

A

S. RM. CT. PL. PALANI APPA CHETTIAR

v.

## THE COMMISSIONER OF INCOME-TAX, MADRAS

October 26, 1967

B

[K. N. WANCHOO, C.J., R. S. BACHAWAT, V. RAMASWAMI,  
G. K. MITTER AND K. S. HEGDE, JJ.]

*Indian Income-tax Act (11 of 1922)—Hindu undivided family, shares acquired from funds of—Remuneration of karta as Managing Director—Whether income of the family.*

C

Out of the funds of a Hindu undivided family, 90 shares out of 300 shares of a company were purchased. After a few years the Karta of the family became a director of the company and was later appointed its Managing Director. The Income-tax Officer added the remuneration of the karta for the assessment of the Hindu undivided family and on the basis of the decision of this Court in *The C.I.T. West Bengal v. Kalu Babu Lal Chand* held that the remuneration was to be treated as income of the family. The assessee appealed unsuccessfully to the Appellate Assistant Commissioner, but the Tribunal accepted the assessee's plea. On reference, the High Court answered in favour of the Revenue holding that its decision in *C.I.T. Madras v. S. N. N. Sankaralinga Iyer* was not authoritative as this Court has subsequently impliedly overruled that decision in *The C.I.T. West Bengal v. Kalu Babu Lal Chand* and the later decision of this Court in *M/s. Piyare Lal Adishwar Lal v. The C.I.T. Delhi* was distinguishable. In appeal, this Court—

D

E

**HELD :** The remuneration of the Managing Director could not be treated as an accretion to the income of the joint family and taxed in its hands. The shares, in this case, were purchased by the joint family not with the object that the karta should become the Managing Director but in the ordinary course of investment. There was no real connection between the investment of joint family funds in the purchase of the shares and the appointment of karta as managing director of the company. Applying the doctrine of Hindu Law, the remuneration of the managing director was not earned by any detriment to the joint family assets.

F

G

The present case did not fall within the principle of this Court's decision in *C.I.T. West Bengal v. Kalu Babu Lal Chand* but bore analogy to this Court's decision in *M/s. Piyare Lal Adishwar Lal v. The C.I.T. Delhi*. The decision of the Madras High Court in *C.I.T. Madras v. S. N. N. Sankaralinga Iyer* was not impliedly over-ruled by this Court in *C.I.T. West Bengal v. Kalu Babu Lal Chand* but was distinguished. The facts in the present case are almost parallel to those in *C.I.T. Madras v. S. N. N. Sankaralinga Iyer*. [60D-F]

*M/s. Piyare Lal Chand Adhishwar Lal v. The C.I.T., Delhi* [1960] 3 S.C.R. 669, followed.

*The C.I.T. West Bengal v. Kalu Babu Lal Chand* [1960] 1 S.C.R. 320, distinguished.

H

*C.I.T. Madras v. S. N. N. Sankaralinga Iyer*, 18 I.T.R. 194 referred to.

**CIVIL APPELLATE JURISDICTION :** Civil Appeal No. 1055 of 1966.

Appeal from the judgment and order dated October 17, 1963 of the Madras High Court in T.C. No. 151 of 1962. A

*R. Gopalakrishnan*, for the appellant.

*T. A. Ramachandran* and *R. N. Sachthey*, for the respondent.

The Judgment of the Court was delivered by

**Ramaswami, J.** This appeal is brought, by certificate, from the judgment of the Madras High Court in T.C. No 151 of 1962 dated October 17, 1963. B

The appellant (hereinafter referred to as the 'assessee') is a Hindu Undivided Family consisting of the father and four major sons. The assessee became a share-holder in the Trichy-Sri Rangam Transport Company Ltd. (hereinafter referred to as the 'company') in 1934 and owned 90 shares out of the 300 shares of the company. The shares were acquired with the funds of the Hindu Undivided family of the father and his four major sons. There were initially four shareholders including the assessee, two of whom were directors. On the death of one of the Directors, the assessee became a director in 1941 and on the death of another director who was managing the business the assessee became the Managing Director with effect from 1942. By a resolution dated April 16, 1944 the company granted him an honorarium of Rs. 3,000 for the year 1943-44 and subsequently raised it gradually till it became Rs. 1,000 per month with 12½% commission on the net profits of the company. The Managing Director had control over the financial and administrative affairs of the company and the only qualification required was set out under Art. 19 of the Articles of Association of the company which was to the following effect : C D E

"The qualification of a Director including the first Director shall be the holding in his own right alone and not jointly with any other person of not less than 25 shares and the qualification shall be acquired within two months of appointment." F

From 1938-39 to 1959-60 the assessee had been submitting returns in the status of Hindu undivided family and upto 1949-50 the assessments were completed in that status. For the assessment years 1950-51 to 1955-56, the assessments were completed in the status of individual, though returns were submitted in the status of Hindu undivided family and the remuneration was included in those assessments. For the assessment year 1956-57, the assessee submitted the return in the status of Hindu undivided family but claimed for the first time that the remuneration and sitting fees from the company should be assessed separately in the karta's hands. The claim was accepted and a separate assessment made G H

- A on him as an individual in respect of the remuneration and commission received from the company. This continued till the assessment for the year 1958-59. For the year ended April 13, 1959 which was the previous year for the assessment year 1959-60, the assessee family returned an income of Rs. 26,780 which did not include the Salary, Commission and Sitting fees received
- B by the karta which amounted to Rs. 18,683. The Income-tax Officer added the remuneration of the karta for the assessment of the Hindu undivided family and on the basis of the decision of this Court in *The C.I.T., West Bengal v. Kalu Babu Lal Chand*<sup>(1)</sup> held that the commission was to be treated as income of the family. The assessee appealed to the Appellate Assistant Commissioner but the appeal was dismissed. The assessee took the matter in further
- C appeal to the Income-tax Appellate Tribunal, Madras Bench. The Tribunal held that the case was governed by the decision of the Madras High Court in *C.I.T. Madras v. S. N. N. Sankaralinga Iyer*<sup>(2)</sup> and that the remuneration of the Managing Director ought not to be treated as income of the family. The Tribunal came to the conclusion that the judgment in *C.I.T., Madras v. S. N. N. Sankaralinga Iyer*<sup>(2)</sup> was not affected by the decision of this Court in *The C.I.T. West Bengal v. Kalu Babu Lal Chand*<sup>(1)</sup>. At the instance of the assessee the Appellate Tribunal stated a case to the Madras Court on the following question of law :

- E "Whether sums of Rs. 9,000, Rs. 8,133 and Rs. 1,550 received by the assessee as Managing Director's remuneration, commission and sitting fees are assessable as the income of the Hindu undivided family of which Palaniappa Chettiar is the Karta ?"

- The High Court took the view that the decision in *C.I.T., Madras v. S. N. N. Sankaralinga Iyer*<sup>(2)</sup> was not authoritative as this Court had subsequently impliedly overruled that decision in *The C.I.T., West Bengal v. Kalu Babu Lal Chand*<sup>(1)</sup> and the later decision of this Court in *M/s. Piyare Lal Adishwar Lal v. The C.I.T., Delhi*<sup>(3)</sup> was distinguishable. The High Court held that the case was governed by the ruling of this Court in *The C.I.T., West Bengal v. Kalu Babu Lal Chand*<sup>(1)</sup> and accordingly decided
- G the question of law against the assessee and in favour of the Income-tax Department.

- H On behalf of the assessee Mr. Gopalakrishnan put forward the argument that the High Court was in error in holding that the present case was governed by the decision of this Court in *The C.I.T., West Bengal v. Kalu Babu Lal Chand*<sup>(1)</sup>, that the remuneration earned by the Managing Director was not earned as a

(1) [1960] 1 S.C.R. 320.

(2) 18 I.T.R. 194.

(3) [1960] 3 S.C.R. 669.

result of the utilisation of the joint family funds in the business and there was no detriment to the joint family assets or the use of the joint family assets in the business. It was not therefore a right proposition to state that under the principle of Hindu Law the remuneration of the Managing Director in the present law was directly an accretion from the utilisation of the joint family funds and therefore constituted the income of the Hindu joint family. It was pointed out that in *C.I.T., West Bengal v. Kalu Babu Lal Chand*<sup>(1)</sup> the income of the Managing Director arose directly from the use of joint family funds, but the material facts in the present case are different. In our opinion, the argument of the appellant is well-founded and must be accepted as correct.

In *The C.I.T., West Bengal v. Kalu Babu Lal Chand*<sup>(1)</sup>, one Rohatgi, manager of a Hindu undivided family, who took over a business as a going concern, promoted a company which was to take over the business. The articles of association of the company provided that Rohatgi would be the first managing director at a remuneration specified in the articles. The shares which stood in the name of Rohatgi and his brother were acquired with funds belonging to the joint family and the joint family was in enjoyment of the dividends paid on those shares, and the company was floated with funds provided by the family, and was at all material times financed by the family. In proceedings for assessment of the Hindu undivided family, it was claimed that the managing director's remuneration constituted the personal earnings of Rohatgi and could not be added to the income of the Hindu undivided family. The claim was rejected by this Court and it was held that the managing director's remuneration received by Rohatgi was, as between him and the Hindu undivided family, the income of the family and should be assessed in its hands. In other words, the Court held that there was a real and sufficient connection between the investment of the joint family funds and the appointment of Rohatgi as the managing director and hence the managing director's remuneration was, as between him and the Hindu undivided family, the income of the family and was taxable in its hands. That is the true *ratio decidendi* or the principle upon which the case was decided. At pages 331-332 of the Report S. R. Das, C.J. speaking for the Court set out the basis of the decision in the following passage :

"The karta was one of the promoters of the Company which he floated with a view to take over the India Electric Works as a going concern. In anticipation of the incorporation of that Company the karta of the family took over the concern, carried it on and supplied the finance at all stages out of the joint family

(1) [1960] 1 S.C.R. 320.

A funds and the finding is that he never contributed any-  
thing out of his separate property, if he had any. The  
Articles of Association of the Company provided for the  
appointment as managing director of the very person  
who, as the karta of the family, had promoted the  
Company. The acquisition of the business, the floatation  
B of the Company and appointment of the managing  
director appear to us to be inseparably linked together.  
The joint family assets were used for acquiring the concern  
and for financing it and in lieu of all that detriment  
to the joint family properties the joint family got not  
only the shares standing in the names of two members  
C of the family but also, as part and parcel of the same  
scheme, the managing directorship of the company when  
incorporated. . . . . The recitals in the agreement  
also clearly point to the fact of B. K. Rohatgi having been  
appointed managing director because of his being a promoter  
of the company and having actually taken over  
D the concern of India Electric Works from Milkhi Ram  
and others. The finding in this case is that the promotion  
of the Company and the taking over of the concern  
and the financing of it were all done with the help of the  
joint family funds and the said B. K. Rohatgi did not  
contribute anything out of his personal funds if any. In  
the circumstances, we are clearly of opinion that the  
E managing director's remuneration received by B. K.  
Rohatgi was, as between him and the Hindu undivided  
family, the income of the latter and should be assessed  
in its hands."

Now, what are the facts found by the Appellate Tribunal in the  
F present case? In 1934, the joint family had acquired 90 shares  
out of the 300 shares of the company. The shares were acquired  
with the funds of the Hindu undivided family of which the father  
was the karta. On the demise of one of the directors, the assessee  
became a director in 1941 and on the death of another director  
who was managing the business the assessee became the Managing  
G Director with effect from 1942. It is apparent therefore that the  
joint family had control only of 90 out of 300 shares and the  
shares were purchased in the ordinary course of business and not  
for the purpose of qualification of the karta to become a director.  
The shares were purchased in 1934, about 8 years before the karta  
was appointed as the managing director. It is apparent that the  
shares were purchased by the joint family not with the object that  
H the karta should become the managing director but in the ordinary  
course of investment. To put it differently, there was no real  
connection between the investment of joint family funds in the

purchase of the shares and the appointment of the karta as managing director of the company. Applying the doctrine of Hindu law, the remuneration of the managing director was not earned by any detriment to the joint family assets. We are therefore of the opinion that the High Court was in error in holding that the present case falls within the principle of the decision of this Court in *The C.I.T. West Bengal v. Kalu Babu Lal Chand*<sup>(1)</sup>. On the contrary, we are of the opinion that the present case bears analogy to the decision of this Court in *M/s. Piyare Lal Adishwar Lal v. The C.I.T., Delhi*<sup>(2)</sup>. In that case, a member of a Hindu undivided family had furnished as security the properties of the family under an agreement whereby he was appointed treasurer of a bank. Remuneration received by the manager of the family for working as a treasurer was claimed to be income of the Hindu undivided family, because the properties of the family were furnished as security, but this claim was rejected by this Court on the ground that there was no detriment and risk to the joint family property and the emoluments of the treasurer could not be treated as an accretion to the income of the Hindu undivided family. We consider it also necessary to state that the decision of Madras High Court in *C.I.T. Madras v. S. N. N. Sankaralinga Iyer*<sup>(3)</sup> was not impliedly overruled by this Court in *C.I.T., West Bengal v. Kalu Babu Lal Chand*<sup>(1)</sup>. It was merely pointed out that the material facts of that case were different from those of *Kalu Babu Lal Chand's case*<sup>(1)</sup>. It was, for instance, found in *C.I.T. Madras v. S. N. N. Sankaralinga Iyer*<sup>(3)</sup> that the remuneration of the managing director was earned by rendering services to the bank and no part of the family funds were utilised except that the necessary shares to acquire the qualification of a managing director were purchased out of joint family funds. It was held that there was no detriment to the family property in any manner or to any extent. In view of this finding it follows that the remuneration of the managing director could not be treated as an accretion to the income of the joint family and taxed in its hands. The process of reasoning of the Madras High Court in *C.I.T., Madras v. S. N. N. Sankaralinga Iyer*<sup>(3)</sup> may be open to criticism and may not be sound but, in our opinion, the actual decision in that case is correct and is supported by the principle that there is no detriment to the family property and no part of the family funds had been spent or utilised for acquiring the remuneration of the managing director. The facts in the present case are almost parallel to those in *C.I.T. Madras v. S. N. N. Sankaralinga Iyer*<sup>(3)</sup> and there is no detriment to the joint family assets and no part of the joint family property was spent in earning the remuneration or making the acquisition. It therefore follows that the principle of the decision

(1) [1960] 1 S.C.R. 320.

(2) [1960] 3 S.C.R. 669.

(3) 18 I.T.R. 194.

- A in *The C.I.T., West Bengal v. Kalu Babu Lal Chand*<sup>(1)</sup> cannot be applied for deciding the question presented for determination in this case.

- B For these reasons we hold that amounts of Rs. 9,000, Rs. 8,133 and Rs. 1,550 received by the assessee as managing director's remuneration, commission and sitting fees respectively are not assessable as income of the Hindu undivided family of which Palaniappa Chettiar is the karta. We accordingly allow this appeal, set aside the judgment of the High Court and answer the question in favour of the assessee and against the Income-tax Department. The appellant is entitled to costs here and in the High Court.

Y.P.

*Appeal allowed.*

---

(1) [1960] 1 S.C.R. 320.