
(1974) 05 AHC CK 0023

In the Allahabad High Court

Case No : Income-tax Reference No. 338 of 1972

Hari Krishna

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 14-05-1974

Acts Referred:

Citation : (1976) 105 ITR 612

Hon'ble Judges : Satish Chandra, J;H.N. Seth, J

Bench : Division Bench

Advocate : R.K. Gulati, for the Appellant; R.R. Misra, Adv, for the Respondent

Final Decision : Disposed Of

Judgement

Satish Chandra, J.—The assessee is a Hindu undivided family of which Hari Krishna is the karta. For the assessment year 1964-65, Had Krishna received Rs. 6,000 as managing director's remuneration from M/s. Beharilal Mannilal Investors and Financiers Private Ltd. The claim of Hari Krishna that this was his individual income was rejected by the Income Tax Officer on the ground that the family funds were Invested in the purchase of the shares of the company of which the assessee became the director.

2. On appeal the finding was affirmed and it was held that the managing director's remuneration was the income of the Hindu undivided family. The assessee carried the dispute to the Tribunal but failed.

3. At the instance of the assessee the Tribunal has referred the following question of law for the opinion of this court :

"Whether, upon the facts and circumstances of the case, the amount of Rs. 6,000 received by Sri Hari Krishna as salary in the capacity of a managing director of M/ s. Beharilal Mannilal Investors and Financiers Pvt. Ltd. constitutes his individual income or is liable to tax in the hands of the assessee Hindu undivided family ?"

4. A partnership, M/S. Beharilal Mannilal, carried on money-lending and kirana

business. It consisted of two partners, namely, Mannilal and Sarju Prasad, who were brothers, and were partners on behalf of their respective Hindu undivided families. In 1950, the business of this firm was taken over by a company styled as M/s. Beharilal Mannilal Investors and Financiers Private Ltd. It had 315 shares in which Hari Krishna acquired 200 shares. The consideration for buying these shares was paid out of his undivided family funds, Hari Krishna was appointed a life-director of the company on the condition that he continued to hold shares of the minimum value of Rs. 800 (sic) in his name. He was to be the first managing director of the company subject to the terms of an agreement between him and the company. On 24th January, 1950, an agreement was entered into under which Hari Krishna was appointed as a managing director for a period of ten years, The managing director's remuneration was fixed at Rs. 500 per month. On the expiry of this agreement, another agreement was entered into on 25th January, 1960, under which Hari Krishna was appointed as a managing director for ten years on the same terms, namely, salary of Rs. 500 per month plus conveyance and travelling expenses incurred by him for the business of the company. Hari Krishna was in addition to be provided with free residential house. The managing director was entitled to the management of the whole affairs of the company. He was to conduct the business of the company. He was given powers to borrow, to lend and invest money and to acquire and dispose of property and to do all other acts and things necessary to act as managing director.

5. Hari Krishna's Hindu undivided family consisted of himself, his wife and four sons. In 1953, there was a partial partition under which out of 200 shares held by this Hindu undivided family in the company, 50 were allotted to Hari Krishna and the remaining were given to the sons. The sons separated from the family. Thereafter, the family consisted of Hari Krishna and his wife only. Since the partition and till the assessment year 1963-64, the managing director's remuneration received by Hari Krishna was assessed in the status of an individual.

6. On 3rd August, 1959, a son was born to Hari Krishna. Accordingly, Hari Krishna filed a return of certain incomes in the status of a Hindu undivided family, but he claimed that the managing director's remuneration was his individual income and could not be assessed as the income of the Hindu undivided family.

7. Before the Tribunal it was urged that after partition and till the year 1963-64, the remuneration received by Hari Krishna as managing director was taxed in his hands as an individual. After the partition the investment in the shares of this company were by Hari Krishna in his individual status, and, therefore, the managing director's remuneration received by him was his individual income.

8. In the next place it was urged that the post of managing director was given to Hari Krishna on the grounds of his personal qualification and ability for managing the type of business carried on by the company, and the remuneration being for

his personal qualifications was his individual income. It was urged that the duties entrusted upon Hari Krishna required expert knowledge in financing and investment. The Tribunal held that the 200 shares held initially in the company belonged to the Hindu undivided family of which Hari Krishna was the karta. The possession of those shares entitled Hari Krishna to be qualified to become a director of the company. Even after the partial partition these shares retained their original character. After the birth of a son, the Hindu undivided family revived and the shares held by Hari Krishna belonged to the Hindu undivided family consisting of himself, his wife and his new born son. The fact that the department chose to assess Hari Krishna in the status of an individual till the birth of a son did not mean that the nature and character of the shares change from ancestral to individual. Since the nucleus for the qualifying shares was Hindu undivided family funds, the remuneration received as managing director would belong to the Hindu undivided family.

9. With regard to the other plea, the Tribunal held:

"It is no doubt true that under the terms of the agreement between the company and the karta of the assessee appointing the latter as the managing director of the former, the duties cast on the managing director do require experience and knowledge in the line of the company's business. The fact, however, remains that under the terms of the articles of association of the company, of which mention has already been made above, no person could be appointed to the post of managing directorship until he was a director of the company and for becoming a director of the company, he was required to have the minimum holding of shares worth Rs. 5,000. This qualification had been achieved by utilising the family funds."

10. After referring to the decisions of the Supreme Court in *Piyare Lal Adishwar Lal Vs. The Commissioner of Income Tax, Delhi*, and *The Commissioner of Income Tax, West Bengal Vs. Kalu Babu Lal Chand*, the Tribunal held that the crucial test was: What was the primary consideration for the appointment to the post: is it the personal qualification or is it the financial qualification? The Tribunal then held:

"Applying the test as laid down above, we find that in the instant case the primary consideration for appointment of Shri Hari Krishna to the post of managing directorship was the holding of shares worth Rs. 5,000 as director of the company, which shares had been admittedly acquired out of the joint family funds. No doubt the duties that he has to perform for the company required experience and knowledge but that was not the primary consideration for his appointment as the managing director of the company. Under such circumstances, we must hold that the income by way of remuneration earned by Shri Hari Krishna arose to the family and had been rightly assessed in its hands."

11. The Supreme Court in *Shri Raj Kumar Singh Hukam Chandji Vs. Commissioner of Income Tax, Madhya Pradesh*, considered the Privy Council

decision in *Gokul Chand Amar Nath v. Hukam Chand Nathu Lal*, AIR 1921 PC 35 and held that the principle adopted in it that "in considering whether gains are partible, there is no valid distinction between the direct use of the joint family funds and a use which qualifies the member to make the gains by his own efforts" is no longer valid. The court considered its own previous decisions and ultimately held that the relevant tests are :

"(1) Whether the income received by a coparcener of a Hindu undivided family as remuneration had any real connection with the investment of the joint family funds;

(2) Whether the income received was directly related to any utilisation of family assets ;

(3) Whether the family had suffered any detriment in the process of realisation of the income ; and

(4) Whether the income was received with the aid and assistance of the family funds."

The court held:

"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 compensation made for the services rendered by the individual coparcener."

12. The crucial test, therefore, is whether the remuneration is, in substance, the return made to the family because of the investment of the family funds in the business, or whether it is compensation for services rendered by the individual coparcener. The Tribunal erred in holding that the crucial test was as to what was the primary consideration for the appointment to the post: personal or the financial qualification. The test of financial qualification adopted by the Privy Council in *Gokul Chand's* case, AIR 1921 PC 35 has been held by the Supreme Court to be valid.

13. Keeping in view the principles enunciated by the Supreme Court, the relevant facts are that the joint family initially held 200 shares in this company, but at the relevant time it had only 50 which enabled Hari Krishna to become a director. No doubt, being a director was a qualifying condition for appointment as managing director, but there were other qualified directors in this company. Hari Krishna became a managing director by virtue of the agreement entered into by him with the company under which he had to render services befitting an investment and financing company. The duties that he had to perform for the company required experience and knowledge in the line of the business carried on by the company. There is nothing to suggest that the joint family suffered any detriment because of the remuneration paid to the managing director. There is no finding that the shares held by the family did not yield dividend. The family funds aided Hari

Krishna in becoming a director But there the aid and assistance of the family funds ceased. It could not be said that the remuneration paid for working as managing director was itself received with the aid and assistance of the family funds. Taking all the facts into consideration, it is difficult to hold that the remuneration paid to Hari Krishna was in substance a return made by the company to the family of its slender investment in the company.

14. Our answer to the question referred to us is that the amount of Rs. 6,000 received by Hari Krishna by way of salary as managing director was his individual income and was not liable to be taxed in the hands of the Hindu undivided family.

15. The assessee would be entitled to costs, which are assessed at Rs. 200. Fee of the learned counsel is assessed at the same figure.