MYSORE HIGH COURT

T.P. Kapadia

Vs

Commissioner of Income Tax

ITRC. 17- 19 of 1970

(Govinda Bhat and Venkataswami, JJ.)

13.01.1972

ORDER

Govinda Bhat, J.

1. These are three references made at the instance of the assessee under section 256(1) of the Income-tax Act, 1961, hereinafter called "the 1961 Act". They relate to the assessment years 1961-62, 1962-63 and 1963-64. The assessee is Dr. T.P. Kapadia. His assessment for 1961-62 was made under the Indian Income-tax Act, 1922, hereinafter called the 1922 Act. His assessments for 1962-63 and 1963-64 were made under the 1961 Act. The assessee's wife, Mrs. Kapadia, was a partner of three firms in which the assessee was a partner during the three assessment years. When the Income-tax Officer made the assessments, he invoked the provisions of section 16(3) of the 1922 Act for the assessment year 1961-62 and section 64 of the 1961 Act for the assessment years 1962-63 and 1963-64 and included the profits or losses arising to Mrs. Kapadia in the assessment of the assessee. After the completion of the original assessments, the Income-tax Officer became aware of the decision of the Gujarat High court in *Dayalbhai Madhavji Vadera v. Commissioner of Income-tax*[1] wherein it was held that "where the share of the wife or minor child in a firm in which the assessee is a partner is a loss, such loss cannot be included in the total income of the assessee." Therefore, he reopened the assessments under section 147(b) of the 1961 Act and redetermined the income of the assessee withdrawing the benefit of the loss which had been taken into account while computing the total income of the assessee. The assessee's appeals to the Appellate Assistant Commissioner and the Income-tax Appellate Tribunal, Bangalore Bench, were dismissed. The Tribunal, following the decision in Dayalbhai's case, affirmed the assessment orders of the Income-tax Officer. The following questions of law have been referred to this court in I.T.R.C. No. 17 of 1970 and they relate to the assessment year 1961-62 :

"1. Whether, on the facts and in the circumstances of the case and on a proper

interpretation of section 16(3) of the Indian Income-tax Act, 1922, the share of the losses of the wife of the assessee in registered firms where the assessee is also a partner could be set off against the income of the assessee while computing the total income ?

[1][1966] 60 I.T.R. 551 (Guj)

2. Whether, on the facts and in the circumstances of the case, the net income of the wife from the various firms in which her husband is also a partner should first be computed before applying the provisions of section 16(3) of the Indian Income-tax Act, 1922 ?"

In I.T.R.Cs. Nos. 18 and 19 of 1970, which relate to the assessment years 1962-63 and 1963-64, the following questions have been referred :

(i) Whether, on the facts and in the circumstances of the case and on a proper interpretation of section 64 of the Income-tax Act, 1961, the share of the loss of the wife of the assessee in registered firms where the assessee is also a partner could be set off against the income of the assessee while computing the total income ?

(ii) Whether, on the facts and in the circumstances of the case, the net income of the wife from the various firms in which her husband is also a partner should first be computed before applying the provisions of section 64 of the Income-tax Act, 1961 ?"

Section 64 of the 1961 Act corresponds to section 16(3) of the 1922 Act though they are not identical in terms and the later Act has made some changes. So far as the questions referred for our decision are concerned, the difference made in the two enactments is of no consequence. Section 16(3) of the 1922 Act reads :

"16. (3) In computing the total income of any individual for the purpose of assessment, there shall be included -

(a) so much of the income of a wife or minor child of such individual as arises directly or indirectly -

(i) from the membership of the wife in a firm of which her husband is a partner :

(ii) from the admission of the wife in a firm of which her husband is a partner;

[(iii) and (iv) omitted as unnecessary].

Section 64 of the 1961 Act reads :

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

(i) to the spouse of such individual from the membership of the spouse in a firm carrying on a business in which such individual is a partner;

(ii) to a minor child of such individual from the admission of the minor to the benefits of partnership in a firm in which such individual is a partner;"

[(iii), (iv), and (v) omitted as unnecessary].

The object of section 16(3) of the 1922 Act was to foil an individual's attempt to avoid or reduce incidence of income-tax by transferring his assets to his wife or minor child or admitting his wife as a partner or admitting his minor child to the benefits of partnership in a firm in which such individual is a partner. Vide *Commissioner of Income-tax v. Manilal Dhanji* . In exercise of the power conferred under section 5(8) of the 1922 Act, the Central Board of Revenue issued C.B.R. Circular No. 20 of 1944, C. No. 4(13)-I.T./44, dated the 15th July, 1944, regarding the interpretation of section 16(3)(a) of the 1922 Act. The Board therein has taken the view that "it is a more equitable view to take that loss incurred by the wife or the minor child should be treated as if it were a loss sustained by the individual." The said circular is found at page 225 of volume II of the Income-tax Circulars published by the Central Board of Revenue, Government of India, in 1960. It reads :

"C.B.R. Circular No. 20 of 1944. C. No. 4(13)-I.T./44 dated the 15th July, 1944.

Subject : Section 16(3)(a) - Loss incurred by wife or minor child - Right of set off under section 24(1) and (2). Attention is invited to the Board's Circular No. 35 of 1941, on the above subject. It was laid down therein that where the wife or minor child of an individual incurs a loss which if it were income would be includible in the income of that individual under section 16(3), such loss should be set off only against the income, if any, of the wife or minor child and if not wholly set off should be carried forward, subject to the provisions of section 24(2). The Board has reconsidered the question and has decided that, although this view may be tenable in law, the other and more equitable view is at least equally tenable that such loss should be treated as if it were a loss sustained by that individual. Thus if the wife or minor child has a personal income of Rs. 5,000 which is not includible in the individual's income and sustains a loss of Rs. 10,000 from a source the income of which would be includible in the income of the individual, the loss should be set off against the income of the individual under section 24(1), and if not wholly set off should be carried forward under section 24(2). The wife or the minor child, would, therefore, be assessable on the personal income of Rs. 5,000. If in any case the wife or minor child claims a set-off of the loss against the personal income, it should be brought to the notice of the Board. Board's Circular No. 35 of 1941 is hereby cancelled." The above circular was not brought to the notice of the Gujarat High Court in *Dayalbhai's case*[2], and the view taken is contrary to the instructions give by the then Central Board of Revenue. Under section 5(8) of the 1922 Act and section 119 of the 1961 Act, a circular of the above kind would be binding on all officers and persons employed in the execution of the 1922 Act and the 1961 Act. Vide *Navnitlal C. Javeri v. K.K. Sen*, Appellate Assistant Commissioner of Income-tax . Though the circular is not binding on the assessee, it was binding on the Income-tax Officer would have reopened the assessments. The decision of the Gujarat High Court would have binding force in the State of Gujarat but not outside that State. In the commentary in the Law and Practice of Income-tax by Kanga and Phalkivala, volume I, sixth edition, at page 526, the learned authors have observed that the decision in *Dayalbhai's case*[3], does not lay down the correct law. That is what has been stated :

> "In *Dayalbhai Madhavji Vadera v. Commissioner of Income-Tax, Gujarat* the Gujarat High Court held that in this section 'income' does not include a loss and therefore the share of loss apportioned to a spouse or minor child in a partnership cannot be included in the individual's total income. It is submitted that the decision is incorrect. On general principles, income from membership in the firm would include a loss, and the context of clauses (i) and (ii) does not

[2][1966] 60 I.T.R. 551 (Guj)

[3][1966] 60 I.T.R. 551 (Guj)

> warrant the contrary construction. The liability to assessment cannot alternate from year to year between the individual and the spouse, depending on whether there is a profit or a loss. Besides, in the absence of other income, the right to carry forward the loss in a running business would be completely lost if the individual is to be vicariously liable when there is a profit and the loss is to remain a dead loss in the assessment of the spouse or minor child."

In our opinion two views are possible on the question as stated in the circular of the Central Board of Revenue and the more equitable view which is possible to take is that the loss incurred by the spouse should be treated as if it were a loss sustained by the individual. When two views are possible, the one which is just should be accepted. The Tribunal has also not noticed the circular. In our judgment, the Tribunal was in error in following the decision in *Dayalbhai's*[4] case when there is a specific circular of the Central Board of Revenue on the subject of the contrary which is binding on the Income-tax Officer. It is relevant to state that the above references were heard by us on December 1, 1971, and at the request of Sri S.R. Rajasekhara Murthy, the learned counsel for the revenue, we granted an adjournment to obtain information from New Delhi as to whether the above circular has been withdrawn or replaced by any other circular after the decision in *Dayalbhai's case, [[1966] 60 I.T.R. 551 (Guj).](Supra)*. Until now, the learned counsel has not been able to state that the above circular is not in force. Our answer to the first question in each of the above references is in the affirmative and in favor of the assessee. In view of our answer to the first question, the second question does not arise. The assessee is entitled to his costs. Advocate's fee Rs. 250 one set.

[4][1966] 60 I.T.R. 551 (Guj)