

1961

*The First National
City Bank*

v.

*The Commissioner
of Income-tax,
Bombay City*

Kapur J.

structure. Under these circumstances it would be erroneous not to treat the amount of "Undivided Profits" as a part of the capital fund.

In our opinion therefore the amount designated as "Undivided Profits" is a part of the reserves and has to be taken into account when computing the capital and reserves within R. 2(1) of Schedule II of the Act. The question which was referred by the Tribunal should have been decided in the affirmative and in favour of the appellant and the amount should have been added to the capital as allowed by R. 2(1) for the Chargeable Accounting Periods. In the result the appeal is allowed. The appellant will have its costs in this Court and in the High Court.

Appeal allowed.

1961

January 10.

K. A. RAMACHAR AND ANOTHER

v.

COMMISSIONER OF INCOME TAX, MADRAS.
(J. L. KAPUR, M. HIDAYATULLAH and J. C. SHAI, JJ.)

Income-tax—Assessee assigning portion of his profits of partnership firm to his wife and daughters—Such profits, if can be included in the assessee's total income for purposes of assessment—Income-tax Act, 1922 (II of 1922), s. 16(1)(c).

One Rangachari, a partner of a partnership firm, assigned by means of a deed of settlement a fourth share of the profits of the firm each to his wife, a married adult daughter and a minor daughter for 8 years with the right to receive the said share of profits absolutely and exclusively from the firm. The question which arose before the High Court on a reference under s. 66(1) of the Income-tax Act was "Whether the inclusion in the assessee's total income of the profits settled by him on his wife and two daughters is justified in law?" The assessee Rangachari relying on the rule laid down by the Privy Council in *Bijoy Singh Dudhuria's* case claimed that the amounts payable to his wife and two daughters never became his income, being diverted by an overriding title and that those amounts could not be included in his total income for the purposes of assessment being excluded by reason of the third proviso to s. 16(1)(c) of the Income-tax Act. The High Court held that the third proviso was not attracted and that the income had accrued to the assessee in the first instance, and had then been applied for payments under the deeds. On appeal with a certificate of the High Court:

Held, that the answer given by the High Court was correct.

An examination of the deeds of settlement showed that the disponent had stated that from the profits "payable to him" certain amounts in specified shares were to be paid to his wife and two daughters. No doubt, the assessee in those deeds created a right in favour of the disponees to get the amounts direct from the firm, of which he was a partner. The tenor of the document showed that the profits were first to accrue to him and were then applied for payments to the disponees.

1961

—

K. A. Ramachar

v.

Commissioner of
Income-tax, Madras

Under the law of partnership, it is the partner and the partner alone who is entitled to the profits. A stranger, even if he were an assignee, has not and cannot have a direct claim to the profits. By the deeds in question, the assessee merely allowed a payment to his wife and daughters to constitute a valid discharge in favour of the firm, but what was paid was, in law, a portion of his profits or, in other words, his income.

The rule in *Bijoy Singh's* case was not applicable to this case, and in view of the decision of this court in *Sitaldas Tirathdas's* case it cannot be said that the profits were diverted by an overriding title before they accrued to the assessee.

Provat Kumar Mitter v. Commissioner of Income-tax, West Bengal [1961] 3 S.C.R. 37.

Tulsidas Kilachand v. The Commissioner of Income-tax [1961] 3 S.C.R. 351.

The Commissioner of Income-tax, Bombay v. Sitaldas Tirathdas [1961] 2 S.C.R. 634, applied.

Bijoy Singh Dudhuria v. Commissioner of Income-tax, Bengal [1933] 1 I.T.R. 135, held inapplicable.

CIVIL APPELLATE JURISDICTION: Civil Appeals Nos. 142 and 143 of 1960.

Appeals from the judgment and order dated July 21, 1955, of the Madras High Court in C.R. No. 32 of 1952.

G. S. Pathak and Naunit Lal, for the appellants.

K. N. Rajagopal Sastri and D. Gupta for the respondent.

1961. January 10. The Judgment of the Court was delivered by

HIDAYATULLAH, J.—These are two appeals by the legal representatives of one A. R. Rangachari, who died during the pendency, in the High Court at Madras, of proceedings in a reference under s. 66(1) of the Income-tax Act made by the Income-tax Appellate Tribunal, Madras Bench. The following question was referred to the High Court for its decision :

Hidayatullah J.

1961

K. A. Ramachar
v.
Commissioner of
Income-tax, Madras
Hidayatullah J.

“Whether the inclusion in the assessee’s total income of the profits settled by him on his wife and two daughters is justified in law?”

The High Court answered the question in the affirmative. The appeals have been filed with a certificate granted by the High Court.

Rangachari was one of five partners of a firm, Messrs. Chari and Ram, and held a six-anna share in the profits and loss of the partnership. On September 22, 1947, he executed three deeds of settlement, which are marked Exts. A, A-1 and A-2, in favour of his wife, a married adult daughter and a minor daughter. To each of them, he assigned a fourth share of the profits of the firm payable to him (but not the losses), for a period of 8 years, vesting the right in them to receive the said share of profits absolutely and exclusively and declaring the settlements to be irrevocable during the above period. It is not necessary to refer to the three documents, because the terms are the same. A few clauses of the deed, Ex. A, may be quoted. After recitals which included the following:

“Whereas the Settlor has settled upon his minor daughter, Srimathi Meera Bai, one-fourth of his share of profits payable to him from the firm for a period of eight years;

And whereas out of natural love and affection, the Settlor is desirous of conferring upon the Beneficiary a similar portion of his share of profits from the firm”,

the deed goes on to say:

“Now this Indenture witnesseth as follows:

1. The Settlor hereby assigns unto the Beneficiary all the rights of the Settlor in respect of one-fourth of his share of profits in the firm (but not the losses) payable to him during a period of eight years commencing from the date hereof to be taken and enjoyed by the Beneficiary in absolute and exclusive right.

2. The Settlor shall not have any manner of right or interest in the said one-fourth share hereby settled and the right to receive from the firm one-fourth of

the Settlor's share during the said period of eight years shall exclusively vest in the Beneficiary.

3. The Beneficiary shall be entitled directly to receive and collect from the firm the share of profits hereby transferred for the said period of eight years.

.....
8. This settlement shall be irrevocable."

For the assessment year 1947-48 corresponding to a previous year ending on April 13, 1947, the profits due to Rangachari amounted to Rs. 86,491-13-0. This amount was credited to the account of Rangachari, and Rs. 21,622-15-3, being one-fourth thereof, were transferred to the accounts of each of the three disponees. In the same way, the profits of the previous year ending April 13, 1948, were disposed of. The assessee claimed that these amounts could not be included in his total income for purposes of assessment, being excluded by reason of the third proviso to s. 16(1)(c) of the Income-tax Act. He also contended that the amount payable to his wife and two daughters never became his income, being diverted by an overriding title, and that the case was governed by the rule laid down by the Privy Council in *Bijoy Singh Dudhuria v. Commissioner of Income-tax, Bengal* (1).

The assessee's contentions were not accepted by the Income-tax Officer, and his appeals to the Appellate Assistant Commissioner and the Tribunal also failed. In so far as the assessment year 1947-48 was concerned, the Income-tax Officer held that the income had already accrued to the assessee, because the deeds were executed five months after the close of the account year. He also held that the transfer to the minor daughter fell within s. 16(3), as there was no adequate consideration for the transfer. With regard to the wife and married daughter, he held that s. 16(1)(c) was not applicable, because what had been transferred was income first accruing to the assessee, while s. 16(1)(c) contemplated income which accrued to a person, to whom the transfer was made. The same reasons (except the first) were given for rejecting the

1961

K. A. Ramachar

v.

Commissioner of
Income-tax, Madras

Hidayatullah J.

(1) [1933] 1 I.T.R. 135.

1961

K. A. Ramachar
v.
Commissioner of
Income-tax, Madras
Hidayatullah J.

assessee's contentions in respect of the other assessment year.

It is not necessary to refer in detail to the decisions of the Appellate Assistant Commissioner, the Tribunal and the High Court. The High Court in an elaborate judgment pointed out that s. 16(1)(c) did not apply to these proceedings, and that the third proviso was, therefore, not attracted. It also held that the income had accrued to the assessee in the first instance, and had then been applied for payments under the deeds.

This Court has recently decided three cases which have a direct bearing in this connection. In *Provat Kumar Mitter v. Commissioner of Income-tax, West Bengal* (1), the assessee had executed a deed of trust under which dividends from certain shares, which continued to be his assets, were transferred to his wife. It was held that the case did not fall within s. 16(1)(c), and that the rule in *Bijoy Singh Dudhuria's* case (2) also did not apply. In *Tulsidas Kilachand v. The Commissioner of Income-tax, Bombay* (3), the husband had created a trust of the shares, constituting himself as the trustee to pay to the wife dividends from those shares for a period of seven years. It was held that the case was not governed by s. 16(1)(c) but by s. 16(3)(b). In *The Commissioner of Income-tax, Bombay v. Sitaldas Tirathdas* (4), the rule laid down by the Privy Council in *Bijoy Singh Dudhuria's* case (2) was considered along with the case of the Privy Council in *P. C. Mullick v. Commissioner of Income-tax, Bengal* (5), and it was pointed out that the rule in *Bijoy Singh Dudhuria's* case (2) applied only to those cases where it could be said that by an overriding title the income was diverted in such a way as never to become the income of the assessee. These three cases, in our opinion, afford a complete answer to the contentions of the appellants.

An examination of the deeds of settlement shows that the disponent had stated that from the profits "payable to him" certain amounts in specified shares were to be paid to his wife and two daughters. No

(1) [1961] 3 S.C.R. 37.

(3) [1961] 3 S.C.R. 351.

(2) [1933] 1 I.T.R. 135.

(4) [1961] 2 S.C.R. 634.

(5) [1938] 6 I.T.R. 206.

doubt, the assessee in those deeds created a right in favour of the disponees to get the amounts direct from the firm, of which he was a partner. The tenor of the documents shows that the profits were first to accrue to him and were then applied for payments to the disponees. Learned counsel for the appellants contended that what had been assigned was an actionable claim, to wit, the right to profits, and therefore the profits were diverted, before they accrued to the disponent. This, in our opinion, is neither in accordance with the law of partnership nor with the facts as we have found on the record. Under the law of partnership, it is the partner and the partner alone who is entitled to the profits. A stranger, even if he were an assignee, has not and cannot have a direct claim to the profits. By the deeds in question, the assessee merely allowed a payment to his wife and daughters to constitute a valid discharge in favour of the firm; but what was paid was, in law, a portion of his profits, or, in other words, his income. A glance at the account books of the firm, Messrs. Chari and Ram, clearly shows that the amounts were first credited in the *Khata* of Rangachari and then under his directions were transferred from his *Khata* to those of his wife and daughters. The dispositions, therefore, were, in law and in fact, portions of the income of Rangachari, after the income had accrued to him, and tax was payable by him at the point of accrual. In view of the decision of this Court in *Sitaldas Tirathdas's* case⁽¹⁾, it cannot be said that the profits were diverted by an overriding title before they accrued to Rangachari; and the rule in *Bijoy Singh Dudhuria's* case⁽²⁾ cannot be called in aid.

For the above reasons, we are in entire agreement with the High Court in the answer given and dismiss these appeals with costs.

Appeals dismissed.

1961

—
K. A. Ramachar
v.
Commissioner of
Income-tax, Madras
—
Hidayatullah J.

(1) [1961] 2 S.C.R. 634.

(2) [1933] 1 I.T.R. 135.