PETITIONER:
COMMISSIONER OF INCOME TAX,LUDHIANA, ETC. ETC.

Vs.

RESPONDENT:
SHRI OM PRAKASH, ETC. ETC.

DATE OF JUDGMENT16/11/1995

BENCH:
JEEVAN REDDY, B.P. (J)
BENCH:
JEEVAN REDDY, B.P. (J)
SEN, S.C. (J)

CITATION:
1996 AIR 593 1995 SCC Supl. (4) 737
JT 1995 (8) 245 1995 SCALE (6)487

ACT:

HEADNOTE:

JUDGMENT:

J U D G M E N T

B.P. JEEVAN REDDY, J.

A conflict of opinion among the High Courts on the meaning and interpretation or clauses (i) and (ii) of sub-section (1) of Section 64 (as they stood prior to 1st April, 1976) of the Income Tax Act, 1961 falls for resolution in this batch of appeals. Prior to April 1, 1976 the said clauses along with the explanation read thus:

(1). 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;

Explanation:- For the purpose of clause (i) the individual, in computing whose total income the income referred to in that clause is to be included, shall be the husband or wife whose total income (excluding the income referred to in that clause) is greater; and, for the purpose of clause (ii), where both the parents are members of the firm in which the minor child is a partner, the income of the minor child from the partnership shall be included in the income of that parent whose total income (excluding the income referred to in that clause) is greater, and where any such income is

once included in the total income of either spouse of parent, any such income arising in any succeeding year shall not be included in the total income of the other spouse or parent unless the income-tax Officer is satisfied, after giving that spouse of parent an opportunity of being heard, that it is necessary so to do".

We may make it clear, at the outset, that whatever we say hereinafter is relevant only to the aforesaid provisions contained in clauses (i) and (ii) of Section 64(1), i.e., to clauses (i) and (ii) as they obtained prior to April 1, 1976.

The sub-section opens with the words "in computing the total income of any individual", and provides for inclusion of the income arising directly or indirectly to persons specified in the sub-section, in the situation specified therein, in the total income of such individual. Clause (i) says that where the spouse of an individual is the member of a firm wherein the individual is a partner, the income of such spouse shall be included in the income of that individual. The Explanation contained in sub-section (1) says that among the spouses, the income of the spouse with lesser income shall be included in the income of the spouse having larger income. It does not matter whether the individual in whose income the income of the spouse is included is husband or wife. Clause (ii) says that if the minor child of such individual is admitted to the benefits of the partner, the income arising to such minor child shall be included in the income of such individual. The Explanation clarifies that where both the mother and father of a minor child are partners in the firm (to benefits of which such minor child is admitted), the income of the minor child shall be included in the income of that parent whose total income (excluding the income referred to in clause (ii)) is greater.

No difficulty arises where the individual is a partner in the firm as an individual. In such a case, the income arising to his/her spouse from the membership of such partnership will be included in the income of that individual. Similarly where the parent of a minor child is a partner in his/her individual capacity, the income arising to the minor from his admission to the benefits of such partnership will be included in the income of that individual. Difficulty has arisen in a limited category of cases - and these are such cases - where the husband/father is a partner in a firm as the karta of an Hindu Undivided Family (H.U.F.). And this is the only question considered in this Judgment. In such cases, the plea is that the husband/father is a partner in the firm not as an individual but as the representative of the H.U.F. and, therefore, clauses (i) and (ii) have no application. Indeed, three lines of thought have emerged regarding the meaning and purport of clauses (i) and (ii). They are: (a) since the husband/father is a partner not as an individual but as the karta of the H.U.F., i.e., as the representative of the H.U.F., clause (i) and (ii) of sub-section (1) are not at all attracted; in such a case the income of the wife or the minor child, as the case may be, cannot be included in the individual income of the husband/father under the said clauses; (b) clauses (i) and (ii) of sub-section (1) operate and apply even where the "individual" happens to be the Karta of the H.U.F. In such a case, all that the clauses mean is that the income of the wife or the minor child, as

the case may be, has to be included in the income of the H.U.F. (c) even though the husband/father is a partner in a firm as the karta of H.U.F., be does not cease to be an individual, which means that the income arising to the wife from the membership of such partnership firm - or the income arising to his minor child from being admitted to the benefits of such partnership firm - has to be included in the individual assessment of such husband/father. In other. In other words, though the income of the wife/minor children cannot be included in the total income of the H.U.F., it has to be included in the individual assessment of such husband/father. It does not matter that such husband/father has no separate individual income of his own; even in such a case, a separate assessment has to be made upon him as an individual, in which assessment the income of the wife and the child arising on the aforesaid account has to be included.

We must immediately say what of the three lines of thought aforesaid, the second line of thought is foreclosed and is no longer available in views of the decisions of this Court in L. Hirday Narain v. Income Tax Officer, A.Ward, Bareilly (78 I.T.R. 26), Commission of Income-tax v. Harbhajanlal (204 I.T.R. 361) and Commissioner of Income-tax, Gujarat v. Jayanthilal Premchand Shah (211 I.T.R. 111). We may briefly refer to the ratio of each of these three decisions.

In Hirday Narain, the assessee, Hirday Narain, and his five sons were members of H.U.F. His accounting year relevant to the Assessment Year 1951-52 was the year commencing on October 1, 1949 and ending with September 30,1950. During the said accounting year, two events occurred. On November 19, 1949 there was a partition between Hirday Narain and his five sons and on April 8, 1950 another son was born to Hirday Narain. Over-ruling the objections of the assessee, the Income-tax Officer made an assessment for the entire year in the status of H.U.F. On appeal, the Appellate Assistant Commissioner treated the sum of Rs. 18,520/- as being the Income of the former H.U.F. for the period October 1, 1949 to November 18, 1949 and directed its exclusion from the assessment. Pursuant to the directions of the Appellate Assistant Commissioner, the Income-tax Officer made two assessments - one assessing the sum of Rs.18,520/- as the income of the former H.U.F. for the period October 1, 1949 to November 18, 1949 and the other assessing the income of Rs. 1,06,156/- for the remaining period as the income of the smaller H.U.F., applying, at the same time, Section 16(3) (a) (ii) of the Indian Income Tax Act, 1922. Hirday Narain then made an application for rectification under Section 35 of the 1922 Act claiming that in the matter of his assessment in the status of H.U.F., Section 16(3) (a) (ii) cannot be invoked. The Income-tax Officer accepted the plea but declined to give relief on another ground. The assessee thereupon approached the High Court under Article 226 which matter was ultimately carried to this Court, Shah, J, speaking for the Bench (comprising himself and Hedge, J.) held that inasmuch as a son was born to Hirday Narain after the partition on November 19, 1949 and before the end of the accounting year, be could not have been assessed as an individual for the period November 19, 1949 to September 30, 1950 and that he ought to have been assessed in the status of H.U.F. Once this is so, the learned Judge held, "Section 16(3) (a) (ii) plainly did not apply and the income of the minor children of Hirday Narain could not be included in the income of Hirday Narain assessed as a H.U.F." It may be mentioned that Section 16(3) (a) (ii) considered in the said

judgment is in pari materia with clause (ii) of Section 64(1) (before it was amended with effect from April 1, 1976).

In Harbhajanlal, the question again was whether the income arising to the minor children from their being admitted to the benefits of a partnership firm could be included in the income of their father who was a partner in that partnership firm as the karta of the H.U.F. Following the decision in Hirday Narain, this Court (B.P. Jeevan Reddy, and S.P. Bharucha, JJ.) held that such inclusion was not permissible. No further contention was raised of considered in the said decision.

In Jayanthilal Premchand Shah, a three-Judge Bench comprising S.P. Bharucha, S.C. Sen and K.S. Paripoornan, JJ. held that the income of the minors arising on account of their being admitted to the benefits of a partnership firm cannot be included in the total income of their father who was a partner of the said firm as the karta of the H.U.F. The aforesaid decisions are binding upon us. In this view of the matter, only two alternatives survive, i.e., (a) and (c) mentioned above, and we have to see which one is the correct one.

A majority of the High Courts have adopted the first line of thought aforesaid. The High Courts taking this view are Andhra Pradesh, Gujarat, Punjab and Haryana, Delhi, Karnataka, Bombay, Madhya Pradesh, Kerala, Guhati and Rajasthan. It is not necessary to refer to the reasoning of all these decisions. It would suffice to note the reasoning of two decisions, vis., Commissioner of Income-Tax v. Sanka Sankarajan (113 I.T.R.313), a decision of the Andhra Pradesh High Court, the first one to take this view and that of the Full Bench of the Karnataka High Court in Arunchalam v. Commissioner of Income-tax (151 I.T.R.172). In Sanka Sankaraiah. it was held:

> "This Section (64(1)) applies only to the computation of total income of an individual. The expression 'individual' does not comprehend in its meaning the 'karta' of a joint family. If it were the intention of the legislature that the expression 'individual' used in Section 64 should also take in a Hindu undivided family, then it would have used the expression 'person' so as to include a Hindu undivided family and not the words 'spouse of such individual in clause (i)' or the words' 'a minor child of such individual in clause (iii)' or the words either spouse or parent' in the Explanation. This section aims at putting an end to the attempts of an individual to avoid or reduce the incidence of tax by transferring the assets to a spouse or minor child. Under this section, the husband's share of the profits of a firm, where husband and wife and both partners could be assessed in the wife's hands or vice versa, depending upon the fact whose total income is greater. The income of the minor child admitted to the benefits of the partnership is similarly to be included in the income of that parent whose total income is greater".

It is not necessary to state all the facts of the case

except the following: the assessee, Sanka Sankariah, effected a partition between himself and his two minor sons by way of a partial partition. The Tribunal accepted his plea that even after the said partial partition effected on April 9, 19967, the assessee constituted a smaller H.U.F., comprising himself, his wife and his minor daughter. The assessee and his wife constituted a partnership, to the benefits of which the two minor sons were admitted. The income received by the wife and the income received by the minor sons from the partnership firm was sought to be included in the individual income of the assessee which was objected to by him, whereupon the following question was referred for the opinion of the High Court:

> "Whether, on the facts and in the circumstances of the case, the share incomes derived by the assessee's wife and minor children could be considered in the hands of the assessee-individual under Section 64 of the Income-Tax Act, 1961?"

It is on those facts that the observations aforesaid were made by the High Court.

In Arunachalam, K.Jagannatha Shetty, J. (as he then was), speaking for the Full Bench of the Karnataka High Court pointed out, in the first instance, what, in his opinion, is the essential difference in tax liability between the Karta-partner and other partners of a firm and then proceeded to hold that the income accruing to wife/minor child cannot be included in the individual assessment of the husband/father in such a situation. This decision considers cases of two different assessees. In the case of one assessee, his minor sons were admitted to the benefits of partnership of which he was a member as the karta of his H.U.F. The other was a case where the Commissioner directed, under Section 263 of the Income Tax Act, 1961, that the share income of the wife and the minor sons of the assessee be included in the total income of the assessee who was a partner in that firm as the karta of H.U.F. The Full Bench held that the share income of the wife/minor children cannot be included in the individual assessment of the husband/father, for the reason that he is a partner not in his individual capacity but as the karta of the H.U.F., i.e., in a representative capacity.

The High Courts which have adopted the third line of thought are Allahabad, Madras, Madhya Pradesh and Orissa. We may refer to the reasoning of the Full Bench of the Allahabad High Court in Sahu Govind Prasad v. Commissioner of Income-tax (144 I.T.R. 851). The Full Bench holds that where the Karta of a H.U.F. is a partner in the firm wherein his wife is also a partner and/or to the benefits of which his minor children are admitted, the income accruing to wife/minor children has to be included in the individual assessment of the husband/father though such income cannot be included in the income of the H.U.F., i.e., in the share income received by the husband/father as the karta of the H.U.F. The ratio of the Full Bench is to be found in the following observations:

> "A partner, being an individual, has a dual capacity - representative and personal. He may be a representative i.e., a karta qua others i.e., other than partners. But with his partners he functions in his personal capacity. The relationship between the partner-karta and the other partners is personal. He

does not act with the other partners in his representative capacity. This position does not, and cannot change when the other partner is related to his as his wife or minor children. To repeat, Section 64 requires an individual and his wife and/or minor children to be partners of each other. That is enough. Their other relationships inter se are not relevant. The fact that he is also the karta, quardian or trustee of benamidar, etc., is immaterial.

An HUF is itself an assessable entity or unit. The income earned by the karta is taxed in the hands of the HUF. No part of such income is computed in his individual assessment. When Section 64 speaks of 'computation of the total income of any individual', it ex hypothesi excludes from such computation, income which is assessable in the hands of the HUF. Section 64 does not deal with the share income of the karta from the firm. It is confined to the clubbing together of the share income of the spouse or minor children of the individual from the firm, with such other income of that individual status. It is thus clear that the share income of the karta from the partnership firm is not exigible to tax a second time under Section 64.

In our opinion, the phrase 'in which such individual is a partner' occurring in Section 64 includes a human being who may be the karta of an HUF. This is what was held by this court in Madho Prasad's case ((1978) 112 ITR 492). With respect we agree with that decision".

In Commissioner of Income-tax v. Shri Manakram (183 I.T.R. 382), the Madhya Pradesh High Court has pointed out that for including the income of the wife/minor children in the individual assessment of the husband/father under Section 64(1), it is not necessary that the husband/father should have separate individual income of his own. Even if he has no separate individual income, still the income of the wife/minor children has to be included by making a separate assessment on the husband/father in his individual capacity.

While the learned counsel for the Revenue commends to us the view taken by Allahabad High Court at (what may be called the third line of thought), the learned counsel for the assessees espouse the first line of thought accepted by the Andhra Pradesh, Karnataka and other High Courts mentioned above.

In the Indian Income Tax Act, 1922, as originally enacted, there was no provision like the one concerned herein. Section 16(3) providing for the same was introduced only in the year 1937. The constitutional validity of this provision was questioned in Balaji v. Income-Tax Officer, Special Investigation Circle (1962 (2) S.C.R. 983). It would be appropriate to refer to some of the reasons given by the Constitution Bench while upholding the validity. Subba Rao,

J., speaking for the Court, observed, in the first instance, that the beneficial provision made in the Income-tax for distributing the profit made by the partnership firm among its partners also provided an effective device to evade taxation. "A husband or a father could nominally take his wife or his minor sons in partnership with him so that tax burden be lightened,..........This device enables an assessee to secure the entire income of the business but at the same time to evade income-tax which he would have otherwise been liable to pay." The learned Judge pointed out that said provision was made pursuant to the recommendations made by the Income-tax Inquiry Commission, 1936 as a measure of plugging the loopholes in the Act. Inasmuch as the validity of the provision was questioned on the ground of violation of Article 14, the learned Judge examined the principles underlying the said Article and held that the provision which included the income derived by wife and/or minor children alone in the income of the husband/father while not including the income of others does not suffer from discrimination. The learned Judge observed that the argument based upon violation of Article 14 ignores the object of the Legislation, viz., to prevent evasion of tax. Learned Judge observed: "A similar device would not ordinarily be resorted to by individuals by entering into partnership with persons other than those mentioned in the sub-section, as it would involve a risk of the third-party turning round and asserting his own rights. The Legislature, therefore, selected for the purpose of classification only that group of persons who in fact are used as a cloak to perpetrate fraud on taxation." The learned Judge then dealt with the argument that there might be a genuine partnership between an individual and his wife and that such a situation is not saved by the said provision. He held: "In demarcating a group, the net was cast a little wider, but it was necessary, as any further sub-classification as genuine and non-genuine partnerships might defeat the purpose of the Act......There is a greater scope for fraudulent evasion by constituting fictitious partnership along with one's wife and minor children than in a case of separate income of the spouses derived from different sources......... When the Legislature of the country, which is assumed to know the conditions of the people and their requirements, with the awareness of this particular widespread fraudulent device in the matter of evasion of taxes, made a law to prevent the said fraud, it is difficult for this Court in the absence of any counter-balancing circumstances to hold, on the analogy drawn from American decisions, that the need for such a law is not in existence." The learned Judge also rejected the attack upon the constitutionality of the said provision based on Article 19(1) (g) holding that it constituted a reasonable restriction which was found necessary "to prevent the prevalent abuse, namely, evasion of tax by an individual doing business under a partnership nominally entered with his wife or minor children." The learned Judge added finally, "This mode of taxation may be a little hard on a husband or a father in the case of genuine partnership with wife or minor children, but that is offset, to a large extent, by the beneficient results that flow therefrom to the public, namely, the prevention of evasion of income-tax, and also by the fact that, by and large, the additional payment of tax made on the income of the wife of the minor children will ultimately be borne by them in the final accounting between them."

While enacting Section 64 of the Income-tax Act, 1961

the Parliament kept in view the decision of this Court in Commissioner of Income-Tax v. Sodra Devi (32 I.T.R. 615) and the report of the Direct Taxes Administration Committee 1958-59. Section 64 basically carried forward the idea in sub-section 3 of Section 16 of the Indian Income-Tax Act, 1922, no doubt, with certain modifications. One constant, however, remained, viz., the provisions contained in clauses (i) and ii) of Section 64(1) were confined only to the partnership income. Now, what are the ingredients of the sections? The opening words are "in computing the total income of any individual". Then it proceeds to say that in the total income of such individual shall be included the income of his spouse arising from the membership of such spouse in the partnership firm in which such individual is the partner. It proceeds further and says that the income arising to the minor children of such individual who are admitted to the benefits of partnership wherein such individual is a partner shall also be included in the total income of such individual. Now an individual can be a partner in a partnership firm in is individual capacity or in the capacity of the karta of a H.U.F. or, for that matter, in any other capacity, e.g., as a trustee. There may be a firm comprising an individual and his wife, to which their minor children are admitted. There can also be a firm comprising two or more individuals wherein the wife/wives of one or more of the partners are also partners. The minor children of one or more of the partners may also have been admitted to the benefits of the partnership firm. In fact, there can be any number of situations where the wife is also a partner along with her husband in a partnership firm or where the minor children of an individual are admitted to the benefits of a partnership firm wherein that individual is a partner. So far as other partners in the partnership firm are concerned, they are not really concerned in what capacity a particular person is a partner, e.e., whether as an individual, as a karta, as a trustee or otherwise. To them, he is an individual, a person. This aspect however becomes relevant as between the partner and those whom he represents in the partnership firm. To wit, where a person is a partner as the karta of a H.U.F., the capacity in which he is a partner in the partnership firm in relevant as between him and the other members of the H.U.F. For, the income the karta receives as a partner is not his individual income; it is the income of the H.U.F. and he receives it on behalf of the H.U.F. It is for this reason that the income of the wife and minor children arising from their membership/admission to the benefits of partnership firm, is held not includible in the income of the H.U.F. since the total income of H.U.F. is not the total income of the individual (husband or father, as the case may be). For Section 64(1) to get attracted, it is necessary that the husband/father should be a partner in a partnership firm as an individual, i.e., in his individual capacity. It is not attracted where he is a partner as the karta of H.U.F. to which such wife and/or minor children belong. This is the holding of the decisions of this Court in Hirday Narain, Harbhajanlal and Jayantilal Premchand Shah. It may not be quite apt to say that vis-a-vis the members of the h
H.U.F., the karta is still an individual and, therefore, such income of wife and minor children should be included in the income of the karta derived as karta. Nor are we satisfied that such income of the wife and/or minor children should be included in the individual assessment of the karta. Indeed, the argument is that even if the karta has no individual income of his own, even then the said income of

the wife and children should be included in the husband/father's individual assessment by making such a separate assessement. This argument ignores the fact that the husband/father is a partner in the partnership firm not in his individual capacity but as the karta. It also ignores the clear language employed in clauses (i) and (ii). In each of these two clauses, the expression "such individual" occurs twice. Firstly, the "individual" must be a partner in a firm and the wife and/or minor children of such individual must also be deriving income from such partnership firm (either on account of her membership or on account of being admitted to the benefits of partnership, as the case may be). For the purposes of clauses (i) and (ii) it is not his capacity vis-a-vis other partners of the firm that is relevant but his capacity vis-a-vis his wife and/or minor children. If this basic fact is ignored, anomalous results may follow as indicated by the Andhra Pradesh High Court in Sanka Sankaraiah.

The learned counsel for the Revenue says that if the above view is taken by this Court, the very objective underlying the said clauses - and emphasized in eloquent terms in Balaji - would be defeated. The result would be, learned counsel says, the income of, say the minor children arising from their being admitted to the benefits of a partnership firm can neither be included in the H.U.F's income nor can it be included in the individual assessment of the father in a case where the father is partner in the firm as the karta of that H.U.F. This confers an undue - and an unfair - advantage to Hindus among whom alone the concept or Hindu undivided family obtains. While members of other communities, among whom the concept of H.U.F. does not obtain, would be directly in the path of the said provisions, the Hindus would be escaping the rigour of the said provisions through the device of H.U.F., says the learned counsel. There is certainly a fair amount of force in this submission but this is an argument really against the very concept, and the permissibility of such concept, in the Income Tax Act. We are not unaware of the criticism that very often H.U.F. is being used to deny the State the tax legitimately due to it. But that is a larger question which does not arise in these case. As a matter of fact, wherever the Parliament has thought it fit, it has intervened to checkmate the evil, e.g., sub-section (2) of Section 4 of the Gift Tax Act inserted by Finance (No.2) Act, 1971 and sub-section (1A) of Section 4 of Wealth Tax Act inserted by the very same Finance Act. Similarly, sub-section (2) was introduced in Section 64 by the Finance Act, 1979 with effect from April 1, 1980. Then Explanation 3 was added by the Taxation Laws (Amendment) Act, 1975 with effect from April 1, 1976, but clauses (i) and (ii) in sub-section (1) remained untouched [except for the deletion of the words "of which such individual is a partner" in clause (iii) corresponding to clause (ii)] until they were deleted by Finance Act, 1992 w.e.f. April 1, 1993 and insertion of sub-section (1A) - with which aspects we are not concerned herein. Suffice it to say that on the language employed in the sub-section and the clauses concerned herein, the view taken by it may possibly be the only view possible. Majority of High Courts too have accepted this view. It cannot also be said that the view taken by us militates in any manner against the ratio of Balaji nor does it tend to defeat the object of the provisions as explained in the said decision.

We must make it clear that we have merely interpreted clauses (i) and (ii) of sub-section (1) of Section 64, as

they stood before April 1, 1976, We have not gone into the facts of the individual cases before us. That is a matter for the authorities under the Act to enquire into and pronounce upon.

For the above reasons, we hold that where a person is a partner in a partnership firm not in his individual capacity but as the karta of the H.U.F., neither the income accruing to his wife on account of her being a partner in the same partnership firm nor the income accruing to his minor children on account of their being admitted to the benefits of such partnership firm, can be included in the total income of such person - neither in his individual assessment nor in the assessment of the H.U.F. Our holding is confined to the above situation alone.

All the appeals are disposed of with the aforesaid enunciation of legal position. The Income-tax Tribunal or the other concerned authorities under the Act, as the case may be, shall pass orders in each of these individual cases in accordance with the above legal position.

No costs.