Commissioner of Income-Tax Calcutta

Vs

Prahladrai Agarwala.

Civil Appeal No. 575 of 1975

(CJI R. S. Pathak, M. H. Kania JJ)

26.04.1989

JUDGMENT

PATHAK C.J.I. –

This appeal by special leave is directed against the judgment of the High Court at Calcutta answering the following question in favour of the assessee and against the Revenue:

> "Whether, on the facts and in the circumstances of the case, the share of profit of the assessee's wife was includible in the total income of the assessee under section 64(1)(iii) of the Income-tax Act, 1961 ?"

The assessee was assessed in the status of an individual for the assessment year 1962-63 corresponding to the previous year March 26, 1961, to April 13, 1962. At the material time, the assessee was a partner in a firm Messrs. Ramesh and Co., with a share of eight annas therein. The balance was shared by three other partner, the assessee's father, Kunjilal Agarwala, the assessee's brother. Hariram Agarwala and a stranger, Jagdish Prasad. On November 10,1960, and on November 28, 1960, the assessee made two gift of Rs. 21,000 and Rs. 30,000 respectively to his wife, Kaushalya Devi, from his account in the firm. On November 28,1960, he made another gift of Rs. 11,000 to his mother Chilli Bai, from that account. It may be observed that Chill Bai received another gift of Rs. 20,000 from her husband, Kunjilal, effected by similarly drawing from his account with the firm.

The assessee's wife, Kaushalya Devi, as well as his mother, chili Bai, became partners with three other persons in a newly constituted firm, Messrs. Kunjilal Hariram and Co. The three other partners were the assessee's grandfather, Moharilal Agarwala, the assessee's brother, Hariram Agarwala and the stranger, Jagdish Parsad Gupta. The partnership deed dated November 10,1960, provided that the business was to commence from November 12,1960. The preamble to the deed stated:

> "Whereas the partner of the fifth part who has extensive experience and outstanding talent of organisation in agree and grains trade but little finance requested the partners of the first four parts to enter into co-partnership with him on contributing the necessary finance to carry on business in jagree and grains and also act as commission agents in jagree, grains and allied commodities to which request they acceded."

Clause 4 of the partnership deed stipulated:

"That the partners of the first four parts shall initially contribute Rs. 25,000 each to be put in within six months from the commencement of the partnership. The said contributions augmented by further deposits and profits or depleted by withdrawals and losses shall carry interest at the rate of 6% per annum. The amount, if any, standing to the credit of the partner of the fifth part shall carry interest at the same rate."

On November 12,1960, Kaushalya Devi contributed Rs. 21,000 as capital, which came out of the gift made by the assessee on November 10,1960. She also contributed Rs. 30,000 as capital, which amount came out of the gift made on November 28,1960.

In the course of assessment proceedings for the assessment year 1962- 63 in respect of the assessee. The Income-tax Officer included the profits of the assessee's wife from the firm, Messrs. Kunjilal Hariram and Co., under section 64(1)(iii) of the Income-tax Act, 1961.

An appeal by the assessee was dismissed by the Appellate Assistant Commissioner of Income-tax who observed that the wife would not have become a partner of the firm unless she had contributed capital, and as the capital was provided by the husband, the inclusion of the wife's share of income in the assessment of the assessee was justified.

In the second appeal, it was conceded by the assessee before the Income-tax Appellate Tribunal that the interest received by the assessee's wife on her capital contribution to the firm was includible in the total income of the assessee, but in was contended that the balance of the share of profit was not so includible as the assessee's wife had become a partner in the firm in her own right, and it was immaterial that the capital invested by her had been provided as a gift by the assessee. The Appellate Tribunal found that the admission of the assessee's wife as a partner in the firm was solely on account of her contribution of capital to the firm, that the assets in the form of cash were transferred directly by the assessee to his wife otherwise than for adequate consideration, and that the income must be said to have arisen indirectly from the assets transferred. The second appeal was dismissed. At the instance of the assessee, the question of law set forth earlier was referred to the High Court at Calcutta for its opinion.

The High Court has taken the view that the share of profits arose to the assessee's wife primarily because the partnership made a profit and although it had connection with the gift, it did not arise as a result of the gift, that the income arose from the share of profits only because the other partners agreed to take the assessee's wife as partner and was allowed to contribute to the partnership firm. That the admission of the assessee's wife to the partnership was not in consequence of the gift, and that, therefore, upon all those circumstances, the connection between the income of the share of profits and the gift by the assessee to his wife was too remote to be included within the provisions of section 64(1)(iii) of the Income-tax Act.

Section 64(1)(iii) of the Income-tax Act, 1961 as it stood at the relevant time, provides:

"64(1) In computing the total income of any individual there shall be included all such income as arises directly or indirectly--...

(iii) subject to the provisions of clause (i) of section 27, to the spouse of such individual from assets transferred directly or indirectly to the spouse by such

> individual otherwise than for adequate consideration or in connection with an agreement to live apart..."

The income may arise directly or indirectly, but there must be a proximate connection between the accrual of the income and the assets transferred by the assessee. In CIT v. Prem Bhai Parekh [1970] 77 ITR 27 this court held that the income of the minor sons, who had invested capital in the firm out of moneys gifted to them by their father (the assessee) could not be included in the assessment of the assessee. The court observed (p. 30):

> "Before any income of the minor child can be brought within the scope of section 16(3)(a)(iv), it must be established that the said income arose directly or indirectly from assets transferred directly or indirectly by his father. There is no dispute that the assessee had transferred to each of his minor sons, a sum of Rs. 75,000. It may also be that the amount contributed by those minors as their share in the firm came from those amounts. But the question still remains whether it can be said that the income with which we are concerned in this case arises directly or indirectly from the assets transferred by the assessee to those minors. The connection between the gifts mentioned earlier and the income in question is a remote one. The income of the minors arose as a result of their admission to the benefits of the partnership. It is true that they were admitted to the benefits of the benefits of the partnership because of the contribution made by them. But there is no nexus between the transfer of the assets and the income in question. It cannot be said that that income arose directly or indirectly from the transfer of the assets referred to earlier. Section 16(3) of the Act created an artificial income. That section must revive a strict construction as observed by this court in CIT v. Keshavlal Lalubhai Patel [1965] 55 ITR 637. In our judgment before an income can be held to come within the ambit of section 16(3) it must be proved to have arisen directly or indirectly from a transfer of assets made by the assessee in favour of his wife or minor children The connection between the transfer of assets and the income must be proximate. The income in question must arise as a result of the transfer and not in some manner connected with it."

It seems to us that the observation of this court in that case fully cover the case before us. There is no doubt that the wife became a partner because of the capital contributed by her in the firm but as observed by the High Court in the judgment under appeal, it was upon agreement by mere contribution of capital by the wife to the firm would not automatically have entitled her to partnership in the firm. The partnership was based on agreement, and it is the event of agreement between the partners that brought the assessee's wife into the firm as partner. Learned counsel for the Revenue relies on CIT v. J. H. Gotta [1985] 156 ITR 323 (SC) CIT v. Jwalaprasad Agarwala [1967] 66 ITR 154 (SC) V. D. Dhanwatey v. CIT [1968] 68 ITR 365 (SC) and Mohini Thapar v. CIT [1972] 83 ITR 208 (SC), but we are not satisfied that those cases are of any assistance to the revenue. Reliance was placed on Potti Veerayya Sresty v. CIT [1972] 85 ITR 194 (AP), where the Andhra Pradesh High Court uphold the inclusion of the wife's income from cloth business the assets transferred by the assessee. It is sufficient to observe that the cloth business was her own business and as the High Court pointed out there was no necessary to depend upon the agreement of others. It is on that basis that the High Court distinguished Prem Bhai Parekh's case [1970] 77 ITR 27 (SC)

We are of the view that the High Court is right in answering the question referred to in the negative in favour of the assessee and against the Revenue.

In the result the appeal fails and is dismissed with costs.

Appeal dismissed.

</html