreement converting the accumulated profits into loans and deposits, and that the interest derived by the minors was interest on loans and deposits, and not on accumulated profits as such. The Tribunal, therefore, confirmed the deletion as directed by the Appellate Assistant Commissioner.

12. On a reference before the High Court, the High Court observed as follows (at page 127) :

"With reference to the taxation of interest payable on the amount to the credit of a minor as capital, it is not in dispute that such interest is liable to be included in the hands of the parent as income arising from the admission of the minor to the benefits of the partnership. The question arises only with reference to any other

amount on which interest is paid. Looking at the provision bereft of authority, it appears to us that the section contemplates the assessment, in the hands of the parent, of all income arising to the minor by way of interest, so long as the interest is traceable to the admission of the minor to the benefits of the partnership, either under the terms of the partnership deed or under a subsequent agreement. Even in the absence of any agreement, interest paid on capital would be traceable to the membership in the firm. So long as the amount of interest is traceable to the admission of the minor to the benefits of partnership, Section 64(1)(ii) of the Act would be attracted."

13. The court, thereafter, proceeded to hold as follows (at page 128) :

"Learned counsel for the assessee sought to distinguish this decision by contending that in the present case the contract of partnership had itself provided that the amount lying to the credit of any partner is to be treated as loan deposit and should bear interest as may be mutually agreed upon having regard to the rate prevailing in the market. The contract itself, according to the learned counsel, provided a conversion of what was accumulated profits into loan or deposits. We are unable to accept this submission. The contract between the parties is not effective to bring about a legal fiction, just as Parliament could do. Let us take the position as on the closing date of the accounting year of a firm like this. On that date, what is arrived at and credited to the account of the minor is only accumulated profit. Merely because the partnership deed declares that this amount should be treated as loan its character is not altered. The provisions in a partnership deed do not have such powers of alchemy. In the present case, the accumulated profits alone are the subject-matter under consideration. It is not stated that there was any other amount provided by the minors on which interest has been paid."

14. We respectfully agree with the views taken by the Madras High Court. The very provision in the partnership deed regarding the accumulated profit is not effective to convert such accumulated profit as a loan or a deposit. The Supreme Court in *S. Srinivasan Vs. Commissioner of Income Tax, Madras*, considered this question. The decision in *Addl. Commissioner of Income Tax Vs. Misrimul Sowcar*, . In *S. Srinivasan Vs. Commissioner of Income Tax, Madras*, , the Supreme Court held (at page 276) :

"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 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 of 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 the funds of theirs, because they had interest 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 Section 16(3)(a)(i) and (ii) of the Income Tax Act."

15. The Supreme Court also observed as follows (at page 278) :

"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."

16. It appears to us that, in this case, there is no separate arrangement or agreement between the guardian of the minor and the firm so as to pay interest by conversion of the amount into a deposit or a loan. The treatment of accumulated, profit as loan has been made in the partnership deed itself. Unless there is an agreement subsequent to the crediting of the share of the profit to the minor's account regarding its conversion, the accumulations of profit and all accretions thereto will be referable to the admission of the minor to the benefits of partnership. Interest on such accumulation is, therefore, includible in the hands of the parent.

17. For the reasons aforesaid, we answer the question in this reference in the negative and in favour of the Revenue.

18. There will be no order as to costs.

Bhagabati Prasad Banerjee, J.

19. I agree.