

**BOMBAY HIGH COURT**

Bhogilal Laherchand

Vs.

Commissioner of Income Tax

I.T. Ref. No. 37 of 1953

(Chagla, C.J. and Tendolkar, J.)

19.03.1954

**JUDGMENT**

**Chagla, C.J.**

1. The following questions of law were referred to the High Court:

- (1) Whether the sums of Rs. 43,210 each, being interest earned respectively by Mahesh Bhogilal and Arvind Bhogilal, the minor sons of the assessee, on the amounts standing to their credit in the firm are liable to be included in the total income of the assessee under Section 16(3) (a) (ii) of the Indian Income Tax Act?
- (2) Whether the premia paid out of the moneys belonging to the minors, Mahesh Bhogilal and Arvind Bhogilal, for effecting insurance on their respective lives are entitled to exemption under Section 15 of the Act?

**Chagla, C.J.**

The question that arises on this reference is a very simple one and not capable of much elaboration. The assessee started a partnership business along with his major son and he admitted to the benefit of this partnership his two minor sons. In the assessment year 1950-51 the share of the profit of each of the minors came to Rs. 1,05,077 and this amount was included in the income of the assessee under the provisions of Section 16(3) (a) (ii). Each of the minors also received interest in the sum of Rs. 43,210 on deposits which stood to their credit in the firm, and the question that we have to consider is whether the interest which the minors received could be included in the income of the assessee under the provisions of Section 16(3) (a) (ii).

2. Now, what Section 16(3)(a)(ii) requires is that a minor must be admitted to the benefits of the partnership in a firm of which the assessee is a partner and income must arise either directly or

indirectly to the minor from his admission to such a partnership. Therefore, there must be a connection between the income and the admission of the minor to the partnership. The connection need not be direct; it may even be indirect. We have to look to the partnership deed in order to determine whether there was a connection direct or indirect between the interest received by the minors on the deposits and their admission into the partnership. For this purpose the relevant clause in the partnership deed is clause (3) and that clause provides:

"Interest at the rate of six per cent. per annum shall be paid to each partner on the moneys for the time being standing to his credit out of the gross profits of the business and such interest shall be cumulative so that any deficiency in any one year shall be made up out of the gross profits of any succeeding year or years."

It is significant to note that this clause does not cast any obligation upon the minors to maintain any deposit in the firm. It is equally significant that this clause does not cast any obligation upon the firm to keep any deposits made by the minors. Therefore, it is optional on both sides, on the side of the depositor and on the side of the depositee, whether to have deposits or not. All that clause (3) does is to fix the rate of interest and it casts an obligation upon the firm to pay interest at the rate of 6 per cent. if there are any deposits or any moneys standing to the credit of the minor.

3. Mr. Joshi has relied on clause (6) for the purpose of contending that although the minors may withdraw their moneys there is an obligation upon the firm to keep the moneys. Now, clause (6) provides for the making up of accounts and it goes on to provide that the profits coming to the share of each partner shall be credited to his account with the partnership. Mr. Joshi reads this expression to mean that if there is any profit, then it is obligatory upon the firm to keep that profit in the partnership and pay interest on it. In our opinion it is impossible to accept that contention. All that clause (6) deals with is book-keeping and the making of proper entries. The only obligation upon the firm is to credit to the account of the partners their share of the profits. But there is no further obligation, after having credited the share in the profits, to retain that share and to pay interest under clause (3).

4. If, therefore, this be the true position under the partnership deed, can it be said that the interest which the minors earned on the deposits was an income which directly or indirectly arose from their admission to the benefits of the partnership? It is clear that the minors earned interest primarily and substantially by reason of the fact that they deposited moneys in the firm. It is not by reason of the fact that they were partners, nor was it by reason of the fact that they were obliged under the partnership deed to make the deposits, that this interest was earned. Therefore, this income arose to the minors not from their admission to the benefits of the partnership, but the income arose because the minors chose to keep moneys in the partnership firm. They could have earned interest on their deposits without being partners, they could have earned interest on their deposits by keeping the deposits in any other firm, and really apart from the fixing of the

rate of interest there is no connection whatsoever between the minors being admitted to the benefit of the partnership and their earning interest on the deposits which they have made or on the moneys that stand to their credit. The position undoubtedly would have been different if there was any obligation upon the minors to make deposits or, on the other hand, if the partnership firm was under an obligation to keep the moneys of the minors, whether they needed them or not.

5. It is then pointed out by Mr. Joshi that the interest is payable out of the gross profits of the business. Now, this provision, if anything, is to the prejudice of the minors. They have no right to receive interest unless there are gross profits. It is true that the interest is cumulative, but their right to receive interest at the rate specified in clause (3) depends upon the firm making gross profits. It is not as if the rate of interest is dependent upon the profits made by the firm. The rate of interest remains stationary and their right to receive the interest is contingent upon the firm making gross profits. If one were to look at the Partnership Act, under Section 13(d) a partner is entitled to receive 6 per cent. if he brings into the firm any moneys beyond what he is liable to bring under the partnership deed, and that payment of 6 per cent. interest to the partner would be independent of the firm making profits or not. There is nothing to suggest here that there was any obligation upon the minors to bring in moneys into the firm or to contribute any capital. Therefore, even independently of the partnership deed they would be entitled to 6 per cent. interest under Section 13(d), Partnership Act. In one sense, by agreeing to clause (3) the minors have limited their right which they would otherwise have under the partnership law.

6. It is then urged by Mr. Joshi that on a true construction of Section 16(3) (a) (ii) any interest received by a minor must be added to the income of the firm. Now, Section 16(3) deals with notional or artificial income and it makes an assessee pay tax on income which in fact is not his own, but which is notionally made to be his income, and therefore Section 16(3) must be very strictly construed, and it is only if a particular income comes within the strict ambit of Section 16(3) that the assessee can be made liable to pay tax on that income. To summarise the argument of Mr. Joshi, what he contends is that under the Income-tax Act the definition of a "partner" includes a minor admitted to the benefit of a partnership and that under the scheme of the Income-tax Act when you assess the profits of a partner you include in his share of profits any salary, interest, commission or other remuneration payable to him, and therefore Mr. Joshi says that when you are considering Section 16(3) you must construe Sub-Section (a) (ii) to mean that the share of a minor in the partnership, the share as understood by the Income-tax Act bearing the extended meaning, should be included in the income of the partner. Mr. Joshi is right that looking to Sections 16(1) (b) and 14 (2) (a) and also Section 23(5), for the purpose of assessment of a partner the Income-tax Act has given an extended meaning to "the share of a partner." The share is not, what is understood in the ordinary language, a share in the profits. The share is much more than that. It is not only the share in profits as just pointed out, but it also includes salary, commission, interest, etc. and there can be no doubt that if the minor were to be assessed on his profits as a partner in the firm, he being looked upon as a partner for the purposes of the

Act, in his share of profits the interest that he has received would be included as part of his profits and would be brought to tax. That is not the question that we are considering. We are not considering the case of the assessment of the minor. What we are considering is Section 16(3), and the question is whether the Legislature has provided that the share of the minor in the partnership in its extended sense should be included in the income of the firm. Turning again to Section 16(3), the Legislature has advisedly not used the expression "share of the minor in the partnership" in the extended sense in which it is used in the Income-tax Act. The Legislature has advisedly used a different expression and that expression is "the income which arises to the minor directly or indirectly from his admission to the benefits of the partnership", and to say that this expression means the same thing as the extended meaning of a share is to put forward an argument which is untenable by any canon of construction. There is good reason why the Legislature has made a distinction between the share of a minor for the purpose of assessing him to tax with regard to his profits, and the benefits which the minor receives from his admission to a partnership, which benefits are to be taxed not in his assessment but in the assessment of his father. The Legislature did not intend that a father should be made to pay tax upon his son's income beyond the limited extent provided in Section 16(3), and the whole attempt of Mr. Joshi is to extend the scope of Section 16(3) by making the father pay tax on an income which is not his, an income which is that of his minor son and which the Legislature for good reasons has not considered to be the artificial or notional income of the father.

7. We must, therefore, differ from the view taken by the Tribunal and answer question (1) in the negative. Question (2) deals with the premia paid out of the moneys belonging to the minors for effecting insurance on their respective lives. Mr. Palkhivala makes it clear that he wanted to argue this question only if we had decided question (1) against him. But inasmuch as we have decided question (1) in his favor and we have held that the income of the minor's is not the income of the father, question No.2 does not arise. Therefore, we will not answer question (2).

8. Commissioner to pay the costs of the reference.  
Answered accordingly.