

KERALA HIGH COURT

Commissioner of Income-Tax

Vs

Mary Ignatius

(P Subramonian Poti, C.J. G Vadakkal, J.)

13.09.1982

JUDGMENT

P Subramonian Poti, Actg. C.J.

1. The question referred to us by the Income-tax Appellate Tribunal, Cochin Bench, is:

"Whether, on the facts and in the circumstances of the case, Rs. 42,632, being the assessee's share of loss from M/s. Tyre & Rubber Industries, is to be set off against Rs. 50,284 being the share income of the minor children of the assessee from the firm, M/s. Ignatius Mill Stores, for the assessment year 1976-77 ? "

2. That arises on the following facts. During the accounting year relevant to the assessment year 1976-77, the assessee, an individual, was a partner in M/s. Tyre & Rubber Industries and also M/s. Natus Latex Industries. Her two minor children were admitted to the benefits of a partnership, M/s. Ignatius Mill Stores. During the relevant accounting year the assessee's share of loss from M/s. Tyre & Rubber Industries was Rs. 42,636 and her share of income from M/s. Natus Latex Industries was Rs. 3,764. The share income of each of the minor children of the assessee from the firm M/s. Ignatius Mills was Rs. 25,142. The assessee filed a return disclosing an income of Rs. 4,200. The loss incurred by her in the firm of M/s. Tyre & Rubber Industries was set off by her against the share income of her minor children included in her total income under Section 64 of the I.T. Act. This return was not accepted by the ITO who held that the share income of the minor children from the firm assessable in the hands of the assessee under Section 64(1)(iii) of the Act could not be taken into account for the purpose of adjustment against her loss, under Section 70 of the Act. Accordingly, he determined the total income as Rs. 48,620. The assessee preferred an appeal to the AAC who accepted the assessee's case and allowed a set-off of the loss against the share income of the minors in the firm. The Department took up the matter to the Appellate Tribunal. The Tribunal agreed with the view of the AAC and held that the share income of the minor children should be treated as the business income of the assessee and that Section 70(1) of the Act warranted the view that the income included in the total income of

the assessee by applying Section 64 of the Act should be considered as the assessee's income for the purpose of adjustment of the loss. It is from these facts that the question referred to us has arisen.

3. "Total income" is denned in Section 2(45) of the I.T. Act as meaning the total amount of income referred to in Section 5, computed in the manner laid down in the Act. Section 5 defines the total income of any previous year of a person who is a resident as including all income from whatever sources derived, (a) which is received or is deemed to be received in India in such year by or on behalf of such person, (b) which accrues or arises or is deemed to accrue or arise to him in India during such year, and (c) which accrues or arises to him outside India during such year. We are not concerned with the proviso or Sub-section (2) in this case. Section 14 defines the heads of income as, (a) salaries, (b) interest on securities, (c) income from house property, (d) profits and gains of business or profession, (e) capital gains, and (f) income from other sources. Section 64(1)(iii) of the I.T. Act, 1961, is relevant for our purpose and we quote the sub-section here:

" 64. Income of individual to include income of spouse, minor child, etc.--(1) In computing the total income of any individual, there shall be included all such income as arises directly or indirectly.....

(iii) to a minor child of such individual from the admission of the minor to the benefits of partnership in a firm."

4. Section 64(1)(iii) in terms refers only to the inclusion of the income that arises directly or indirectly to a minor child. Whether the section would take within its scope a loss arising to such minor child was a matter on which opinion was once divided. Now, the doubt has been resolved by Expln. 2 to Section 64(2), which reads :

" Explanation 2.--For the purposes of this section, ' income' includes loss. "

5. Though the Explanation comes into effect only with effect from April 1, 1980, by its very nature, it is clarificatory. The position of law as it stood prior thereto was not in any way different as we have indicated.

6. Section 70(1) provides for a set-off of the loss of an assessee. That subsection reads thus :

"70. (1) Save as otherwise provided in this Act, where the net result for any assessment year in respect of any source falling under any head of income other than 'capital gains' is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head."

7. Sub-section (1) of Section 71 provides that where, in respect of any assessment year, the net

result of the computation under any head of income other than " Capital gains " is a loss and the assessee has no income under the head " Capital gains " he shall, subject to the provisions of Chap. VI be entitled to have the amount of such loss set off against his income, if any, assessable for that assessment year under any other head. In other words, if the set-off is in the same year it need not be against the same head of income but may be against any other head of income of the year. But if it is a set-off of a loss carried forward then the set-off must be against the same head of income of the assessee.

8. According to the Revenue, though the income of the minor children are included in the income of their mother, that does not partake the character of her income and it retains its identity as the income of the children and, therefore, for the purpose of set-off under Section 70(1) of the Act, such income is not to be taken into account. It is further urged by learned counsel for the Department that even assuming that it is her income, the income of the minor children included in the total income is not income under the same head as that of her business income and, therefore, cannot be set off against her loss.

9. The scope of Section 64 is very much larger than the scope of the corresponding Section 16 of the Indian I.T. Act, 1922. But it may not be necessary to go into the scope of enlargement for the purpose of this case. When the minor children of an individual are admitted to the benefits of partnership in any firm--whether it be a firm in which the individual assessed is a partner or not and whether the minor children's contribution to the firm is from out of the funds of that individual or not--the income of the minor children are to be included in the total income of the individual. Such individual may be the mother or the father, depending on the answer to the question whose total income is greater (Explan. 1 to Section 64(1)). In this case it is the mother's. By reason of Section 64(1) the income of the minor children has to be included in the total income of the mother. When once it is so included it becomes part of her income irrespective of the character of the income so included. In other words, though, independent of the provisions of the I.T. Act, the minors' income may be claimed to belong to the minors, for the purpose of the Act such income becomes part of the income of the mother by inclusion in her total income. What is part of the income of a person is his income. Therefore, it is the mother's income. Once it is considered as her income if she has incurred a loss from another source such loss could be set off against such income. Whether both fall under the same head of income or not is not relevant for a set-off in the year in which the income is so derived against the loss incurred in the same year. The question whether they fall under different heads need not be examined if the set-off is to be in the same year in view of Section 71(1) of the Act. Thus, when the income of the minor children is part of income of the mother by reason of Section 64(1) of the Act, irrespective of the question whether her loss from business on the one hand and the income of the minors treated as her income on the other fall under two different heads or not, a set-off is permissible under Section 71(1). We need not be taken to have said that the income from the business of the minor brought in as part of the income of the mother by reason of Section 64(1) falls under the head of "Income from other sources" as contended by counsel for the Revenue. The examination of the

question would be called for only if an adjustment is sought of a loss carried forward and not of a loss incurred in the same year. It seems to us that if the matter was res integra the answer to the question referred to us is plain and that is to be in the affirmative, that is, in favour of the assessee and against the Revenue.

10. Now we will refer to the decisions cited at the Bar. The High Court of Gujarat in *Dayalbai Madhavji Vadera v. CIT*¹ referred to the absence of definition of the term "income" in Section 16(3) of the Indian I.T. Act, 1922, and found that a loss arising under any of the sub-clauses of Section 16(3)(a) cannot be set off against the income arising from the other or the rest of the sub-clauses. In that case, the ITO, while assessing the applicant-assessee included in the total income of the assessee the income from interest arising to his wife and minor son, but did not set off the share in the loss of the registered firm against such income. In effect what the court said was that in the absence of a provision to reckon the loss of the wife and minor in the income of the husband or the parent, as the case may be, there was no question of a set-off of the loss. The scope of the term "income" as comprehending "loss" also has already been adverted to by us and that answers the decision of the Gujarat High Court. A decision of this court--I.T.R. No. 35 of 1971 decided on 3rd April, 1973 (H.H. Marthanda Varma Elayarajah of Travancore v. CIT) followed the decision in *Dayalbai Madhavji Vadera v. CIT*² and held that income under Section 60 will not take in loss and, therefore, the Income-tax Appellate Tribunal was right in holding, having regard to the provisions of Section 64 of the I.T. Act, that the share of loss of the assessee's wife in the registered firm in which the assessee was a partner could not be set off in computing the applicant's total income. A Full Bench of this court in *CIT v. B.M. Edward, India Sea Foods*³ referred to the decision of the Division Bench in ITR No. 35 of 1971 (*HM. Marthanda Varma Elayarajah of Travancore v. CIT*) and also to the decision in⁴ (*Dayalbai Madhavji Vadera v. CIT*) and held that the decision of this court in⁵ was wrong as it failed to take note of the existence of the circular which had directed that loss of one spouse could be set off against the income of the other spouse. Of course the circular ceased to be in force on April 6, 1972, but had been in force during the year 1971-72 which was the year with which the case in T.T.R. No. 35 of 1971 was concerned. It may not be necessary to go into this also for the reason already adverted to, namely, the incorporation of the Explanation so as to define the scope of the term "income" as taking in loss also, which is evidently clarificatory.

11. *Dayalbai Madhavji Vadera v. CIT*⁶ was dissented from by the Karnataka High Court in *Kapadia v. CIT*⁷ That held that the term "income" included loss also. The same view was taken by that court in *J.H. Gotla v. CIT*⁸ In Kanga and Palkivala's Law and Practice of Income Tax there is a relevant comment on this aspect of the matter and it may be pertinent to notice it here. Referring to the decision of the Gujarat High Court the commentators state thus (p. 599 of 7th Edn.):

"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 (iii) does

not 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."

12. We are in agreement with the views expressed by the Karnataka High Court. The comment was made prior to the amendment of Section 64(2) by the incorporation of Explan. 2 to that section.

13. Before we close we have to advert to a decision of the Madras High Court in *CIT v. A.L. Srinivasan*⁹ There the assessee was the sole proprietor of a business, in which business he had sustained substantial losses in 1954-55 as well as in 1957-58. The losses were brought forward for consideration in the assessment year 1958-59. During that year, the assessee and his wife were partners in a firm. The assessee had a half share in the firm and the wife had the other half share. There was substantial income in the business of the firm during that year and this was allocated equally to the husband and wife. The amount so allocated to the wife was liable to be taxed in the hands of the husband under the provisions of Section 16(3)(a). In making the assessment, the ITO set off the loss of the previous years, which had been brought forward, against the share income of the assessee from the registered firm but did not allow set off of the balance of the loss so brought forward against the share income of his wife which had been treated as his income under Section 16(3) of the Act. It was the correctness of this that was the subject-matter of a reference before the Madras High Court. The question is seen discussed at p. 671 of the judgment and it would be profitable to extract the discussion here:

"The idea behind this provision is to restrict the set-off only to business income of the year to which it is carried forward. The requirement of this provision is that the loss must have been sustained by him in any other business, profession or vocation and that, if so, it could be set-off against the income from any business, profession or vocation carried on by him in that year. The Tribunal has taken the view that notwithstanding that the wife is also a partner in the firm, the business carried on by the firm could be treated as the business carried on by the assessee in that year. Though for certain purposes, when the business carried on by the firm is treated as the business carried on by the partner, still for applying Section 24(1) the statute requires that the income against which the set-off is claimed belongs to the assessee. This requirement is not set aside in Section 24(2). In the context of Section 24(2)(ii) of the Act, it is difficult to hold that the business in this case was wholly carried on by the husband or the assessee here or that the income wholly belonged to him."

14. With great respect to the learned judges, we are afraid that the question the court had to deal

with has not been properly noticed. The question was not whether the income of the firm is the income of the assessee. In fact it was the share income of the assessee that was set off against the loss. The assessee's share in the income of the firm and the share of the assessee's wife in the income of the firm are both to be treated as the assessee's income by virtue of Section 16(3) of the 1922 Act. Section 24(2)(ii) allowed a set-off of the loss sustained by a person in any business against the gains of any business carried on by him during that year. For the purpose of the section, it cannot be said that the income that he derived as a partner from the firm, which was doing business, was not income from business carried on by him in that year. The question that the court had really to deal with was whether the wife's income was part of the husband's income. If it was part of his income it could be set off against the loss of that year whatever be the head under which the losses are incurred.

15. We, therefore, answer the question as above, namely, in favour of the assessee and against the Revenue.

16. A copy of this judgment under the seal of the High Court and the signature of the Registrar will be sent to the Income-tax Appellate Tribunal, Cochin Bench.

Cases Referred.

1[1966] 60 ITR 551

2[1966] 60 ITR 551 (Guj)

3[1979] 119 ITR 334

4[1966] 60 ITR 551 (Guj)

5I.T.R. No. 35 of 1971

6[1966] 60 ITR 551 (Guj)

7[1973] 87 ITR 511 (Mys)

8[1973] 91 ITR 531 (Mys)

9[1977] 108 ITR 667