

(1979) 01 BOM CK 0025

In the Bombay High Court

Case No : Income-tax Reference No. 107 of 1970

Commissioner of Income Tax, Poona

APPELLANT

Vs

S.V. Nashte

RESPONDENT

Date of Decision : 30-01-1979

Acts Referred:

Income Tax Act, 1961 — Section 64

Citation : (1979) 119 ITR 130 : (1979) 1 TAXMAN 429

Hon'ble Judges : M.N. Chandurkar, J;Desai, J

Bench : Division Bench

Advocate : R.J. Joshi, for the Appellant; I.M. Munim, for the Respondent

Judgement

Chandurkar, J.—A firm by name Messrs. V. L. Nashte & Co. was constituted under an instrument of partnership dated 25th November, 1960, with five partners, that is, the assessee in this case and his four major sons. Three minor sons of the assessee, namely, A. S. Nashte, R. S. Nashte and K. S. Nashte, were admitted to the benefits of the partnership. Under clause 5 of the deed of partnership dated 21st January, 1955, the two minor sons, A. S. Nashte and R. S. Nashte, contributed a capital of Rs. 42,753. By a subsequent deed dated 24th October, 1957, the assessee's other minor son, K. S. Nashte, was admitted to the benefits of the partnership and he had contributed a capital of Rs. 25,000 as provided in clause 3 of the partnership deed. It is common ground that the capital contributions made by the three minor sons of the assessee came out of the assets received by them on a partial partition of their HUF property. By a letter dated 1st of November, 1958, written by the assessee in his capacity as guardian of his three minor sons he instructed the firm to transfer a sum of Rs. 64,500 from the capital account of the two minors, A. S. Nashte and R. S. Nashte, and a sum of Rs. 42,000 from the account of the third minor son, K. S. Nashte, to the loan accounts to be opened in their respective names in the books of the firm. This letter said that the firm has to pay interest at the rate of 6% p. a. on these amounts transferred to the loan accounts. In subsequent years also

some more amounts from the minors" capital accounts were transferred to the loan accounts in their respective names on which the firm paid interest to the minors. In assessment proceedings of the assessee for the assessment years 1962-63, 1963-64 and 1964-65, apart from including the share income of the three minor sons in the income of the assessee, the interest credited to these minors" loan accounts was also included in the income of the assessee by the ITO purporting to give effect to s. 64(ii) of the I. T. Act 1961, as the provisions stood at the material time.

2. In appeal by the assessee, the AAC upheld the inclusion of the shares of the profit of the minors in the assessment of the assessee but directed the ITO to exclude the interest amounts from the assessee's assessments following a decision of this court in *Bhogilal Laherchand Vs. Commissioner of Income Tax, Bombay City*, .

3. The ITO filed an appeal before the Appellate Tribunal against the order of the AAC. The Tribunal took the view that the interest earned on the loan accounts in the firm in which the assessee was also a partner did not lead to the inference that the interest income was earned by the minors on account of their admission to the benefits of partnership. The Tribunal observed that if the assessee, instead of transferring a part of the minors" capital accounts to the loan accounts opened in their names, has chosen to take out that portion of the capital and invested it somewhere else, the interest earned thereon would not have been taxed as the income of the assessee.

4. The revenue was aggrieved by the view taken by the Tribunal and the AAC and the following question has, therefore, been referred to this court under s. 256(1) of the I. T. Act, 1961, for the assessment years 1962-63 to 1964-65 :

"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the interest credited to the loan account of the minors in the books of the firm was not includible in the total income of the Assessee ?"

5. At the outset, we will reproduce the material provision in s. 64(ii) as it was at the material time. It reads as follows :

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

(ii) to a minor child of such individual from the admission of the minor to be benefits of partnership in a firm in which such individual is a partner....."

6. Mr. Joshi appearing on behalf of the revenue has contended that since interest on capital contributed by the minor could properly be included in the assessment of the assessee, and since the loan account is created out of the money standing in the capital account, the interest paid on these loans was also liable to be included in the assessment of the assessee. In other words, the argument is that this is not a case where a loan simpliciter has been advanced by or on behalf of a minor out of his own funds, but that a part of the capital account has been

converted into a loan account and, therefore, the income must be said to arise directly or indirectly from the admission of the minor to the benefits of the partnership.

7. Now, a bare reading of the provisions in s. 64(ii) would indicate that there must be some nexus direct or indirect between the income which accrues to a minor and his admission to the benefits of the partnership firm. It is not in dispute that the amounts which were originally contributed as capital and which were then transferred to the loan accounts belonged to the minors in their own right because they came to them as their share at the partition of the property of the joint Hindu family. The assessee acting as the guardian of the minors could well have invested moneys belonging to the minors in any other manner or, as it is not disputed by Mr. Joshi, they could initially have been advanced as loan to the partnership firm. There was no obligation on any of the minors to advance any moneys by way of loans to the partnership firm and it is not that unless he advanced that amount by way of loan, he could not be admitted to the benefits of the partnership. It is true that the moneys initially were contributed as capital of the partnership firm. But the moment the guardian of the minor, that is, the assessee, had directed that a part of the capital amount should be withdrawn and be treated as a loan, the nature of the amount immediately underwent a change and the amount now stood as a loan advanced by the minor. Whether this loan came out of the capital, which was originally invested in the partnership firm or whether this loan was made independently, would not be relevant because in neither case could this transaction be related, even remotely, to the admission of the minor to the benefits of the partnership. The minor received interest in his own right as a lender of money to the partnership firm and if this was not in any way related to his admission to the benefits of the partnership, it will not be possible to bring it within the words of s. 64(ii) of the I. T. Act, 1961. Section 64(ii), which fictionally or notionally makes the income of the minor child includible in the income of the assessee, must be strictly construed. Giving the words their natural and normal meaning, interest received on loans advanced by a minor out of his own funds to a partnership firm to the benefits of which he is admitted cannot be said to be income arising directly or indirectly from the admission of the minor to the benefits of the partnership. In *Bhogilal Laherchand v. CIT* [1954] 25 ITR 532, this court has taken the view that the interest earned by the minors on the amounts standing to their credit in the firm could not be included in the total income of the assessee under s. 16(3) (a) (ii) of the Indian I. T. Act, 1922, which was the corresponding provision under that Act. In that case, the assessee had started a partnership business with his major son and admitted to the benefits of partnership his two minor sons. In the relevant assessment year, the share of profit of each of the minors was included in the total income of the assessee under s. 16(3) (a) (ii) of the Indian I. T. Act, 1922, and the question which had to be decided by this court was whether interest which the minors received on deposits standing to their credit in the firm could not be included in the total income of the assessee under s. 16(3) (a) (ii). In that

case, it was found that the partnership deed did not cast any obligation upon the minors to maintain any deposits in the firm or upon the firm to keep any deposits made by the minors. The partnership deed had fixed the rate of interest and had provided that interest at that rate should be paid by the firm if there were any deposits or moneys standing to the credit of the minors. The court on those facts held that s. 16(3) must be very strictly construed and that the interest earned by the minors on the amounts standing to their credit in the firm could not be included in the total income of the assessee.

8. Mr. Joshi on behalf of the revenue sought to distinguish this case, and, according to him, as already stated, the distinguishing feature was that in the present case a part of the capital amount was converted into a loan by transferring it to a loan account. That, in our view, would not make any difference so far as the scope of s. 64(ii) is concerned. We may also refer to another recent decision of this court in *Commissioner of Income Tax, Bombay City-II Vs. Chandanmal Kasturchand*, It was pointed out in that case that in deciding whether a case falls under s. 16(3) (a) (ii) of the Indian I. T. Act, 1922. or s. 64(ii) of the Act of 1961, it is necessary to find out whether there is any connection between the income and the admission of the minor to the benefits of partnership. This connection need not be direct and it may even be indirect. We may briefly refer to the facts in that case. There was a partial partition of an HUF and the erstwhile coparceners of the family formed a partnership to carry on the business. Two minor sons of the assessee, who was the karta, were admitted to the benefits of the partnership. The capital of the business was also divided among the coparceners and a sum of Rs. 25,788.89 forming part of the initial capital came to be credited in the name of each of the erstwhile coparceners including the two minor sons. Clauses 4 and 5 of the partnership deed, in that case, showed that no obligation was cast on the minors to bring in any capital, but at the same time there was also no bar to their bringing in any capital. Clause 6 provided for payment of interest on the capital. The question was whether the interest credited on the sum of Rs. 25,788.89 as well as interest credited on the accumulated profits credited to the account of the minors but remaining with the firm was liable to be included in the total income of the assessee. It was held that the interest on the amount of Rs. 25,788.89 had a connection with the admission of the minors to the benefits of the partnership and was liable to be included in the total income of the assessee, but that interest on the accumulated profits which remained in the firm could not be included in the total income of the assessee. Dealing with the second question, namely, whether interest on the accumulated profits which remained with the firm could be included in the total income of the assessee, this court has referred exhaustively to the decision of the Supreme Court in *S. Srinivasan Vs. Commissioner of Income Tax, Madras*, and pointed out that in that decision the Supreme Court had clearly carved out an exception where an arrangement with the firm to keep the accumulated profits as deposits could be made on behalf of the minor sons and it was held that if such an arrangement could be said to have

been made, the ratio of the decision in *S. Srinivasan Vs. Commissioner of Income Tax, Madras*, would not apply. Srinivasan's case was expressly a case where the shares of the profits of the wife and the minor sons were allowed to accumulate without interest and later on interest was paid on these accumulated profits and the question was whether the interest so allowed was assessable in the hands of the assessee under s. 16(3) (a) (i) and (ii) of the Indian I. T. Act, 1922. The Supreme Court held that the interest accrued to the wife and the minor sons at least indirectly because of their capacity mentioned in s. 16(3) (a) (i) and (ii) were, therefore, assessable in the appellant's hands. In that case, the Supreme Court also pointed out that the cases where interest is earned on a deposit or loan differ from cases where interest is earned on the accumulated profits arising from the firm itself. Mr. Joshi had relied on the decision in Srinivasan's case [1967] 63 ITR 237 . But, as we have earlier pointed out, the ratio of that decision was considered in detail in *Commissioner of Income Tax, Bombay City-II Vs. Chandanmal Kasturchand*, and it was held by this court that where an arrangement with the firm to keep the accumulated profits as deposits could be made on behalf of the minor sons and if such an arrangement is found to have been made, the ratio of *S. Srinivasan Vs. Commissioner of Income Tax, Madras*, would not be attracted.

9. The argument of Mr. Joshi that a part of the capital account was converted into a loan account any by mere change of nomenclature the applicability of s. 64(ii) could not be prevented relying on *S. Srinivasan Vs. Commissioner of Income Tax, Madras*, must, in our view, be clearly rejected. We have already referred earlier to the letter dated 1st November, 1959, where there is an express direction by the assessee acting on behalf of his minor sons that a part of the capital amount should be transferred to a loan account and the firm would be liable to pay interest. This letter, in our view, is crucial, inasmuch as it changes the nature of the money lying with the firm from capital to that of loan. It is also important to note that the entire capital has not been withdrawn and converted into a loan because the lender clearly states that "... out of the amount standing to the credit of the above (minors) the amount of Rs. 64,500 be credited to the loan account of... " The assessee acting as the guardian could well have first withdrawn the amounts of Rs. 64,500 and Rs. 42,000 from capital and then advanced them as loans. Merely because this formality has not been gone through, it is not open to the revenue to contend that the character of the money has not undergone a change. The moment the amounts stood advanced as loans, the interest thereon could not be said to arise from the fact of admission of the minors to the benefits of the partnership either directly or indirectly. The Tribunal, in our view, was, therefore, right in holding that the interest earned on these loans could not be included in the income of the assessee under s. 64(ii) of the I. T. Act, 1961.

10. The question referred to us most, therefore, be answered in the affirmative and against the revenue. The revenue to pay the costs of the assessee.