

(2008) 06 GUJ CK 0017
In the Gujarat High Court

Case No : Income Tax Reference No. 46 of 1999

P.V. Thakar

APPELLANT

Vs

The Commissioner of Income Tax

RESPONDENT

Date of Decision : 25-06-2008

Acts Referred:

Income Tax Act, 1961 — Section 171, 64, 64(1)

Citation : (2008) 06 GUJ CK 0017

Hon'ble Judges : Jayant Patel, J; Akil Kureshi, J

Bench : Division Bench

Advocate : S.N. Divatia, for the Appellant; Manish R. Bhatt, for Respondent 1, for the Respondent

Judgement

Jayant Patel, J.—The question referred to this Court at the instance of the assessee are as under:

(1) Whether the Tribunal is right on facts and in law in holding that the assessee's wife and son are entitled to receive 1/3rd share each from only 75% shares in the profit of the business in the name and style of M/s. Mukund and that they have no right to receive any share from the remaining 25% share?

(2) Whether the Tribunal is right on facts and in law in holding that the assessee is entitled to a deduction of only 50% and not 2/3rd of the total income from the business of M/s. Mukund.

2. At the instance of Revenue, following questions are referred to this Court:

(1) Whether the Appellate Tribunal is right in law and on facts in confirming the order passed by CIT(A) directing the A.O. to exclude 2/3rd of the profits derived from M/s. Mukund as having been accrued in favour of the assessee's wife and minor son, is on account of an over-riding title?

(2) Whether the Appellate Tribunal is right in law and on facts in holding that the aspects of Section 64 have no application in the instant case?

3. The short facts, which may be relevant for examining the questions are as under:

3.1 M/s. Mukund was carrying on the business of dealers of cloth and the said business was carried by a partnership firm w.e.f. S.Y. 2033 i.e. upto 28.2.1977 and the partnership comprised of three partners namely; Shri Pravinchandra V. Thakar, Shri Kantilal P. Pandya and Shri N.N. Joshi at the initial stage. Shri N.N. Joshi retired from the firm w.e.f. 28.2.1977 and the remaining partners continued the business of partnership firm from 1.3.1977. As per the partnership deed executed on 10.3.1977 between two remaining partners, share of Shri P.V. Thakar was 75%, whereas the share of Shri K.P. Pandya was 25%.

3.2 It is an undisputed position that Shri P.V. Thakar was partner in the firm in his capacity as Karta of HUF comprising of Shri P.V. Thakar as Karta, his wife Smt. Ranjanben and his minor son Dhruvan P. Thakar. The partial partition of the aforesaid HUF was made by the registered deed of partial partition dated 19.1.1978 and the said partial partition was made effective from 19.4.1977. Upon the application of HUF u/s 171 of Income Tax Act (hereinafter referred to as "IT Act"), the ITO vide order dated 17.3.1979 duly recognized such partial partition. As per the term of the partition, each member of the said family had accepted his/her share in the above referred 75% share in profit of M/s. Mukund in equal proportion and it was also agreed that Shri P.V. Thakar shall receive share as per the terms of the partnership deed executed between Shri P.V. Thakar and the other partners of the firm. In accordance with the terms of the said Memorandum of partial partition, assessee had been duly showing the share of the income from the said partnership after deducting 2/3rd share thereof as belonging to assessee's wife and minor child in view of the over-riding title created in favour of his wife and minor son by the above referred registered deed of partial partition. Such continued from the A.Y. 1978-79 to 1987-88, which was also accepted by the Assessment Officer.

4. In A.Y. 1987-88, the partnership firm of M/s. Mukund was dissolved and Shri P.V. Thakar became sole proprietor of the said business. The assessee has, in the return of income for A.Y. 1987-88 onwards shown the aforesaid income after deducting 2/3rd share as belonging to his wife and minor son on account of the above referred partial partition and resulting over-riding title. In A.Y. 1988-89, the assessee shown the income accordingly. The A.O. came to the conclusion that the entire income from the business of M/s. Mukund represents individual income of the assessee and no part of the said income belongs to either Smt. Ranjanben P. Thakar, being wife or Dhruvan P. Thakar, being minor son. He also opined that partial partition made by HUF on 19.4.1977 was a colourable device made for avoiding taxes. In appeal by the assessee, CIT(A) directed the A.O. to exclude 1/3rd share of the profit each belonging to the assessee's wife and minor son from the assessee's income. In further appeal by the Revenue, the Tribunal while accepting the over-riding title of wife and minor son held that the assessee's wife and minor son had no right to receive any share from the

remaining 25% share of the profit derived from the business of M/s. Mukund and they will continue to receive 1/3rd share each from the 75% profit of the said business, which the said HUF originally had in the partnership and also that the assessee shall be entitled to a deduction of an aggregate amount of 50% of the total income from the business of M/s. Mukund by virtue of an over-riding title in favour of the assessee's wife and minor son. It is under these circumstances, the present reference to this Court on the above referred questions.

5. We have heard Mr. Divatia, learned Counsel for the assessee and Mr. Manish Bhatt, learned Counsel for the Revenue.

6. It appears that on the factual aspects, there is neither any dispute qua the existence of partial partition, nor any on the aspects of existence of the fact of recognition of such partial partition. The pertinent aspect is that the position of over-riding title in view of the partial partition amongst, inter se, three members of the HUF namely; Shri P.V. Thakar, his wife, Ranjanben P. Thakar and his minor son, Dhruvan P. Thakar was accepted in the earlier assessment proceedings by the Department from A.Y. 1978-79 to A.Y. 1987-88. It is also not in dispute that the partnership firm came to be dissolved and it remained as the sole proprietary concern held by Shri P.V. Thakar.

7. Mr. Divatia, learned Counsel appearing for the assessee, contended that in view of the partial partition having been recognized and the consequence of conversion as sole proprietary concern, the proportion of the shares amongst three members of HUF would continue on the basis of 1/3rd as it existed prior to the dissolution and, therefore, it was submitted that the error is committed by the Tribunal in restricting the share of the other two members of HUF and assessing the shares of Shri P.V. Thakar to the extent of 50%. In the submission of Mr. Divatia, the Tribunal has committed error in law in considering the consequence upon the dissolution.

8. Whereas on behalf of the Revenue, Mr. Bhatt, learned Counsel contended that the HUF could not be as the partner in a partnership firm and if the Karta of HUF has joined the partnership firm, the income will be taxed at the hands of Karta in individual capacity, though thereafter such income may be appropriated amongst the other members of HUF. He submitted that the earlier assessment during the period from 1978-79 to 1987-88 was also contrary to the legal position and, therefore, the same was rightly not accepted by the A. O. He submitted that if the status of the Karta was not concerned in the relationship of the partnership firm, the Tribunal has committed error even in recognizing 1/3rd share of each member amongst 75% share of the HUF, which existed in the firm of Shri P.V. Thakar. He also contended that if the properties, upon the dissolution, are considered as individual share of the partner namely; Shri P.V. Thakar, none of the other members will have any share so far as the partnership firm is concerned and, therefore, it was submitted that the Tribunal has committed error.

9. In order to examine the legal position, we may refer to the Constitution

Bench's decision of the Apex Court in case of Commissioner of Income Tax, Ludhiana Vs. Shri Om Prakash, The Apex Court had an occasion to settle the issue in view of conflicting decisions of various High Courts, which, inter alia, included the question of treatment to the income of Karta of HUF with reference to the provisions of Section 64 of the IT Act. The other part of the decision may not be much relevant and, therefore, it may not be required to be considered in the present decision. However, the relevant observations made by the Apex Court can be extracted at para 19 of the said decision, which reads as under:

When a Karta of a Hindu undivided family is a partner in a partnership firm, he has a dual capacity qua the partnership, he functions in his personal capacity and qua third parties, in his representative capacity. Under Income Tax Act, when he is assessed in respect of the income derived by him from the partnership firm as a partner, it is in his representative capacity as Karta of the Hindu undivided family and not as an individual as such. That is because his capacity vis-a-vis spouse/minor children who are members of the Hindu undivided family is that of Karta and not as individual though vis-a-vis other partners of the partnership firm he functions in his personal capacity. This being the position, the income of Karta's spouse/minor child cannot be included in computation of his total income for that is the income of the Hindu undivided family and not his individual income. Section 64 will be attracted only when an assessee's own income is being assessed and not that of Hindu undivided family. If a Karta is brought within the ambit of "individual" in Section 64(1), the share income of the spouse of the Karta and his minor children will, in effect, be included in the income of the Hindu undivided family, which is not what is contemplated by Section 64(1) (i) and (ii) and which, with respect, we say has rightly been held to be impermissible by this Court in *L. Hirday Narain v. ITO*, *CIT v. Harbhajan Lal* and *CIT v. Jayantilal Prem Chand Shah*.

10. As such in the above referred decision, the Constitution Bench of the Apex Court has confirmed its earlier view in case of *Charandas Haridas and Anr. v. Commissioner of Income Tax, Bombay North, Kutch and Saurashtra*, *ahmedabad and Anr.* reported at 39 Income Tax Report, p. 202. Based on the above referred decision of law settled by the Apex Court, it can be said that as a consequence of the dissolution, the property as was held by Shri P.V. Thakar became absolute so far as the rights amongst the partners in the firm, but the effect of the over-riding title already confirmed earlier qua his share will have to be recognized. If the over-riding title is existed in the property held by Shri P.V. Thakar, the consequence would be that each member namely; Shri P.V. Thakar, his wife, Smt. Ranjanben and his minor son Dhruman P. Thakar will have equal share namely; 1/3rd in the total property and such will be the consequence even in the income so derived therefrom.

11. The Tribunal, in principle, has accepted the over-riding title, however, it appears to us that without there being any factual foundation, has committed error in restricting such consequence to the extent of 75% of the profits of the

business instead of 100%. Further, there is no factual foundation either from the order of the A.O. Or of CIT(A) for making departure based on service rendered by Shri P.V. Thakar in his individual capacity.

12. The reliance placed by Mr. Bhatt, learned Counsel for the Revenue, upon the decision of the Apex Court in case of *Commission of Income Tax v. Sunil J. Kinariwala* is ill-founded inasmuch as it was a case for assessment of the interest by assessee, who was the partner in the firm. The assessment would stand on a different footing than that of Karta representing HUF in a partnership firm. In case of *National Wire Manufacturing Co. Vs. Commissioner of Income Tax*, upon which the reliance is placed by Mr. Bhatt, learned Counsel for the Revenue, this Court was considering the question as to whether the partner could claim the remuneration in a firm on the premise that his capacity is as Karta of HUF and not as the partner. The relationship amongst the partner, inter se, would not get altered irrespective of his capacity as partner in individual capacity or as Karta of HUF. Such aspect is not the subject matter in the present case and, therefore, the decision cannot be made applicable in the questions to be considered by this Court.

13. Mr. Bhatt, learned Counsel for the Revenue, also relied upon the observations of the Apex Court in case of *Rashiklal and Co. Vs. Commissioner of Income Tax, Orissa*, for contending that if a person has become partner in his capacity as Karta of HUF, he is not entitled to have a separate status and so far as the Partnership Act is concerned, he is to be treated as in personal capacity and his capacity being Karta of HUF is of no relevance.

14. As such the aforesaid decision is also a case for admissibility of the additional remuneration by way of commission by a partner, claiming his capacity as Karta of HUF. Such observations may apply if the rights are to be considered, inter se, amongst the partners for entitlement of the remuneration vis-a-vis Partnership Act and the admissibility of the expenses under the Income Tax Act. Such is not the fact situation to be considered in the present questions coming up before this Court.

15. In view of the above, it is held that each Member of HUF being Shri P.V. Thakar, his wife, Smt. Ranjanben P. Thakar, and his minor son, Dhruman P. Thakar, in view of the over-riding title, were entitled to equal 1/3rd share each. Hence, we answer Question Nos.1 and 2 in favour of assessee, against the Revenue.

16. Such will be the situation for question referred to at the instance of Revenue inasmuch as Question No. 1 is answered against the Revenue, in favour of the assessee.

17. As regards Question No. 2 referred at the instance of Revenue is concerned, it appears to us that there is absolutely no factual foundation inasmuch as the Appellate Tribunal has not held that the provisions of Section 64 of the IT Act has no application in the instant case. Therefore, as the question does not arise from

the Judgment of the Tribunal, the same is not required to be answered.

18. The Reference shall stand disposed of accordingly.