

M/S. Y. L. AGARWALLA AND ORS.

v.

COMMISSIONER OF INCOME TAX, CENTRAL, CALCUTTA

July 27, 1978

[P. N. BHAGWATI AND V. D. TULZAPUKAR, JJ.]

Hindu Undivided Family Firm—Karta having 36% shares as one of the partners of partnership firm and after his death his widow and three daughters declined to continue in the partnership, but his three minor sons were admitted into partnership with 14% shares each under a new deed—Clause 6 of the new deed ensure to the firm the continued use of the capital of Hindu Undivided Family standing in the account of the minors' late father, free of interest—Whether the share income of three minor sons from the partnership firm liable to be assessed as the income of Hindu Undivided Family ?

One Yudhisthir Lal Agarwala, since deceased, was the Karta of a Hindu Undivided Family known as M/s. Y. L. Agarwala & Co. and was assessed to tax as such, including his 36% share income from the Partnership firm known as 'M/s. Grand Smithy Works'. After his death on 18-12-1967, his surviving wife and three major daughters by two letters dated January 11, 1968 declined to exercise the option reserved, under clause 13 of the Partnership deed dated 20-9-1961 and refused to join the Partnership business, however his three minor sons were admitted to the benefits of the partnership. Under the new partnership deed, the minor sons were given 14% share each with a right to become a full fledged partner on attaining majority. Clause 6 of the deed ensured to the firm the continued use of the capital of Hindu Undivided Family standing in the account of late Yudnisthir Lal, free of interest.

In the return filed by the widow representing the H.U.F. for the relevant accounting period 1-9-67 to 31-8-68 i.e. the assessment year 1969-70, the share of the income from M/s. Grand Smithy Works was shown only from 1-9-67 to 18-12-67 i.e. upto the date when Yudhisthir was alive and was a partner in that firm, claiming that w.e.f. 19-12-67, the Hindu Undivided Family had no interest in the said firm and that her minor sons were admitted to the benefits of partnership in their individual and personal capacity and therefore their share of Rs. 3,08,187/- could not be included. The Income Tax Officer negatived that contention and held that the shares of the minor sons were assessable in the hands of the Hindu Undivided Family. The Appellate Assistant Commissioner on appeal and the Tribunal in further appeal confirmed it. On a reference the High Court also answered against the assessee.

Dismissing the appeal by special leave the Court

HELD : (1) In *Rajkumar Singh Hukumchandji v. Commissioner of Income Tax, M.P.* (78 I.T.R. 33) though the question that arose for determination was whether the Managing Director's remuneration received from the company by the Karta of a Hindu Undivided Family was assessable to tax as his individual income or as the income of Hindu Undivided Family, certain subsidiary tests as also, broader principle of general applicability were laid down. They 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 utilization of family assets;
- (3) whether the family had suffered any detriment in the process of the family funds; and
- (4) whether the income was received with the aid and assistance of the family funds, and

A

- (5) The broader principle 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 a compensation made for the services rendered by the individual coparcener. If it is the former, it is an income of the Hindu Undivided Family but if it is the latter then it is the income of the individual coparcener. If the income was essentially earned as a result of the funds invested the fact that a coparcener has rendered some service would not change the character of the receipt. But if on the other hand it is essentially a remuneration for the services rendered by a coparcener, the circumstance that his services were availed of because of the reason that he was a member of the family which had invested funds in that business or that he had obtained the qualification shares from out of the family funds would not make the receipt, the income of the Hindu Undivided Family". [1066 F-H, 1067 A-D]

B

C

In the instant case the taxing authorities as well as the Tribunal and the High Court were right in assessing the said income in the hands of the Hindu Undivided Family assessee. [1067 G]

D

(a) Applying the subsidiary principles Nos. 2, 3 and 4 it will be clear that the share income that was received by the three minor sons during the relevant period was earned with the aid and assistance of Hindu Undivided Family funds and was directly related to the utilization of such funds by the firm and further that Hindu Undivided Family had suffered detriment in the process of realization of such income inasmuch as the capital amount lying to the credit of deceased Yudhisthir Lal was utilized by the firm free of interest. [1067 E-F]

(b) There was no question of any services being rendered by the three minor sons and therefore applying the broader principles the share income received by them must, in substance be regarded as a return made to the family because of the investment of family funds in the business. [1067 F]

E

Rajkumar Singh Hukumchandji v. Commissioner of Income Tax, M.P. 78 I.T.R. 33; applied.

P. D. Dhanwatey v. C.I.T., M. P., 68 I.T.R. 365; explained.

(c) There was direct and substantial nexus between the share income earned by and allocated to the three minor sons and the family funds that remained with and were utilized by the firm and hence the share income would not be their individual income but the income of the Hindu Undivided Family. [1066 D-E]

F

- (i) It is clear that by the two letters dated January 11, 1968 all that the widow and the daughters did was that they declined to become partners in the firm presumably because none wanted to take the risk of being held liable for the losses the firm might incur, but it would be significant to note that none of the heirs disclaimed or relinquished his or her right to claim the share, right, title and interest of deceased Yudhisthir Lal in the partnership firm and its assets. In fact no demand for the return of the capital amount lying to the credit of Yudhisthir Lal's account, which admittedly stood at Rs. 10,00,000, was made by any of the heirs from the date of Yudhisthir Lal's death till the date of the new deed. [1065 E-G]

G

- (ii) Clause 6 is a tell-tale clause which carries its own tale that this new partnership agreement containing such a term could not have come about without the assent and agreement on the part of the widow on behalf of the Hindu Undivided Family. [1066 A]

H

- (iii) the factual interest-free retention and utilization of the said capital amount of the Hindu Undivided Family by the Firm during the entire relevant period i.e. from December 19, 1967 to August 31, 1968—presumably pursuant to the said clause—clinches the said inference. It is true that the widow is not a signatory to the new deed of partnership; it is also true that the three minor sons could

not in law be regarded as the nominees or benamidars of the Hindu Undivided Family in the firm but the facts and circumstances discussed above, especially the incorporation of a term like clause 6 in the new deed and the factual interest-free retention and utilization of the Hindu Undivided Family's Funds for the relevant period by the firm clearly lead to the inference that the new partnership under the deed dated January 11, 1968 was brought about with the tacit assent and agreement on the part of the widow representing the Hindu Undivided Family and that the *quid pro quo* for admitting the three minor sons of Yudhisthir Lal to the benefits of the partnership was the continued free-of-interest-use of the capital amount lying in Yudhisthir Lal's account for the firm which was ensured to it by clause 6. [1066 B-E]

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1112 of 1976.

Appeal by Special Leave from the Judgment and Order dated 23-3-76 of the Calcutta High Court in I.T.R. No. 206 of 1973.

S. T. Desai, V. D. Desai, Sanjay Bhattacharya, P. K. Dhar, Sardar Amzad Ali and Rathin Das for the Appellant.

S. V. Gupte, Attorney General. R. N. Sachthey, K. C. Dua and Miss A. Subhashini for the Respondent.

The Judgment of the Court was delivered by

TULZAPURKAR, J.—This appeal by special leave raises an important question as to whether the sum of Rs. 3,08,187, being the share income of three minor sons from the firm of M/s. Grand Smithy Works for the period from 19-12-1967 to 31-8-1968 is liable to be assessed as the income of the Hindu Undivided Family—M/s. Y. L. Agarwalla & Company—for the assessment year 1969-70?

The facts giving rise to the question may briefly be stated as follows : One Yudhisthir Lal Agarwalla, since deceased, was the Karta of a Hindu Undivided Family known as M/s Y. L. Agarwalla & Co. (the Assessee herein). During his life time in his capacity as the Karta of the said Hindu Undivided Family he carried on business in partnership with three others (Shiv Charan Laul, Ram Gopal Garodia and Tula Ram Budhia) in the name and style of M/s. Grand Smithy Works. His share in that firm was 36%. Under clause 13 of the Partnership Deed dated September 20, 1961, pursuant to which the said firm used to carry on its business, it was provided that "the death or retirement of any of the partners shall not have the effect of dissolving this co-partnership; in such an eventuality the co-partnership business may be carried on between the surviving partners and the heirs/legal representatives of the deceased and or retiring partner or if mutually agreed upon between the surviving partners and heirs etc. of the deceased or retiring partner with outsiders also." Yudhisthir Lal died on December 18, 1967 leaving behind him his widow Smt. Bhagwati Devi, six daughters (three married and three unmarried out of whom two were minors) and three minor sons. By two letters both dated January 11, 1968, one addressed by the widow on behalf of herself and the Hindu Undivided Family and

A the other by the four major daughters, Smt. Bhagwati Devi and the four major daughters declined to exercise the option reserved to them under clause (13) of the deed and refused to join the partnership business; however, the three minor sons were admitted to the benefits of the partnership. Since Yudhisthir Lal died on December 18, 1967 i.e. before the expiry of the year of account of the firm which was from 1-9-1967 to 31-8-1968, the firm closed its accounts on December 18, 1967 and the surviving partners after admitting the three minor sons to the benefits thereof continued to carry on the business of the partnership with effect from December 19, 1967 and a new deed of partnership was executed by the surviving partners on January 11, 1968 the terms and conditions whereof were made effective from December 19, 1967. Under this new deed each one of the three minor sons of Yudhisthir Lal was given 14% share in the profits of the firm, as also a right to become a full-fledged partner on his attaining majority. Clause 6 of the deed ensured to the firm the continued use of the capital of Hindu Undivided Family standing in the account of late Yudhisthir Lal free of interest.

D For the assessment year 1969-70, (the relevant accounting period being 1-9-1967 to 31-8-1968) Smt. Bhagwati Devi Agarwalla filed the return on behalf of Hindu Undivided Family disclosing the share income from the firm of Grand Smithy Works for the period from September 1, 1967 to December 18, 1967 only i.e. up to the date when her husband was alive and was a partner in that firm. It was claimed that with effect from December 19, 1967 the Hindu Undivided Family of which her husband was the Karta and after whose death she was managing the affairs had no interest in the said firm and that her three minor sons were admitted to the benefits of partnership in their individual and personal capacity as agreed to between the three surviving partners of that firm and, therefore, the share income of the firm received by her three minor sons for the period December 19, 1967 to August 31, 1968 amounting to Rs. 3,08,187, could not be included in the income of the Hindu Undivided Family and assessed as such. The Income Tax Officer negatived that contention; he noticed that in spite of the two letters of disclaimer addressed to the surviving partners, the three minor sons of late Yudhisthir Lal Agarwalla had been admitted to the benefits of the partnership with collective shares of 42% which was more than what their father was holding at the time of his death and further that the Hindu Undivided Family had not charged any interest on its capital amount which was permitted to lie with the firm for which no explanation had been offered by the assessee. He, therefore, took the view that the family of late Yudhisthir Lal continued to have interest in the business of the firm and that the share of profit allocated to the three minor sons really belonged to the Hindu Undivided Family and was accordingly assessable in its hands.

H On appeal, the Appellate Assistant Commissioner, by his order dated March 24, 1971, confirmed the view of the Income Tax Officer. The assessee carried the matter in further appeal to the Appellate

Tribunal but the Tribunal also dismissed the appeal. On a reference the High Court following the principles and guidelines enunciated by this Court in the case of *Raj Kumar Singh Hukumchandji v. Commissioner of Income Tax, M.P.*⁽¹⁾, in substance, held that the shares that had been allocated to the three minor sons in the assessee Hindu Undivided Family. The assessee has come up in appeal to this Court by special leave.

In support of the appeal counsel for the assessee raised two or three contentions. In the first place he urged that when a minor was admitted to the benefits of a partnership his share of profits of firm would be his individual income unless it was shown by the Department that in the firm he was really a benamidar or nominee of the Hindu Undivided Family of which he was a member and in that behalf relying upon three undisputed circumstances it was urged that the Department had failed to discharge that burden. In the first place it was pointed out that the Department had never doubted the genuineness or bona fides of the transaction of the admission of the three minor sons of Yudhisthir Lal to the benefits of the Partnership of M/s. Grand Smithy Works with effect from December 19, 1967 under the new deed of partnership dated January 11, 1968; it was further pointed out that the said three minors did not and could not in law represent the Hindu Undivided Family in the firm and thirdly, it was pointed out that the minors had been admitted to the benefits of the partnership after Smt. Bhagwati Devi on behalf of the Hindu Undivided Family and the four major daughters had by their letters of disclaimer dated January 11, 1968 refused to have any connection with the partnership business. In spite of these three circumstances the Tribunal had, counsel contended, wrongly held that the minors were either the benamidars or nominees of the Hindu Undivided Family and that, therefore, the share income allocated to them was of the Hindu Undivided Family. It was further contended that there was no finding recorded by the Tribunal that there was any agreement between the surviving partners and anyone on behalf of the heirs of deceased Yudhisthir Lal to the effect that the Hindu Undivided Family was to continue to be the real owner of the shares given to the minors nor was there any evidence to that effect and since the burden of proving any such transaction was on the Department which the Department had failed to discharge, the Tribunal as well as the High Court had wrongly come to the conclusion that the shares allocated to the three minors constituted the income of the Hindu Undivided Family and was assessable as such in the hands of the Hindu Undivided Family. According to him the decisions on the subject of remuneration, commission, fees or salaries earned by a Karta and other members of a Hindu Undivided Family such as, for instance, *Dhanwatey's*⁽²⁾ case and *Raj Kumar*⁽¹⁾ case could have no relevance to the case of a minor admitted to the benefits of partnership. He, therefore, urged that since the three minor sons could not in law

(1) 78 I.T.R. 33.

(2) 68 I.T.R. 365.

- A represent the Hindu Undivided Family in the firm and in the absence of any finding that there was any agreement between the surviving partners and any one on behalf of the heirs of Yudhisthir Lal to the effect that the Hindu Undivided Family was to continue to be the real owner of the shares given to the minors neither the Tribunal nor the High Court could come to the conclusion that the share income allocated to the three minors amounting in aggregate to Rs. 3,08,187 for the period from 19-12-1967 to 31-8-1968 was liable to be assessed as the income of the Hindu Undivided Family.

- On the other hand, on behalf of the Revenue it was urged by the learned Attorney General that where a minor had been admitted to the benefits of the partnership it was not necessary to show that he was either the benamidar or nominee of the Hindu Undivided Family in the partnership firm for the purpose of assessing his share of profit in the firm as income of the Hindu Undivided Family but the real test was whether such share income was earned with the aid and assistance of the Hindu Undivided Family funds and the Hindu Undivided Family had suffered any detriment in the process of realisation of such income, in fact, he urged that the question had to be viewed from the broader principle, namely, whether the share income received by minor coparcener was by way of return made to the family because of the investment of family funds in the business and if that was so it would be the income of the Hindu Undivided Family. In this behalf reliance was placed by the learned Attorney General upon the principles enunciated by this Court in its two decisions, namely, *Dhamwatey's*, case and *Raj Kumar's* case (supra). He pointed out that since in the instant case the three minor sons of Yudhisthir Lal had been admitted to the benefits of the partnership there was no question of any remuneration, commission, fees or salary being paid to any one of them for rendering any services to the firm, and therefore, having regard to clause 6 of the new deed of partnership dated January 11, 1968, the direct nexus between the share income allocated to the minors and the utilisation of the capital amount belonging to the Hindu Undivided Family was established and what was more such capital amount of the Hindu Undivided Family was permitted to be retained and utilised by the firm to the detriment of the Hindu Undivided Family since such retention or user of the said capital amount was free of interest and, therefore, the share income allocated to the three minor sons had been rightly assessed as income of the assessee. Alternatively, he urged that though no formal finding had been recorded by the Tribunal the facts and circumstances obtaining in the case furnished clear material leading to the only inference that the admission of the three minors to the benefits of the partnership on the terms contained in the new deed was not without the assent and agreement of the widow who was a natural guardian of the three minors though she had not formally executed the deed. Therefore, no fault could be found with the ultimate conclusion drawn by the Tribunal and the High Court.

Having regard to the rival contentions urged by counsel on either side, which we have summarised above, it will be clear that the ques-

tion which really falls for our determination in this case is whether the share of profits or income allocated and received from the partnership firm for the period from December 19, 1967 to August 31, 1968 by the three minor sons who were admitted to the benefits of the partnership is really the individual income of the minors or that of the Hindu Undivided Family?

Dealing with the factual aspect of the question we shall first indicate the broad and undisputed facts that emerge clearly on the record. Admittedly, deceased Yudhisthir Lal represented the Hindu Undivided Family as its Karta in the firm of M/s Grand Smithy Works right up to the time of his death and his share of 36% in the profits of the firm was always assessed as the income of the Hindu Undivided Family. It is not disputed that on his death on December, 19, 1967 the family continued to be joint, and as per clause 13 of the partnership deed dated September 20, 1961, the heirs of Yudhisthir Lal were given the option of joining the partnership firm but by two letters both dated January 11, 1968, the widow and the four major daughters declined the offer; instead the three minor sons were admitted to the benefits of the partnership each one getting 14% share in the profits and a new deed of partnership dated January 11, 1968 was executed by surviving partners having retrospective effect as from December 19, 1967. Since strong reliance was placed by counsel for the appellant on these two letters of disclaimer it would be desirable to note what exactly was disclaimed under these two letters. The four major daughters categorically stated that "we do not intend to exercise our option to become partners and declined to be partners with you in M/s Grand Smithy Works". The widow stated: "Now I am a widow with minor sons and minor daughters. I already understand that the amount of capital lying to the credit of H.U.F. in the firm exceeds the liability of the H.U.F. In the circumstances I am not willing to join the partnership business of my behalf and on the behalf of the H.U.F." It will thus be clear that by these two letters all that the widow and the daughters did was that they declined to become partners in the firm presumably because none wanted to take the risk of being held liable for the losses the firm might incur, but it would be significant to note that none of the heirs disclaimed or relinquished his or her right to claim the share, right, title and interest of deceased Yudhisthir Lal in the partnership firm and its assets. In fact no demand for the return of the capital amount lying to the credit of Yudhisthir Lal's account, which admittedly stood at Rs. 10,00,000, was made by any of the heirs from the date of Yudhisthir Lal's death till the date of the new deed; on the other hand clause 6 of the new deed runs thus :

"6. That the capital of the partnership shall be the amount as will be found to the credit of the Parties Hereto of the first (Shiv Charan Laul), Second (Ram Gopal Garodia) Third (Tola Ram Budhia) Parts and the said Yudhisthir Lal Agarwalla since deceased."

- A What is more, there is no provision for payment of interest on the respective amounts of capital lying to the credit of three surviving partners and the deceased Yudhisthir Lal. In our view clause 6 is a tell-tale clause which carries its own tale that this new partnership agreement containing such a term could not have come about without the assent and agreement on the part of the widow on behalf of the Hindu Undivided Family. Further the factual interest-free retention and utilization of the said capital amount of the Hindu Undivided Family by the Firm for the entire relevant period i.e. from December 19, 1967 to August 31, 1968—presumably pursuant to the said clause—clinches the said inference. It is true that the widow is not a signatory to the new deed of partnership; it is also true that the three minor sons could not in law be regarded as the nominees or benamidars of the Hindu Undivided Family in the firm, but the facts and circumstances discussed above, especially the incorporation of a term like clause 6 in the new deed and the factual interest-free retention and utilization of the Hindu Undivided Family's Funds for the relevant period by the firm clearly lead to the inference that the new partnership under the deed dated January 11, 1968 was brought about with the tacit assent and agreement on the part of the widow representing the Hindu Undivided Family and that the *quid pro quo* for admitting the three minor sons of Yudhisthir Lal to the benefits of the partnership was the continued free of interest use of the capital amount lying in Yudhisthir Lal's account for the firm which was ensured to it by clause 6. In these circumstances there was direct and substantial nexus between the share income earned by and allocated to the three minor sons and the family funds that remained with and were utilized by the firm and hence the share income would not be their individual income but the income of the Hindu Undivided Family.

Turning to the legal aspect of the question it is unnecessary to refer to the several decisions cited at the bar but a reference to only one decision of this Court in *Raj Kumar's* case (*supra*) will suffice. It is true that the question that arose for determination before this Court in that case was whether the Managing Director's remuneration received from the company by the Karta of a Hindu Undivided Family was assessable to tax as his individual income or as the income of Hindu Undivided Family. But this Court, after discussing the entire previous case law on the subject laid down certain tests and guide lines which would cover the question raised in the appeal before us. From the earlier decisions this Court culled out some tests which were described as subsidiary tests or subsidiary principles and then indicated a broader test or principle which would be of general application. At pages 43—44 of the report, this Court has observed thus :—

“The other tests enumerated are :

- H (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 utilization of family assets;
- (3) whether the family had suffered any detriment in the process of the family funds; and
- (4) whether the income was received with the aid and assistance of the family funds.

In our opinion from these subsidiary principles, the broader principles 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 a compensation made for the services rendered by the individual coparcener. If it is the former, it is an income of the Hindu Undivided Family but if it is the latter then it is the income of the individual coparcener. If the income was essentially earned as a result of the funds invested the fact that a coparcener has rendered some service would not change the character of the receipt. But if on the other hand it is essentially a remuneration for the services rendered by a coparcener, the circumstance that his services were availed of because of the reason that he was a member of the family which had invested funds in that business or that he had obtained the qualification shares from out of the family funds would not make the receipt, the income of the Hindu Undivided Family."

In the instant case the question raised before us gets easily answered by applying the subsidiary principles indicated at Nos. 2, 3 and 4 above as well as by applying the broader principle indicated above. There can be no doubt that the share income that was received by the three minor sons during the relevant period was earned with the aid and assistance of Hindu Undivided Family Funds and was directly related to the utilization of such funds by the firm and further that Hindu Undivided Family had suffered detriment in the process of realisation of such income inasmuch as the capital amount lying to the credit of deceased Yudhisthir Lal was utilized by the firm free of interest. Further in this case there was no question of any services being rendered by the three minors and therefore the share income received by them must, in substance, be regarded as a return made to the family because of the investment of family funds in the business. In our view, therefore, the taxing authorities as also the Tribunal and the High Court were right in assessing the said income in the hands of the Hindu Undivided Family assessee.

The appeal is, therefore, dismissed with costs.