CHAPTER: FOUR
HINDU UNDIVIDED FAMILY AND THE LAW OF INCOME TAX
A Hindu Undivided Family has acquired a special connotation with the passage of time. Since Hindu Undivided Family was, and continues to be a living and vibrant unit of Indian society, our tax law makers considered it both pragmatic and convenient to include it as a unit of assessment. Having once been included as a unit of assessment, it has continued to be so. It has survived many a storms wherein it has been accused as the medium for tax evasion.

The law and procedure governing the assessment of direct taxes is the same for all assessee including Hindu Undivided Families but the very nature of the constitution of a Hindu Undivided Family, governed as it is by different schools of the Hindu Law and represented by a manager usually known as a 'karta' throw up many problems in this regard which are peculiar to the Hindu Undivided Family. In this chapter an attempt is made to deal with some of the significant problems relating to the assessment to Direct taxes of Hindu Undivided Families.

(I) Hindu Undivided Family as a Taxable Entity

Under Section 2(31) of the Income Tax Act, 1961, a Hindu Undivided Family is a 'person' and therefore an assessee within the meaning of Section 2(7). Section 4 of the Act requires an assessment to be made on the Hindu Undivided Family as an assessee. The income of a Hindu Undivided Family can be assessed in the hands of the Hindu Undivided Family alone and not in the hands of any of its members, unless specifically so provided by law. This is so because the Hindu Undivided Family is a separate and distinct tax entity.
Income Tax Officer v. Bachulal Kapoor,\(^1\) it has been held that:

So long as the Hindu Undivided Family exists, the individuals thereof cannot separately be assessed in respect of its income. Nonetheless, if under some mistake such income was assessed to tax in the hands of the individual members, which should not have been done, when a proper assessment was made on the Hindu Undivided Family in respect of the income, the revenue had to make appropriate adjustments. Otherwise the assessment made in respect of that income on the Hindu Undivided Family would be contrary to the provisions of the Act. We, therefore, hold, that if the assessment proceeding initiated under Section 34 of the Act culminate in the assessment of the Hindu Undivided Family, appropriate adjustments have to be made by the Income Tax Officer in respect of tax realized by the Revenue in respect of that part of the income of the family assessed on the individuals of the said family. To do so is not to reopen the final orders of assessment but in reality to arrive at the correct figure of tax payable by the Hindu Undivided Family. Thus, Hindu Undivided Family is a separate and distinct tax entity and income arising to Hindu Undivided Family can be assessed only in its own hands, and cannot be assessed in the hands of any member or coparcener.

In Udham Singh v. CIT,\(^2\) it is reiterated that a Hindu Undivided Family is a separate legal entity and it is in this sense that this legal expression has been employed in the taxation law.\(^3\) The legislature deliberately did not define the expression in the Income Tax Act as it has a well known connotation

---

2. (1988) 171 ITR 471 (Ori.).
under the Hindu Law. The Hindu Undivided Family is being assessed to income tax as a distinct entity or a unit of assessment. In this context it was held that Hindu Undivided Family was not entitled to the benefit of set off in its assessment of amounts disclosed by the members of the Hindu Undivided Family in their individual assessment under the Voluntary Disclosure of Income and Wealth Ordinance 1975.

In *Dharamdas Agarwal v. C.I.T.*,\(^4\) income from certain property and the property itself were taxed in the hands of Hindu Undivided Family for income tax and wealth tax purposes on the basis of a specific admission that property belonged to Hindu Undivided Family. Subsequent evidence in the form of order of Tehsildar was produced to show that the property belonged to the wife of the karta. The High Court held that the property had been admittedly assessed as belonging to Hindu Undivided Family and there was a categorical admission before the income tax appellate Tribunal that even though the property stood in the name of M, it belonged to Hindu Undivided Family. The Tribunal was justified in upholding assessment on the income in the hands of Hindu Undivided Family and an admission is the best evidence that an opposing party can rely upon, and though not conclusive, is decisive of the matter unless successfully withdrawn or proved erroneous.\(^5\)

(II) Residential Status of Hindu Undivided Family:

The subject residential status of an assessee is a very important and complicated one because incidence of taxation varies with residence. The first enquiry is directed towards the correct ascertainment of residential qualification.

---

4. \((1988) 172\) ITR 244 (M.P.).

of an assessee before he could be correctly assessed. The question of residence is determined with reference to each 'previous year', i.e., accounting year. Residence indicates a personal quality and is not descriptive of a person's property. What is material is his status during the previous year and not during the assessment year. The word "residence" in its simple and ordinary meaning signifies the place where a human being eats, drinks and sleeps or where his family and servants eat, drink of sleep and when there is some permanence or continuance in such activities. All the assesses are divided into three categories, namely: (a) resident and ordinarily resident (b) resident but not ordinarily resident and (c) non-resident.

The liability to income tax is dependent on residential status of Hindu Undivided Family, i.e., whether it is 'resident' or 'not resident' in India and if it is resident whether it is 'ordinarily resident in India' or not ordinarily resident in India.

According to sub-Section (2) of Section 6 "a Hindu Undivided Family, firm or other association of persons is said to be 'resident' in India in any previous year in every case except where during the year the control and management of its affairs is situated wholly outside India." Thus in order to determine the residential status of a Hindu Undivided Family, it is to be seen that whether the control and management of its affairs is wholly situated outside India. The word 'wholly' is significant because, if the control and management of its affairs is even partially situated in India, then the Hindu Undivided Family would be resident in India. In other words, a Hindu Undivided Family is regarded resident in India if the control and management of its affairs is situated


either partly or wholly and it, would he non resident if the control and management of its affairs is situated wholly outside India.

Thus a Hindu Undivided Family is presumed to be a "resident" unless it is proved that the control and management of its affairs is wholly situated outside India. 'Control' and 'management' means de facto power which is actually exercised and not merely the right to control and manage. Where a coparcener of a Hindu Undivided Family became a partner with another in a firm, it was held that the partnership firm cannot be an 'affair' of the Hindu Undivided Family capable of being controlled and managed by the Hindu Undivided Family so far as the partnership is concerned, the control and management was in the hands of the individual coparcener, who is a partner and not the Hindu Undivided Family. The business of the partnership belonged to the partner, even though he represents the family, and as such could not be the affair of the Hindu Undivided Family. Thus the expression 'of its affairs' refers to the affairs of the tax payer or the assessee concerned and not the affairs of another 'person'.

In V.R.N.M. Subbayya Chettiar v. CIT, it was held that the mere fact that the assessee Hindu Undivided Family has a house in India, where some of its members live, does not necessarily mean that the control and management of the affairs is located where the house is situated. In this case the assessee had started partnerships in India and had remained in India for sometime after the commencement of these business. The assessee, though a permanent resident of Ceylon, did not produce evidence to help the Income Tax Officer to determine

10. (1951) 19 ITR 168 (S.C.).
whether the management and control of the business was situated wholly in Colombo. The Supreme Court observed that the onus of proving that the Hindu Undivided Family taxpayer is not resident in India is on the assessee. Since the assessee had failed to discharge the onus, it was held to be resident in India.

In *Gangabishan Mohanlal v. CIT*, it was held that in the absence of any material to show that during his stay in India the karta actually exercised any control or management, the mere visit of the karta to the place of business in India does not amount to exercise of control and management.

According to Section 6(6), "a person is said to be 'not ordinarily resident' in India in any previous year if such person is (a) an Individual.... (b) a Hindu Undivided Family, whose manager has not been resident in India in nine out of the ten previous years preceding that year, or has not during the seven previous years, preceding that year been in India for a period or periods amounting in all to seven hundred and thirty days." If a Hindu Undivided Family is resident in India, the next question is whether it is 'ordinarily resident' in India or "not ordinarily resident" in India. For this it is to be seen that whether the manager was 'not ordinarily resident' in India. The manager would not be ordinarily resident in India if he has not been resident in India in nine out of the ten preceeding previous years or has not during the seven preceding previous years been in India for a total of 730 days or more.

The residential status is determined with reference to the previous year relevant to a particular assessment year. It is possible that the residential status is different for different assessment years depending on the facts relevant to the

---

11. (1945) 13 ITR 20 (Mad.).
The question whether a Hindu Undivided Family is 'ordinarily resident' or 'not ordinarily resident' would be relevant if the Hindu Undivided Family is held to be resident in terms of Section 6(2) of the Income Tax Act, i.e., control and management of its affairs is situated within the territory of India. Residential status of an assessee is important because foreign income, i.e., income accruing or arising outside India, is includible in the total income of a Hindu Undivided Family which is 'resident and ordinarily resident'. In the case of a Hindu Undivided Family which is 'resident but not ordinarily resident,' foreign income can be included in the total income if it is derived from a business controlled in, or a profession set up in India vide Section 5(1). In the case of 'non-resident' Hindu Undivided Family, the foreign income is not to be included in the total income and is never taxed.

In Income Tax Officer v. Tarlok Singh and Sons, it is held that relief for self occupation of house is admissible under Section 23 of the Income Tax Act to a Hindu Undivided Family also. There is nothing in the words used in Section 23(2) which may show that they cannot apply to Hindu Undivided Family which is nothing but a group of individuals related to each other.

(III) Return of Income:

If the total income of the Hindu Undivided Family during the previous year exceeds the maximum amount which is not changeable to tax, the Hindu Undivided Family is required to furnish a return of its income. The return of income should be furnished in the prescribed form and is to be verified in the prescribed manner. It should be signed by the karta and where the karta is absent

12. 29 ITD 139 (Del.).

13. See Section 139 (1) of Income Tax Act, 1961. Exempted limit in case of non-specified HUF is Rs. 35,000 and Rs. 18,000 in the case of specified HUF (Amended by Finance Act, 1995).
from India or is mentally incapacitated from attending to his affairs, by any other adult member of any other adult member of such family. The return should be furnished on or before the due date. Due date means, that when Hindu Undivided Family is required to get his accounts audited under Income Tax Act or any other law it is 31st October. Where the Hindu Undivided Family has income from business or profession, it is 31st August and in any other case it is 30th June.

A Hindu Undivided Family which has sustained a loss is required to file a return of loss by the due date. If the return is not furnished within the time allowed under Section 139(i) or within the time allowed under notice issued under Section 142(i), the Hindu Undivided Family may furnish the return for any previous year at any time before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment which ever is earlier.

If the Hindu Undivided Family after having furnished a return under Section 139(i) or in pursuance of a notice issued under Section 142(i) discovers any omission or any wrong statement therein, it may furnish a revised return within one year from the end of the relevant assessment year or before the assessment is made, whichever is earlier.

Where the Income Tax Officer considers that the return of incomes furnished by the Hindu Undivided Family after 31 August, 1980 is defective, he

--

is given the discretion to intimate the defect and give an opportunity to rectify the defects within a period of 15 days from the date of intimation or within such further extended time as the Income Tax Officer may allow. If the return is not rectified within the period of 15 days or such further extended period, then the Income Tax Officer may treat the return as an invalid return and the other provisions of the Income Tax Act will apply as if no return has been filed.

(IV) Service of Notice on Hindu Undivided Family:

In the case of a Hindu Undivided Family, notices under the Income Tax Act can be served on the karta or any adult member of the family. Section 282(2) provides that any such notice or requisition may be addressed in the case of a firm or a Hindu Undivided Family to any member of the firm or to the manager or any adult member, of the family. Adult member of the family need not be a coparcener. According to the Indian Income Tax Act, 1922, the adult member should be a male member. Thus, there has been a change in the law in this regard as now notice can be addressed to and served on any adult member of Hindu Undivided Family including a daughter-in-law and daughter.

A notice which is issued in the trading name in which the Hindu Undivided Family was carrying on business and served on the karta is a valid notice. The contention of the assessee that the persons named in the notice were no longer living was rejected and it was held that notice in the trading name was perfectly valid.¹⁸

In Bhagwan Devi Sarogi and Others v. Income Tax Officer,¹⁹ the

¹⁸. Sonu Lal v. CIT, (1938) 6 ITR 94 (Pat.)
¹⁹. (1979) 118 ITR 906 (Cal.).
Calcutta High Court in writ proceedings under Act. 226 of the Constitution of India held that, where a notice was served on Smt. B.D. Sarogi and Others but did not indicate whether B.D. Sarogi and other were a firm or an association of persons, notice was invalid and liable to be quashed.

It is submitted that though a notice in respect of a Hindu Undivided Family can be served on any adult member of the family yet it should clearly indicate that it is meant for the family and not for that particular adult member. The provision of sub-Section (2) of Section 282 is permissive and not mandatory, the word used is 'may and not' shall'. Thus if a notice is not addressed to, and served upon the manager or adult member of the family, the notice would not necessarily be bad. Notice to an agent of Hindu Undivided Family may be good service.\(^{20}\) Section 283(i) provides that 'after a total partition has been recorded by the Income Tax Officer under Section 171 in respect of any Hindu Family, notice under this Act in respect of the Hindu Family, shall be served on the person who was the last manager of the Hindu family or if such a person is dead, then on all adult members who were members of the Hindu Undivided Family immediately before partition.

In \textit{ManiLal Raghavji v. CIT},\(^ {21}\) the notice of re-assessment after partition clearly indicated that a fresh return had to be filed by the Hindu Undivided Family. The fact that Manilal was not mentioned as karta in the notice was not relevant. There has been sufficient compliance with law and notice was valid. It was further held that demand notice served upon Mani Lal, the karta did not vitiate the assessment proceedings as the Department could proceed against any of the coparceners.

\(^{20}\) \textit{Ramanathan Chettiar, 2 ITC 474}.

\(^{21}\) (1985) 156 ITR 661 (Pat.).
Lakshminaryan Badani v. CIT, 22 is an authority for the proposition that where the Income Tax Officer proceeds to assess the income of the Hindu Undivided Family for the year prior to partition, it is not necessary to issue notice of the proceedings to every member of the family. In that case the karta of the family was assessed to income tax for the year 1939-40. It was noticed in the year 1944 that some income had escaped assessment. In the meantime the family was disrupted and the partition was recognized under Section 25 A(1) of the Indian Income Tax Act, 1922. Notice for reassessment was served on the karta who filed a return in response to the same and the assessment was duly completed. The Supreme Court held:

It does not appear necessary, when proceedings are initiated under Section 34 read with Section 22 of the Income Tax Act, to issue notice to every member of the family.

In Golabrai Manmohan Lal v. CIT, 23 it was held that after passing of an order under Section 25A(1) of the 1922 Act, it is not necessary that proceedings for assessment prior to partition be initiated by issue of a notice to every member of the family. Service of notice on karta is not improper. However, since tax is to be realised from the separate members of the family, notices of demand should be issued separately on each member.

In Balchand Malaiya and others v. Income Tax Officer, 24 it was held that it was sufficient if notice is issued to the karta and it is not necessary to issue notice of the proceedings to every member of the family.

22. (1951) 20 ITR 594 (S.C.).
23. (1953) 23 ITR 333 (Pat.).
In CIT v. Laxmi Dyeing and Finishing Factory, the Punjab and Haryana High Court dealt with the question of service of notice after partial partition of a Hindu Undivided Family. The Tribunal had held that as notice under Section 263 had not been served on each of the four members of the Hindu Undivided Family, the proceedings under Section 263 were bad. The Court held that here only a partial partition had taken place and Hindu Undivided Family was still in existence. By virtue of the provisions of Section 282(2), a notice served on any member of the Hindu Undivided Family was sufficient. Therefore, "notice served on any one of them would be sufficient compliance with the provision of Section 263 by virtue of the provisions of Section 282(2) (c) or (d)."

(V) Exempted Incomes of Hindu Undivided Family:

The following incomes are absolutely exempt from tax as they do not form part of total income:

1. Agricultural income
2. Casual and non-recurring income to the extent such receipts do not exceed Rs 5,000.
3. Interest, premium, redemption or other payment on notified securities, bonds, certificates and deposits etc subject to notified conditions and limits.
4. Interest on notified Capital Investment Bonds.
5. Interest on notified Relief Bonds.
6. Interest received from industrial undertaking in India on money lent to it under a loan agreement.

25. 25 Taxman 126 (P & H).
(7) Interest at approved rate received from Indian industrial undertaking on moneys lent or debt incurred in a foreign country.

(8) Interest received at approved rate from specified financial institutions in India on moneys lent from sources outside India.

(9) Interest received at approved rate from other Indian financial institutions or banks or moneys lent for specified purpose, from sources outside India under approved loan agreement.

(10) Interest received at approved rate from Indian industrial undertaking on money lent in foreign currency from sources outside India under approved loan agreement.

(11) Interest received from any public sector company in respect of notified bonds or debentures and subject to certain conditions.

(12) Amount received in pursuance of award whether in cash or kind instituted in public interest by Central/State Government or approved award instituted by other body.

(13) Reward whether in cash or kind received from Central/State Government for approved purposes in public interest.

(14) Section 10(2) exempts any sum received by an individual as a member of a Hindu Undivided Family where such sum has been paid out of the income of the family or income of the impartable estate belonging to the family. Thus if an individual received in his capacity as member of Hindu Undivided Family a sum out of the income of the family or of holder of impartable estate, such a sum would be exempt from tax even if the Hindu Undivided Family or impartable estate has not paid tax on the income out of which the sum has been paid.27 Under Sections 18 and 20 of the Hindu Adoptions and Maintenance Act, 1956 any allowance secured by a will, decree or contract deed will be exempt.

from tax. In *Majaraj Kumar of Vizianagaram*,\(^{28}\) it was held that if the assessee is entitled to be maintained by his father the allowance will be as member of Hindu Undivided Family. The same view was endorsed in *CIT v. Guan Manjuri Kuari*\(^{29}\). However, the allowance must be paid out of the income of the Hindu Undivided Family. If the regular payment received is not as a member of Hindu Undivided Family or out of the income of the Hindu Undivided Family, then the exemption under Section 10(2) cannot be claimed.\(^{30}\)

In *CIT v. Shreeji Maharana Bhagwat Singh*,\(^{31}\) it was held that payment to Rajmata of Rs. 18,000 as Hath Karach allowance from the privy purse of the Hindu Undivided Family rested on the discretion of the karta and was not in the nature of any obligation. So it was not taxable in the hands of the member.

(VI) Deductions available to Hindu Undivided Family

A number of deductions are made available to Hindu Undivided Family for arriving at its net taxable income, which is the basis of computation and levy of income tax.

Deduction under Capital Gains

Before the Finance Act 1992, the deductions in respect of any gain

\(^{28}\) (1934) 2 ITR 186 (All.).

\(^{29}\) (1945) 13 ITR 55 (Pat.).


\(^{31}\) Taxation 98 (3) 488 (Raj.); *Arvind Singh v. CIT*, (1986) 160 ITR 905.
made by the Hindu Undivided Family on account of transfer of capital assert were.

(i) Expenditure incurred wholly and exclusively in connection with transfer of capital assist.32

(ii) Cost of acquisition of capital asset and of any improvement thereto.33

(iii) Whose long term capital gain arrived at after allowing deduction under Section 48(1)(a) is less than Rs. 15,000 whole of such amount.34

The scheme of taxing capital gains has been absolutely recasted by Finance Act, 1992 w.e.F. 1-4-1993 and a new concept of 'capital gains tax' has been introduced. Under the revised provisions of the proposed Section 48, the cost of acquisition and the cost of any improvement will be computed with reference to an index to be notified by the Central Government having regard to seventy-five percent of average rise in the Consumer Price Index for urban non-manual employees for each year. The sale price as reduced by the indexed cost of requisition, indexed cost of improvement and expenses related to sale shall be the long term capital gains.

The Finance Act, 1992 inserted a new Section 112 in chapter XII of the Income Tax Act. The new section provides for taxation of long term capital gains at a flat rate of twenty percent in case of individuals and Hindu Undivided families. In respect of income other than long term capital gains income tax will be levied as per the normal provisions of the Act. The assessee will not get any deduction under Chapter VIA or tax rebate under Section 88 on the income tax in respect of long term capital gains.

Deductions under Chapter VI

The following deductions from the gross taxable income are available to Hindu Undivided Family.

(i) Section 80 CCA

Deposits in notified National Saving Scheme or amounts paid to keep in force contract for annuity plan of the LIC which has been notified by the Government (100% up to maximum of Rs. 40,000)

Finance Act 1992 has withdrawn the deduction available under Section 80CCA. Under the amended provisions, no tax will be levied on any amount received by the assessee on account of the surrender of the policy in accordance with the terms of the annuity plan of the LIC, where the assessee elects to surrender the said annuity plan before 1st October 1992 in respect of which he had paid any amount under clause (i) of sub Section (1) before 1st April 1992.

(ii) Section 80 CCB (Equity Linked Saving Scheme)

From Assessment Year 1991-92 a deduction was allowed in the case of a Hindu Undivided Family or in relation to the investment made in the units of any plan, framed in accordance with the Equity Linked Savings Scheme of the Mutual Funds specified under clause (23D) of Section 10 or Unit Trust of India. The deduction shall be allowed on so much of the amount invested as does not exceed Rs. 10,000.

But amendments made by Finance Act, 1992 have withdrawn deduction available under this Section 80 CCB relating to deductions in
respect of investment made under Equity Linked Savings Scheme. The amendment provides that no deduction shall be allowed in relation to any amount invested under the said section on or after 1st April 1992. However the investments made under Equity Linked Saving Scheme shall be included in the overall limit of Rs. 60,000.

(iii) Section 80D (Deduction in respect of Medical Insurance Premia)

From Assessment year 1987-88, Section 80D is modified by Income Tax (Amendment) Act 1986. A Hindu Undivided Family can claim a deduction upto Rs 6000 a year in respect of premia paid by him by cheque for insurance on the health of any member of such family.

(iv) Section 80DD (Deduction in respect of Medical Treatment of Handicapped Dependents)

This provision is inserted from assessment year 1991-92. Under this provision deduction of a sum of Rs. 12,000 shall be allowed in the case of Hindu Undivided Families resident in India, who incur expenditure on the medical treatment, training and rehabilitation of a person suffering from a permanent physical disability (including blindness) or mental retardation. This deduction will be allowed if the person suffering from disability is a member of the joint family and is wholly dependent on the assessee. The permanent physical disability has to be certified by doctor working in a government hospital.

(v) Deduction under Sec 80G

Donations to certain funds, trusts, charitable institutions, donations for renovation or repairs of notified temples etc (amount of deduction is 50% of net qualifying amount) 100% of qualifying donations to Prime
Minister National Relief Fund, Prime Minister Armenia Earthquake Relief Fund, Rajiv Gandhi Foundation and Government approved associations for promoting family Planning.

(vi) **Deduction under Section 80L**

Interest on certain securities dividends, income in respect of units of UTI or of specified Mutual fund etc. subject to maximum of Rs 10,000. From 1.4.1996, this limit of Rs. 10,000 has been raised to 13,000.

(vii) **Deductions from House Property Income**

The following deductions are allowed from income from house property under Section 24 of Income Tax Act, 1961.

1. A composite standard deduction of a sum equal to 1/5 of the annual value in respect of repairs and in respect of collection of rent.
2. Deduction for premium paid for insuring the property against damage or destruction.
3. Deduction in respect of an annual change not being change created by the assessee voluntarily or a capital charge.
4. Deduction in respect of interest on money borrowed for the acquisition, construction, repair, renewal or reconstruction of the property.
5. Deduction in respect of any sum paid on amount of land revenue or any other tax levied by the State Government in respect of property.
6. Deduction by way of vacancy allowance where a let out property is vacant for a part of the year.
(VI) Tax Rebates available to Hindu Undivided Family under Chapter VIB

Rebate under Section 88

The provisions of Section 80c has been replaced by Section 88 w.e.f. assessment year 1991-92. Under this new provision, an assessee will be entitled to a deduction of 20% of the amount invested or deposited in the life insurance policies, provident funds, superannuation funds. From the income tax payable by him on his total income, the maximum tax rebate allowed will be Rs 10,000 which is Rs. 12,000 w.e.f. 1.4.1993.

The amendments by Finance Act, 1992 provides for a higher tax rebate for individuals whose income derived from the exercise of their profession as authors, artists, actors etc. is 25% or more of their total income. The higher rebate is in terms of rate and in terms of ceiling amount. The enhanced tax rebate rate is 25% and the rebate will be allowed up to a limit of seventeen thousand five hundred rupees. The amendments also provide for tax rebate in respect of contribution to pension funds set up by a Mutual Fund or by the National Housing Bank as well as in respect of subscription to the schemes covered under Section 80CCA and 80CCB.

(VIII) Hindu Undivided Family and Business in Partnership

As a Hindu Undivided Family is liable to income tax on its income, the most common source of a Hindu Undivided Family earning income is from business which is assessable under Section 28 of the Income Tax Act, 1961. Although Income Tax Law recognises Hindu Undivided Family as a person under Section 2(31) of the Income Tax Act, but Hindu Undivided Family is not
a juristic person for all purposes. For instance, it cannot enter into partnership with another person like an individual, another Hindu Undivided Family, a company or a firm because of the operation of the Indian Partnership Act. Nevertheless a Hindu Undivided Family is capable of carrying on a business as a unit and for this purpose, enter into dealings with third parties.

In *Venkatesh Emporium*,\(^{35}\) the Madras High Court observed that the structure and way of existence of a Hindu Undivided Family is such that it has to have some human activist to discharge its responsibilities and manage its affairs, as an incorporated company must have a managing director to look after its affairs. The karta performs such a function vis-a-vis the Hindu Undivided Family. The transactions, remain that of the family but they are put through by karta. The Court observed that the proper way is not to regard him as a representative or an agent of the family, but as its alter-ego. However, the concept of a joint family, being a unit by itself, may not fit in with some branches of law, specifically the law of partnership. The law governing partnership does not recognize a Hindu Undivided Family becoming partners, but there is no bar on an individual member of a Hindu Undivided Family entering into partnership with another but in reality acting on behalf of the Hindu Undivided Family.

In *Ram Laxman Sugar Mills v. CIT*,\(^{36}\) it has been held that it is open to the karta of a Hindu Undivided Family to become a partner with another person but acting on behalf of the Hindu Undivided Family. The Court held that:

For certain purposes, such as a partnership agreement, a Hindu Undivided Family as a unit is incapable of being

---

35. (1982) 137 ITR 93 (Mad.).
engaged in carrying on business, in entering into dealings with third parties, in buying or selling goods or in lending or borrowing monies. The thesis cannot be accepted that even where the family as such had purported to enter into dealings as a unit, such a transaction must be dealt with as a transaction effected by the karta as an individual.

The Supreme Court further observed that:

A Hindu Undivided Family is undoubtedly a person within the meaning of the Indian Income Tax Act, it is however not a juristic person for all purposes and cannot enter into an agreement of partnership either with another undivided family or individual. It is open to the manager of a joint Hindu Family as representing the family to agree to become a partner with another person.

The Income Tax Law recognizes a Hindu Undivided Family as a unit and makes the karta its representative for the purpose of assessment. It recognizes that the karta or even one of its members could in effect be representing the Hindu Undivided Family, if the facts so warrant, when he, as an individual becomes a partner in a firm. Joint Families especially trading families have been recognized in our system of law and have been in existence with other commercial organizations like sole proprietary concerns, companies and corporations. Hindu Undivided Family is a legal entry recognized by law capable of carrying on business, even in partnership with others, acting through its karta or any other members.

(a) Rights and Interests of Coparceners In Hindu Undivided Family Business:

Coparceners have interest in the business of the Hindu Undivided
Family in the same way as in any other asset of the family. Therefore when disputes arise between coparcener of a family in respect of the business of the family, recourse must be had to the provisions of Hindu law and not to the Indian Partnership Act, 1932.

In a Mitakshara family no member can predict any definite share in any asset of the family until partition takes place. Similar is the position in the case of a business of the family. On partition, the members are entitled to a share in the assets of the family as they existed at the time of partition but they cannot question the utilisation of the profit and assets by the karta prior to the partition. They cannot call for the rendition of accounts from the karta. Thus the business of the joint family is unlike a partnership though the family does consists of a number of people with distinct rights and obligations under Hindu Law and who have a distinct individual entity of their own.

(b) Income of Hindu Undivided Family or Individual Member

One of the problems relating to Hindu Undivided Family which has been generating controversy is the character of income (whether individual or Hindu Undivided Family) which is earned by a person by using Hindu Undivided Family funds. A very clear and lucid test was laid down by Ramaswami, J., while speaking for majority in V.D. Dhanwatey v. CIT, in the following terms:

The general doctrine of Hindu law is that property acquired by a Karta or coparcener with the aid or assistance of joint family assets is impressed with the character of joint family property. To put it differently it is an essential feature of self-acquired

property that it should have been acquired without assistance or aid of the joint family property. The test of self-acquisition by the karta or coparcener is that it should be without detriment to the ancestral property.

Need for Passing Hindu Gains of Learning Act, 1930.

It is worth mentioning that prior to this Act, in 1921 the judicial committee had ruled in *Gokal Chand v. Hukam Chand Nath Mat*38:

In considering whether gains are partible there could be no valid distinction between the direct use of the joint family funds and a use which qualified the members to make the gains by his efforts.

In the above case a member of Hindu Undivided Family was educated by expending Hindu Undivided Family funds. He was selected in the Indian Civil Service. The question arose whether salary received by him as an I.C.S. Officer was his individual income or belonged to his Hindu Undivided Family. The Privy Council ruled that it was the income of the Hindu Undivided Family and not his individual income. To nullify the effect of this decision, Hindu Gains of Learning Act was passed in 1930. The result is that even if a coparcener has prosecuted his studies with the help of Hindu Undivided Family funds, the income earned by him as a result of personal exertion and usage of his education would no longer be the income of the Hindu Undivided Family.39

38. AIR 1921 P.C. 35.

In *P.N. Krishna Iyer v. CIT*, the Supreme Court slightly modified the test by holding thus:

Income received by a member of a Hindu Undivided Family from a firm or a company in which the funds of the Hindu Undivided family are invested, even though the income may be partially traceable to personal exertion of the members, is taxable as income of the Hindu Undivided Family if it is earned by detriment to the family funds or with the aid or assistance of those funds, otherwise it is taxable as the member's separate income.

While a Hindu Undivided Family can carry on business as a proprietor and be assessed as such, it is settled law that members of a Hindu Undivided Family including the coparceners and the karta can carry on a business in their individual capacity, the income from which would be their own, and not that of the Hindu Undivided Family. The question as to whether a business belongs to the Hindu Undivided Family or an individual member in his personal capacity is a difficult one as the Hindu Undivided Family can carry on its business only through one of its members, usually a coparcener and mostly the coparcener who is the karta of Hindu Undivided Family.

In *Raj Kumar Singh Hukan Chandji v. CIT*, the Supreme Court has laid down following criteria for determining whether a particular income belongs to an individual or Hindu Undivided Family of which such an individual is a coparcener.

1. Whether the income received by the coparcener had any real connection

---


with the investment of joint family funds;

2. Whether the income was directly related to any utilization of family funds or assets;

3. Whether the family had suffered any detriment in the process of realization of income from the business;

4. Whether income was earned, with the aid and assistance of family funds;

From these subsidiary principles, the Supreme Court, deduced the following broader principle, namely:

Whether the remuneration received by the coparcener in substance though not in form was but one of the modes of return made to the family because of the investment of the family funds in the business or whether it was compensation made for the services rendered by the individual coparcener. If it is the former, it is an income of the Hindu Undivided Family but if it is the latter than it is the income of the individual coparcener. If the income was essentially earned as a result of the funds invested, the fact a coparcener has rendered some service would not change the character of the receipt. But if on the other hand it is essentially a remuneration for the services rendered by the coparcener, the circumstance that his services were availed of because of the reason that he was a member of the family which had invested funds in that business or that he had obtained the qualification shares from out of the family funds would not make the receipt, the income of the Hindu Undivided Family.

In Khubchand Moti Lal Jain v. CIT,\(^{42}\) it was held that the income of a

\(^{42}\) (1975) 100 ITR 206 (M.P.).
member of the Hindu Undivided Family would be treated as income of the Hindu Undivided Family if it is earned by detriment to the family funds or with the aid and assistance of Hindu Undivided Family funds. It does not make a difference that the member also had to physically exert himself for earning the income. The general principle is that when business is managed by a member of Hindu Undivided Family, it belongs to the Hindu Undivided Family if the funds of the family have been invested in the business or where the assets of the family have been pledged or credits of the family used to raise funds for the business.

When a member of the family contributes funds towards the business of his own or towards the business of partnership, there is no presumption that the funds were contributed from joint family funds.43

Any member or karta of a Hindu Undivided Family may take a loan from the family for starting his own business. In such case, the income from business will be assessed as income of an individual and not as income of the Hindu Undivided Family.

Where there is no nucleus from which the family business could have been acquired and there is no vesting of individual property into Hindu Undivided Family, it cannot be presumed that the property belonged to Hindu Undivided Family and not to individual44 but where nucleus of Hindu Undivided Family property, existed and could be utilised to acquire further property, it is presumed that the new property acquired by a member of Hindu

43. Mangilal Rungta v. CIT, (1955) 28 ITR 167 (Pat.) and Jai Narayan Balabakas v. CIT, (1957) 31 ITR 271 (Nag.).
44. Chandmull Rajgarhia v. CIT, (1967) 66 ITR 347 (Pat.) and Padampat Sighania, (1953) 24 ITR 184 (All.).
Undivided Family belonged to the Hindu Undivided Family.\textsuperscript{45}

In \textit{Gajanad Sutwala v. CIT},\textsuperscript{46} funds of the Hindu Undivided Family invested with the firm constituted the capital which enabled the member of Hindu Undivided Family to continue as partner of the firm. No contribution had been made by the individual by virtue of his being a working partner. It was held that share income earned from the partnership firm as a partner was the income of the Hindu Undivided Family as it directly related to the utilization of family assets and had accrued with the aid of assets of the family. The family suffered detriment in the process of realization of such income.

In \textit{CIT v. Gopal Narain Singh},\textsuperscript{47} it was held that in view of the finding of the fact that remuneration had been paid to G as Director on account of his skill and acumen, it was not assessable in the hands of Hindu Undivided Family. The test is whether remuneration was compensation made for services rendered by individual coparcener or whether it was in substance one of the modes of return made to the family because of investment of family funds in business.

It must be proved that the member has acquired the new property, new asset or the income with the help and assistance of or to the detriment of the joint family funds.\textsuperscript{48} There is no presumption that any business carried on by a manager or member of a joint family is Hindu Undivided Family business.

\footnotesize
\textsuperscript{45} \textit{Gopiram Bhagwan Das v. CIT}, (1960) 39 ITR 513 (Pat.). and \textit{Janki Sao v. CIT}, (1958) 33 ITR 835, (Pat.).
\textsuperscript{46} (1973) 92 ITR 119.
\textsuperscript{47} (1988) 170 ITR 72 (Pat.).
In Annamalai v. Subramanian, the judicial Committee of the Privy Council held:

A member of a Hindu Undivided Family can make a separate acquisition of property for his own benefit, and unless it can be shown that the business grew from joint family property or that the earnings were blended with the joint family estate, they remain free and separate.

In Bhuru Mai v. Jagannath, it was held:

Whether or not it can be said that if a joint family is possessed of some joint property, there is no presumption that any property in the hands of an individual member is not his separate individual property but joint property, no such presumption can be applied to a business.

In Chattanatha Karayalar v. Ramachandra Iyer, the Supreme Court held:

Under Hindu Law there is no presumption that a business standing in the name of any member is a joint family one, even when that member is the manager of the family and it makes no difference in this respect that the manager is the father of the other coparcener.

In CIT v. Rati Lal Natha Lal, the karta and his son executed a deed whereby certain house property of the family was transferred to a trust. The beneficiaries of the trust were the karta in his life and the son after his death. It was held that income of the trust could not be included in the income of the

49. AIR 1929 (P.C.).
Hindu Undivided Family and the income belonged to the beneficiaries in their individual capacity.

In CIT v. Kalu Babu Lal Chand, one B.K. Rohtagi who was the karta of Hindu undivided Family floated a company to take over the concern India Electric Works. Before the take over by the company, the Hindu Undivided Family took over the concern and financed and nurtured it with the joint family funds. The articles of association of the company provided for appointment of the karta as managing Director of the company. Majority of the shares were held by karta and his brother. The question that cropped up for consideration was whether remuneration was assessable as individual income of Karta. It was held by the Supreme Court that joint family funds were used for acquiring the concern and floating the company. Thus there was detriment to joint family funds and in lieu thereof the joint family got not only the shares but also, as part and parcel of the same scheme, managing Directorship of the company. In view of this, the remuneration received by the karta as managing Director, was the income of the joint family.

In Piare Lal Adhishwar Lal v. CIT, the karta of Hindu Undivided Family was appointed the treasurer of a bank. He furnished as security his family properties. But for this security, he would not have been appointed as treasurer. The Supreme Court held that there was no direct and substantial nexus between income in dispute and the family funds nor was there any detriment to joint family property. As such salary as treasurer could not be held as joint family income.

In Mathura Prasad v. CIT,\textsuperscript{55} karta of Hindu Undivided Family became a partner on behalf of the family in a firm. Funds of the joint family constituted his capital in this firm. Karta was also paid a monthly allowance for managing the affairs of the firm. The Supreme Court held that this monthly allowance paid to the karta was the income of the joint family as it was directly related to investment of family funds.

In V.D. Dhanwatey v. CIT,\textsuperscript{56} and M.D. Dhanwatey v. CIT,\textsuperscript{57} the Supreme Court held that the remuneration received by the partner who represented his joint family in the firm, should be treated as income of the Hindu Undivided Family.

In Palaniappa Chettier v. CIT,\textsuperscript{58} the karta of Hindu Undivided Family acquired 90 out of 300 shares in a company and thus became one of the four shareholders. Two of the shareholders were Directors. On the death of one of the Directors, the karta was made director and subsequently on the death of the managing director, he was made the Managing Director. The question arose whether salary and commission received by karta of Hindu Undivided Family in his capacity as managing Director was his individual income or income of his joint family. It was held by the Supreme Court that the shares were acquired by the family in the ordinary course of investment and not with the object that the karta should become the managing director. There was no real connection between the investment of joint family funds in the purchase of shares and the appointment of karta as managing director. Further remuneration of the

\textsuperscript{55} (1966) 66 ITR 428 (S.C.).
\textsuperscript{56} (1968) 68 ITR 365 (S.C.).
\textsuperscript{57} (1968) 68 ITR 385 (S.C.).
\textsuperscript{58} (1968) 68 ITR 221 (S.C.).
managing director was not earned by detriment to the joint family funds. As such the remuneration received as managing director could not be treated as income of the joint family.

In *CIT v. Gurunath Dhakappa*, the karta of a Hindu Undivided Family became a partner in a firm on behalf of his Hindu Undivided Family. He was appointed manager of the firm on a monthly remuneration of Rs. 500. The question was whether salary received as manager was income of the Hindu Undivided Family. Since there was nothing to show that salary was directly related to assets of the family, the Supreme Court held that it could not be the income of the Hindu Undivided Family.

In *CIT v. D.C. Shah*, the Supreme Court held that the remuneration of the managing partner earned by rich experience and not by sufficient connection or detriment to joint family funds was individual income of the karta and not of his joint family. But in *V.L. Agarwalla v. CIT*, the karta of the Hindu Undivided Family was a partner in a firm as representing the family. On the death of karta, other partners admitted three minors sons to the benefits of partnership. Family's capital remained invested in the firm carrying no interest. It was held that the share of profits was the income of the Hindu Undivided Family and not the individual income.

In *CIT v. Charan Das Khanna and Sons*, four coparcener had withdrawn funds as interest free loans from the family business of dealing in

62. (1980) 123 ITR 194 (Del.).
optical goods and had invested the same in a partnership for manufacturer of optical goods and steel furniture. On the facts of the case it was held that the coparcener did not possess any specialized skill for the manufacture and the factory building belonging to Hindu Undivided Family was taken at a nominal rent. The new partnership business started by the coparcener was held to belong to the Hindu Undivided Family.

The Court further held that the investment of the family funds was the main factor in the setting up of new business and its profitability and that this was not a case where the personal efforts, specialized skill and enterprise of the individual partners had played any major part.

In Anil Kumar Roy Chowdhry v. CIT, it was held that on the facts of the case there was no evidence to hold that property yielding income belonged to the Hindu Undivided Family and in the absence of it being proved affirmatively it could not be held that income belonged to the Hindu Undivided Family. It further held that the person who asserts that certain property is joint family property has the duty to prove the same. The Court also held that there is no material to show that the property was acquired with the help of any joint family property belonging to the assessee and in the absence of such evidence, the burden cannot shift to the appellants to prove affirmatively that the property in question was acquired with the joint family funds.

In G. Narayana Raju v. G. Chamaraju, it was held that it is well established that there is no presumption under Hindu law that a business standing in the name of any member of the joint family is a joint family business even if
that member is the manager of the joint family. Unless it could be shown that the business in the hands of the coparcener grew up with the assistance of the joint family property or joint family funds.

In *Satinder Kumar v. CIT*, the Himachal Pradesh High Court has held that when a karta joins a business as a partner on his own without utilising Hindu Undivided Family funds or property, there is no presumption that the Hindu Undivided Family owns the business or the income belongs to the Hindu Undivided Family. The Court also held that there was no evidence to show that the partner drew on the family funds or acted to detriment of family funds in carrying out such business and that he represented the family. In fact there were hardly any funds with the Hindu Undivided Family which could have been invested in the firm. If the karta does not claim to represent the family, there must be clear and definite material if the contrary is to be proved linking the family with the business of the karta.

In *Deo Naryan Bhandari v. CIT*, the Hindu Undivided Family was carrying on business and made some deposits in a bank. The explanation given by the karta regarding the source of these funds was found to be false. It was held that the amount was assessable as income from undisclosed sources in the hands of the Hindu Undivided Family. The Patna High Court also held that the karta had not led any evidence to show that he had any source of income as an individual whereas the Hindu Undivided Family was being assessed from year to year. While the individual had no other source of income, the Hindu Undivided Family had a business income of Rs. 50,380. This Court also distinguished the

65. (1977) 106 ITR 64 (H.P.).
facts of this case from the facts in the case of Premsukhdas Jagnani v. CIT, and Satinder Kumar v. CIT. It was held in the above mentioned cases that there is no presumption in Hindu Law that any business carried on by a member or members of a joint family is the joint family business. Also in Chattanatha Karayatar v. Ram Chandra Iyer, and G. Narayana Raju v. G. Chamaraju, the Supreme Court has laid down as under that unless it could be shown that business in the hands of the coparcener grew up with the assistance of Hindu Undivided Family property or Hindu Undivided Family funds or that the earning of the business were blended with the joint family estate, the business remains free and separate.

The Patna High Court agreed with the view expressed in following judgements:

(i) Sankara Narayana v. Official Receiver, it was observed:

That where a manager of a joint family claims that any immovable property had been acquired by him with his own separate funds and not with the help of the joint family funds of which he was in possession or in charge, it was for him to prove by clear and satisfactory evidence his plea that the purchase money proceeded from his separate fund and the onus of proof must, in such a case be placed on the manager and not on his coparcener.

67. (1962) 46 ITR 376 (Pat.).
68. See Supra Note 65.
70. AIR 1968 S.C. 1276.
71. AIR 1977 Mad. 171.
(ii) Mallesappa Bandappa Desai v. Desai Mallappa alias Mallesappa,\textsuperscript{72} it was held that if a member of a joint family argues joint property, whatever may be the mode of augmentation, the property which goes to augment the joint family proper becomes part of the joint family property.

(iii) Rajangam Ayyar v. Rajangam Ayyar,\textsuperscript{73} it was held that where the nucleus is admitted or proved, the burden of proving the particular property is self-acquired rests on the party alleging it.

In CIT v. S. Balakrishnan,\textsuperscript{74} the assessee's father entered into a deed of partition with his sons, and certain properties fell to his share. The assessee's father executed a settlement deed in respect of the properties which fell to his share in favour of his wife and daughters. With regard to one item, the wife was given a right to enjoy the property during her life time without creating any encumbrance over the property and, after her life time, the property was directed to be divided among the three sons and their heirs. With regard to another item, the wife was given the right to sell and enjoy the sale proceeds with absolute right. However, it was provided that, if the wife did not sell or dispose of the said property during her life time, it was to be divided among the three sons of the settlor and their heirs equally in three shares. As the wife did not dispose of the property before her death, the said property became the property of the assessee and his two brothers and their heirs. The assessee claimed that one third share of income from the said property could not be subjected to tax in his hands as an individual but should be treated as income of the Hindu Undivided

\textsuperscript{72} AIR 1961 S.C. 1268.

\textsuperscript{73} AIR 1922 P.C. 266.

\textsuperscript{74} (1992) 193 ITR 593 (Mad.).
Family consisting of himself and his sons. Though the I.T. O. rejected this claim, it was accepted by the appellate authority and the Tribunal. On a reference it was held that the wife of the settlor had been given the power to sell and enjoy the sale proceeds with absolute right in regard to the property and the further provision was to the effect that, if the wife did not sell or dispose of the property during her life time, the same should be divided among the three sons of the settlor and their heirs equally in three shares. The use of the expression 'heir' in the settlement deed was not intended to connote heritable and alienable estate but to denote a class of beneficiaries viz. the assessee and his heirs. The intention of the settlor was that the property should be taken by the three sons not for their individual personal benefit but for the benefit of their family. Accordingly, the income from the properties could be assessed only in the hands of the assessee as Hindu Undivided Family and not in his individual hands.

(c) Income From Undisclosed Sources

In *Kailash Chandra Mohanty v. CIT,75* it was held that the property had been purchased in the joint names of two coparceners. It was obligatory on the part of assessee Hindu Undivided Family to file clear acceptable material wherefrom an inference could be drawn that the property had been purchased from the individual funds of the coparcener. This fact was within their knowledge. Non-disclosure of this fact made the affidavit stating that the property had been purchased by the coparceners out of their individual funds, not acceptable. The amount invested in the property was assessable as the undisclosed income of the Hindu Undivided Family.

---

75. (1991) 188 ITR 509 (Ori.).
(d) Hindu Undivided Family As A Partner In A Firm:

A Hindu Undivided Family cannot enter into partnership with either an individual or another Hindu Undivided Family or another firm. A karta or a member can, however, acting on behalf of the Hindu Undivided Family enter into valid partnership with the stranger or karta member of another family. The partnership in law in such cases is between karta as an individual and the stranger or karta of one family and karta of another family, as the case may be. In common parlance the family and stranger in one case and the two families in the other are said to have entered into partnership. This is so because the kartas are accountable to their families having utilized family funds to enter into partnership. A Hindu Undivided Family cannot enter into partnership as such but the karta of the Hindu Undivided Family can. A partnership between a karta and a stranger is governed by the Indian partnership Act, 1932. Under its provisions the partnership is dissolved on the death of any of the partners. If the Hindu Undivided Family is a partner in law, it could claim that the firm is not dissolved on the death of its karta as the Hindu Undivided Family does not die and continues on his death. Similarly the stranger could claim the karta's share of losses from the family. But in view of the legal position, the claim of the former is as untenable as the claim of the latter. This position in law does not change where an individual member of one Hindu Undivided Family enters into partnership with individual members of another Hindu Undivided Family. In such a case it is partnership between individual members and not between the Hindu Undivided Families.76

(e) **Representation of Hindu Undivided Family in a Firm by Female Member:**

In *CIT v. Banaik Industries*, a question arose whether a Hindu Undivided Family can join a firm through a female member. The Patna High Court held:

There is no law, to our knowledge, which prohibits a female member from representing the family; of course she can not be the karta of the family, but in the matters which concern the family, to our mind there is no law which prohibits a female from acting on behalf of the family.

The Court further observed:

A female is as good a member of the Hindu Undivided Family as male, of course, with certain limits, in the sense that she cannot become the karta of the family, nor can she be a coparcener. These limits, however, do not disable her from acting in the capacity of a member of the family and enter into a contract of partnership with the permission of the family, for the family.

(f) **Rights of Coparceners in Partnership:**

When the karta of a Hindu Undivided Family joins a firm as partner, even though he contributes his investment from out of the family funds, the other members of the family do not become partners. The Income Tax Officer cannot argue that all the adult members of the Hindu Undivided Family are partners of the firm. Nor can Section 4(3) of the Companies Act, 1913 be invoked to hold

77. *(1979) 119 ITR 282 (Pat.).*
that Hindu Undivided Family is a partner. The definition of a person under Section 2(31) of the Income Tax Act, 1961 which says that person includes Hindu Undivided Family cannot be imported into the Partnership Act and it is the Partnership Act alone which is relevant for finding out as to who can be joined as partners. Thus for the purpose of finding out as to who are the partners of a firm one has to look into the partnership deed alone and not to go behind it. It is not open to Income Tax Officer to go behind the deed and find out whether partners have joined in their own right or as representing others in so far the assessment of the partnership and its registration under the Income Tax Act, is concerned.

A partner of a firm may be the karta of a Hindu Undivided Family; he may be a trustee; he may enter into sub-partnership with others; he may represent under an agreement a group of persons or he may be a benamidar for another. The partner in all such cases occupies a dual position (i) qua the partnership he functions in his personal capacity, and (ii) qua the third parties or the members of the Hindu Undivided Family he functions in his representative capacity. The coparceners of the Hindu Undivided Family whom the partners represent cannot enforce their rights against the other partners of the firm and similarly the other partners cannot do so against the Hindu Undivided Family. The other members of the Hindu Undivided Family have only the right to a share in profits of the partner representative in the firm in accordance with Hindu law and have no enforcement rights against the firm. Similarly the firm has no enforcement rights against the Hindu Undivided Family though it can proceed against the member of the Hindu Undivided Family who is a partner in the firm. The law of partnership and Hindu law thus function in their respective fields. A divided member or some of the divided members can certainly enter into partnership with third parties. Their shares in the partnership depend on the terms of the partnership deed. The shares of members of the divided family in the interest of their representative in the partnership depend upon the terms of
the partition deed.\textsuperscript{78}

In \textit{P.K.P.S. Pichappa Chettiar v. Chokalingam Pillai},\textsuperscript{79} the Judicial Committee has approved the observations in Mayne's Hindu Law\textsuperscript{80}:

Where a managing member of a joint family enters into a partnership with a stranger, the other members of the family do not \textit{ipso facto} become partners in the business. The family as a unit does not become a partner, but only such of its members as in fact enter into a contractual relation with the stranger.

Once the Income Tax Officer has granted registration to a firm he cannot proceed to enquire whether share allocated to a partner is beneficially held by some other person or entity.\textsuperscript{81} The Income Tax Officer is not concerned to determine in whom the beneficial interest in the partnership vests.\textsuperscript{82}

In \textit{Charan Das Hardas v. CIT},\textsuperscript{83} the Supreme Court has reaffirmed the principle that one or more members of a Hindu Undivided Family may enter into a contractual relationship in the nature of partnership with a stranger and qua the stranger they become partners.

\begin{itemize}
\item \textsuperscript{78} \textit{CIT v. Bhagyya Lakshmi and Co.}, (1965) 55 ITR 660 (S.C.).
\item \textsuperscript{79} AIR 1934 P.C. 112.
\item \textsuperscript{80} 9th Ed. , 398.
\item \textsuperscript{81} \textit{CIT v. J.P. Kamodia and Co.}, (1970) 77 ITR 515 (S.C.).
\item \textsuperscript{82} \textit{CIT v. Abdul Rahim and Co.}, (1965) 55 ITR 651 (S.C.).
\item \textsuperscript{83} (1960) 39 ITR 202 S.C.
\end{itemize}
Both under the law of partnership and Hindu law, family as such can exercise no control and management over the business of a partnership of which the coparcener is a member through the karta.\textsuperscript{84}

Members of a Hindu Undivided Family are under no disability in the matter of entering into a contract interse or with a stranger. A partnership is not invalid merely because two or more of its partners are members of Hindu Undivided Family and represent the interest of the family. In a case two coparceners of a Hindu Undivided Family were two of the five partners of the firm. Such a firm was held valid and entitled to registration as while considering registration of a firm the Income Tax Officer is not concerned to determine in whom the beneficial interest in the share in partnership vests.\textsuperscript{85}

If the karta describes himself as representing the family when joining as partner, it cannot be inferred that partnership agreement was between a Hindu Undivided Family consisting of all its adult members, families, minors etc.\textsuperscript{86}

In \textit{Chhagan Lal Gulab Chand v. CIT},\textsuperscript{87} it was held that there was no illegality in the formation of partnership between a stranger and karta of Hindu Undivided Family or another undivided member of same Hindu Undivided Family who carry on separate business without disturbing the status of joint family and it was not necessary that every member should contribute capital.


\textsuperscript{87} Taxation 89(3) - 96 (Raj. Rattan Chand Darbau Lal v. CIT, (1985) 155 ITR 720 (S.C.) followed.
Notwithstanding lack of capital contribution by undivided member, the partnership was valid and entitled to registration:

It is, therefore, settled law that as Hindu Undivided Family is not a juristic person. It cannot enter into an agreement of partnership with either a Hindu Undivided Family or an individual. The karta can represent the family by becoming a partner with another person. The partnership agreement in the case is between the karta and the other person and by the partnership agreement no member of the family except the karta acquires a right or interest in the partnership. The junior members of the family may make a claim against the karta for treating the income or profits received from the partnership as a joint family assets, but they cannot claim to exercise the rights of partners nor be liable as partners. In this situation the Hindu Undivided Family is loosely referred to as partner of the firm though legally speaking it is only the karta/coparcener who is a partner in the firm.

(g) Partnership between the Karta Representing the Family and a member of Hindu Undivided Family

An individual coparcener of a Hindu Undivided Family remaining joint with the family can possess, enjoy and utilise in any way he likes the property which is his individual property and not acquired with the aid of or without detriment to the joint family property. If he can utilize this property at his will, it follows that he must be accorded the freedom to enter into contractual relation with other including his family, so long as it is represented in such transactions by a definite personality like its manager. It is clear that if a stranger can enter into partnership with a Hindu Undivided Family through its karta, there is no sound reason to withhold such opportunity from a coparcener if he makes the investment in the firm from out of his separate and individual property. In
Lachmen Das v. CIT, the Privy Council held that there can be a valid partnership between a karta of a Hindu Undivided Family representing the family on the one hand and a member of that family in his individual capacity on the other.

(h) Same Person in Individual Capacity and Representing Hindu Undivided Family in a Firm.

In CIT v. Brij Bhushan Lal Suresh Kumar, it was held that in law there was no bar on the karta B to enter into partnership with the coparcener S and consequently the registration of the firm under Section 184 was not liable to cancellation. The coparcener had contributed his labour and skill instead of separate capital. Though admittedly, an individual member of a Hindu Undivided Family can enter into partnership with another individual who represents the Hindu Undivided Family of which he is the member, a question arises as to whether he can form a partnership consisting of himself as an individual and of the Hindu Undivided Family represented by himself. The question has to be examined from two angles. The first is as to whether a partnership can be formed by the same person acting in two separate capacities, one as individual and the other as representing his Hindu Undivided Family without there being a third partner. The answer is 'no' because such a partnership would not be valid in as much as the plurality of person necessary to constitute the relationship of partners under Section 4 of the Partnership Act, 1932 does not exist in such a case. There must be at least two persons to enter into a contract of partnership and the same person in one capacity cannot enter

88. (1948) 16 ITR 35 (P.C.).

into a valid contract with himself in a representative capacity.\footnote{Rat Bahadur Lok Nath Prasad Dhaudhania \textit{v.} CIT, (1940) 8 ITR 369 (Pat.); CIT \textit{v.} Raghavil Anandji and Co., (1975) 100 ITR 246 (Bom).}

The second is the case of a partnership consisting of more than two partners, one of the partners representing a Hindu Undivided Family as well as himself as individual. In \textit{CIT v. Raghavji Anandji and Co.},\footnote{(1975) 100 ITR 246 followed in \textit{CIT v. Kandath Motors}, (1979) 120 ITR 644 (Ker.). and \textit{CIT v. Baudhalal Amulakhada}, (1981) 129 ITR 97.} the Bombay High Court examined this aspect and held that where the partnership deed of a firm consisting of eleven partners was signed by one of the partners in two capacities as an individual and as the karta of a Hindu Undivided Family the partnership was valid and was entitled to registration. Thus, there is no legal infirmity in the same individual signing for himself and also as a representative of the Hindu Undivided Family provided that there is at least another partner in the firm.

(i) Coparcener as Working Partner with Karta:

A coparcener can be a working partner with his father representing the Hindu Undivided Family.\footnote{I.P. Mannavalli \textit{v.} CIT, (1969) 74 ITR 529 (Mys.). Following \textit{Lachman Das v. CIT}, (1948) 16 ITR 35 (P.C.).} There is no distinction between a case where a member of Hindu Undivided Family admitted as a partner brings his separate property into the partnership and the case where he instead brings in his labour and skill only. In a firm with karta of Hindu Undivided Family as partner along with a coparcener who had contributed no capital but only labour and skill, it was held that a coparcener could become a partner without there being a partition. An agreement to put in labour and skill was sufficient to entitle
coparceners to become partners.\textsuperscript{93}

In \textit{CIT v. Mariappa Muthiriyar and Sons},\textsuperscript{94} it was held that there could be a valid partnership between the karta and one or two coparcener in their individual capacity, while still remaining joint, if the coparcener contributes to the partnership his admitted individual separate property. Thus it is settled law that a coparcener having separate property of his own can invest the same in the partnership with the karta and a proper partnership is formed.

In \textit{Shah Prabhudas Gulab Chand v. CIT},\textsuperscript{95} it was held that unless the coparcener brought in his separate property as contribution, he cannot become a partner with karta. However, this case has been overruled by Supreme Court in \textit{Chandra Kant Manilal Shah v. CIT},\textsuperscript{96}, wherein it was held following \textit{I.P. Munnavali v. CIT},\textsuperscript{97} that there could be a valid partnership between an individual coparcener contributing to the partnership only his skill, experience, and labour and karta of the family. In \textit{Ram Chand Nawalrai v. CIT}\textsuperscript{98} the Court held:

There seems no valid season why a coparcener cannot, by contributing merely his skill and labour, enter into a partnership with the karta.

\begin{itemize}
\item \textsuperscript{94} (1985) 154 ITR 466 (Mad.).
\item \textsuperscript{95} (1970) 77 ITR 870 (Bom.).
\item \textsuperscript{96} (1992) 193 ITR 1 (S.C.).
\item \textsuperscript{97} (1969) 74 ITR 529 (Mys.).
\item \textsuperscript{98} (1981) 130 ITR 826 (M.P.).
\end{itemize}
It held that a coparcener could join as a working partner with the karta without contributing his separate property because as a coparcener is free to use his individual property, he is free to use his skill and labour. It held:

In our opinion the argument that as the capital investment in the partnership is only of the funds of the undivided family, there cannot be any partnership, cannot be accepted.

He can enter into a partnership with the karta of his Hindu Undivided Family by contributing his skill and labour instead of his separate properties. This case has been approved by the Supreme Court in the above mentioned case of Chandrakant Manilal Shah v. CIT.99

In Gulraj Poonam Chand v. CIT,100 it was held that it is permissible for a karta of a Hindu Undivided Family representing the Hindu Undivided Family to enter into a partnership with any other member of the Hindu Undivided Family or any stranger who is taken in partnership even as a working partner and even if they did not contribute any separate or individual property of their own. Following the decision in this case, it has been held in CIT v. Murlidhar and Company,101 that a member of a Hindu Undivided Family is at liberty to contract with any other individual including another member of the Hindu Undivided Family and it is permissible for a karta representing the Hindu Undivided Family to enter into a partnership with any other member of the Hindu Undivided Family who join as working partner, even if he does not contribute any separate or individual share in the capital of the firm.

99. (1992) 193 ITR 1 S.C.
101. (1986) 160 ITR 855 (Raj.).
In *CIT v. Virdhi Chand*,\(^{102}\) the Rajasthan High Court held that the assessee as the karta of an Hindu Undivided Family could take one of his sons and thereafter both the sons as partner even though they have not contributed anything by way of capital out of their self acquired funds. The income of these partners who were unseparated coparceners were not be included as part of the income of the assessee Hindu Undivided Family.

In *Ratan Chand Darbari Lal v. CIT*,\(^{103}\) the Supreme Court examined the point whether a coparcener could join a partnership without a partition in the Hindu Undivided Family and it was observed:

The High Court obviously fell into an error in proceeding on the footing that without a partition or a partial partition some of the members belonging to the Hindu Undivided Family could not constitute themselves into a partnership firm. We do not think this view is correct in law. It is a well settled proposition applicable to Hindu Law that members of the joint family and even coparceners can without disturbing the status of the joint family or the coparcener acquire separate property or some independent business for themselves.

On the facts of this particular case it was found that, while living within the joint family or being coparceners, the members could draw a part of their interest in the family business and invest the same in their separate business. The Tribunal had recorded a finding to this effect and, therefore, the separate business started by the coparceners had to be treated as a separate business and

\(^{102}\) 24 Taxman 532 (Raj.).

\(^{103}\) (1985) 155 ITR 720 S.C.
the partnership so formed was ordered to be registered, thus vacating the order of High Court. Thus the money withdrawn from the Hindu Undivided Family by the members was treated to be their own money which could be utilized for starting or investing in a new business.

In a case where two coparceners, who were bothers, commenced a new partnership business from 8th Jan. 1967 a partnership deed was executed only on 25th December 1968 and capital came out of the funds of the Hindu Undivided Family, it was held that income did not belong to the firm and the Hindu Undivided Family having contributed the funds owned the business. The Hindu Undivided Family having omitted to declare the income was guilty of concealment. The case was decided on the basis of a finding of the Tribunal that partnership was not a genuine firm.

In *Tippala Apparao v. CIT*, the assessee karta was representing Hindu Undivided Family in a partnership firm. On the basis of a voluntary disclosure made by the firm, a notice under Section 148 of the Income Tax Act, 1961 was issued to the assessee Hindu Undivided Family and an expert assessment made. The High Court held that no material had been placed on record by the assessee Hindu Undivided Family in support of the plea that the partner in the firm was not Hindu Undivided Family but the individual who had taken loans from the Hindu Undivided Family. The High Court further observed.

Having regard to the probabilities of the case and because there was no evidence to the contrary the Tribunal came to a conclusion adverse to the

104. (1982) 138 ITR 368 (Bom).

In Mohan Lal Daulat Ram v. CIT, the Supreme Court had held that it was not correct to say that on the death of an individual his interest in the firm became the property of the Hindu Undivided Family. In fact "on his death his interest in the partnership devolved on his widow and his son." They both inherited in equal shares the property of the deceased and they were fully competent to enter into a partnership in regard to the business.

(j) Remuneration Received by a Karta or a Member from a firm; in which Hindu Undivided Family is a Partner:

With change in law w.e.f. 1.4.1993, the question of allowability of salary paid to partner of a firm and its assessability has gained importance and the problem becomes more cumbersome when it is paid to a partner who is representing his Hindu Undivided Family as karta there of or a member. A question has often arisen as to the assessability or other wise of the remuneration received by the karta or member of a Hindu Undivided Family from a firm in which the Hindu Undivided Family is a partner. Such remuneration is usually paid in terms of the agreement and more often, the remuneration is paid because the karta or member of the Hindu Undivided Family is actively engaged in carrying on the business of the firm. It is often argued that remuneration is paid for personal services rendered by karta/member of the Hindu Undivided Family to the firm and should be subject to tax in his hands in the status of 'individual'. On the other hand it is argued that had the karta/member not represented the Hindu Undivided Family in the firm, he would have no locus stand vis-a-vis the firm. Any service that he is rendering to the firm to ensure that the Hindu

Undivided Family of which he is karta or member and which is vitally interested in the firm of which it is a partner through him is in the interest of the Hindu Undivided Family. What he receives as remuneration is no different from the share of profit of the Hindu Undivided Family and is assessable in the hands of the Hindu Undivided Family. The question has been of so great importance that litigation on the subject has reached the Supreme Court on many occasions. The consensus that emerges is that the answer to the question as to whether the remuneration be assessed in the hands of the karta/member as an 'individual' or in the hands of the 'Hindu Undivided Family' would depend on the facts of each case. In *Prem Nath v. CIT*,\(^{107}\) the appellant assessee was a partner in the firm as representing his Hindu Undivided Family but he was allowed salary per month for being a working partner. In this case remuneration was held to be individual income as, in the opinion of the Court, there was no evidence on the record that the remuneration agreed to be paid was not for services rendered to the partnership. The Court found that there was no real and sufficient connection between the investment by the Hindu Undivided Family and services rendered by him. It was held that there could not be any doubt that the allowance received by the karta was remuneration for services rendered to the partnership and could not be treated as income of the Hindu Undivided Family.

In *CIT v. D.C. Shah*,\(^ {108}\) the karta of Hindu Undivided Family was a partner representing the Hindu Undivided Family in two partnerships and he was drawing salary from both as manager of the firms. In this case the Supreme Court held:

(i) There was no real and sufficient connection

---


between the investment of the Hindu Undivided Family funds and the salary paid to Mr. Shah.

(ii) The karta was a man of rich experience in the line of business and the deed also showed that salary was paid for personal qualification and for specific acts of management resting on his personal calibre.

(iii) Salary was earned without detriment to the family funds the salary paid to him was not assessable in the hand of Hindu Undivided Family but belonged to him as an individual.

In *Laxman Dass v. CIT*,\(^{109}\) the Allahabad High Court was dealing with a case where Hindu Undivided Family was partner in a firm through its karta, who received salary from the firm for services rendered to the firm. The Tribunal held that this was not the income of karta as individual. This was so because in their view the payment to the karta was part of the partnership agreement and was paid to him as he was the karta of Hindu Undivided Family, The High Court, however, held that merely because the payment of salary to the karta was on account of a clause in the partnership agreement, that by itself, would not necessarily render the payment to the individual as a payment to his Hindu Undivided Family and that on the facts of the case the payment of salary to the karta could not be assessed as the income of his Hindu Undivided Family.

In *CIT v. Gurunath v. Dhakappa*,\(^{110}\) Gurunath as karta was a partner in the firm on behalf of the Hindu Undivided Family and drew salary from the firm for service rendered. The finding of the Tribunal was that salary paid was

---


for managing the firm. The Court held that there was no finding record by the Tribunal that there was real and sufficient connection between the joint family funds and the salary or remuneration paid to the karta. It was, therefore, held that the remuneration was assessable in the hands of the individual.

In *CIT v. Atma Ram Bhudia*, the Court held that salary received by the assessee from the firm in which he was a partner as the karta of his Hindu Undivided Family was in individual capacity for services rendered by him personally to the firm and therefore could not be included in the total income of the Hindu Undivided Family. Notwithstanding the provisions contained in Section 67(i)(b), of Income Tax Act, 1961, there is no bar for a firm to prove and establish that any amount apportioned to his account as salary or remuneration, etc. will not be added to the share income of the firm. If there is no real and sufficient connection between the investment of the joint family assets in the firm and the remuneration, the remuneration by the karta could not be treated as income of the family.

In *Madan Mohan v. CIT*, the assessee represented Hindu Undivided Family in a partnership where the partners were not to contributes any capital for becoming partners. It was held that as the salary received by him from the firm was not attributable to the utilization of the funds of the Hindu Undivided Family, it was his individual income and not that of his Hindu Undivided Family. In this case it was held that no asset of the Hindu Undivided Family was utilized for becoming a partner in the firm and in these circumstances it cannot be said that the amount paid towards the salary of the assessee was nothing but a constituent of the profits falling to the share of the Hindu Undivided Family.


112. 26 Taxman 493 (P & H).
There have been a series of judgments taking the contrary view and holding that remuneration paid to the karta or member of a Hindu Undivided Family by a firm in which he is a partner representing the family is assessable as income of the Hindu Undivided Family.

In *V.D Dhanwatey v. CIT*,¹¹³ V.D. Dhanwatey as a member of a bigger Hindu Undivided Family was looking after the family business of lithography and printing and was remunerated for the same between 1930 and 1939. After partition, the business was converted into a partnership but V.D. Dhanwatey, continued to be a partner with 1/8th share on behalf of his smaller Hindu Undivided Family which had contributed proportionate capital. Under Clause 7 of the partnership deed the general management and supervision of the business was to be in the hands of V. D. Dhanwatey, who under clause 16, was to be paid remuneration at Rs. 1250 per month subject to revision with the consent of other partners. The Income Tax Tribunal held that the remuneration was paid to V.D. Dhanwatey for work done by him and without any detriment to his family funds, and as such was assessable in his hands in the status of 'individual'. The Supreme Court, held that V.D. Dhanwatey was made a partner due to the contribution made by the joint family and the remuneration paid was directly related to investments from the assets of the Hindu Undivided Family. There was a real and sufficient connection between the investment made by the Hindu Undivided Family and the remuneration paid to him.

It is, therefore, followed that remuneration was not earned without detriment to Hindu Undivided Family funds. The majority, therefore, held that the karta was partner representing the family under the partnership agreement.

¹¹³ (1968) 68 ITR 365 (S.C.).
that he was responsible for general management and supervision of the partnership business and that he was to be paid monthly remuneration for the same. The remuneration paid was held to be directly related to the investment in the partnership business from the assets of the family and salary was held to be assessable in the hands of the Hindu Undivided Family. The dissenting judge, however, held that intelligent direction is no less important in a firm making a profit than investment of money and this finding of fact could not be set aside in appeal.

In *Nagar Das v. CIT*,\(^{114}\) it was held on the facts of the case that remuneration received by the karta from the firm in which he was a partner representing the family was income of the family.

In *Manmohan Sachdeva v. CIT*,\(^{115}\) and *Brij Mohan v. CIT*,\(^{116}\) it was held that salary paid by the firm to the karta and member of Hindu Undivided Family who were partners of the firm in their representative capacity was to be taxed in the hands of assessee Hindu Undivided Family and not in the hands of the karta or member as individual. The Supreme Court has granted special leave to appeal against the judgment in the case of *Brij Mohan v. CIT*.\(^{117}\)

In *D.N. Bhandarkar and Others v. CIT*,\(^{118}\) it was held that where partners do not possess any special qualifications in the business warranting the special remuneration paid to them, it is obvious that remuneration to partners by

---


\(^{115}\) (1986) 158 ITR 12 (Del.).

\(^{116}\) (1986) 158 ITR 14 (Del.).

\(^{117}\) *Id.*

\(^{118}\) (1986) 158 ITR 724 (Kar.).
firms were not paid either for their special knowledge or for their special position in the firms like managing partners and where remuneration to the three partners was more or less on the profit sharing ratio and the substantial payment were detrimental to the family funds, the remuneration was taxable in the hands of Hindu Undivided Family. As all the three partners were paid remuneration and the remuneration would have gone to respective families as their share of profits had no such remuneration been paid, it was held that the salary was rightly assessed in the hands of the Hindu Undivided Families.

Thus we can conclude by saying that where the remuneration was earned because of any personal qualifications of the members of Hindu Undivided Family and was not earned by detriment to Hindu Undivided Family funds then the remuneration would be taxed in hands of individual and will be excluded from the income of Hindu Undivided Family. It is, therefore, well settled law that where a karta or member of a Hindu Undivided Family is a partner in a firm and where the share of that partner, including remuneration if any, received by him is due entirely to the investments of the family funds both the share of profits and the remuneration will be assessed as income of the Hindu Undivided Family. If, however, the remuneration paid to such karta/member partner is linked to some professional expertise that he may possess and specific services rendered by him to the firm without any detriment to the funds invested by the Hindu Undivided Family in the firm, then alone the remuneration will be assessed in his individual hands. The share of profits in their firm will continue to be assessed as income of the Hindu Undivided Family.

After the amendment w.e.f. 1.4.1993, there is no dispute about allowance of salary out of the income of the firm, of course, subject to the limits laid down in section 40(b) itself. The explanations added to Section 40(b) even did not change the law pertaining to assessability of the salary received by a karta of the Hindu Undivided Family and in the ultimate analysis the solution to
the problem would lie in the fact as to whether the salary has been paid due to individual volition of the assessee or on accounts of funds or investment of the Hindu Undivided Family. In the former case the assessment will be made in the hands of the individual and the latter in the hands of the Hindu Undivided Family.

Since under the amended provisions, w.e.f. 1.4.1993 interest paid on capital investment of partners is admissible, subject to maximum of 18%, the salary paid to the karta as working partner will assume a different character. The Hindu Undivided Family is since entitled to interest on its capital as other partners of the firm are, the payment of salary to the karta may not be `to the detriment of the family funds'. The amendment w.e.f. 1.4.1993 has, therefore, changed the complexion and in its subtlety carries the statutory recognition of the concept of `real recipient'.

(k) Remuneration Received by Members of Hindu Undivided Family

We have considered the case of a member of a Hindu Undivided Family receiving remuneration from a firm in which he is partner representing the Hindu Undivided Family. Now we shall consider the cases where remuneration is received by a karta or member from others for services rendered and see as to whether it is assessable in his hands as in-individual or whether it is includable in the income of the Hindu Undivided Family.

The first case is *Piyare Lal Adishwar Lal v. CIT*,119 where S was appointed Treasurers to a Bank after the death of his father. He furnished security to the Bank of certain properties of the Hindu Undivided Family. It was held in this case that, under the agreement with the Bank, he was an employee of

the Bank, and there was no expenditure of the joint family funds and no detriment to the Hindu Undivided Family property. The Court held the remuneration received by him to be individual income as in its opinion the mere fact of giving joint family property as security for good conduct of a member of the Hindu Undivided Family employed in a place of trust, was not sufficient to make the emoluments of the post as joint family income. The Court observed:

Treasurership is an employment of responsibility, trust and fidelity and personal integrity and ability; and mere ability to furnish a substantial security is not the sole or even the main reason for being appointed to such a responsible post in a bank like the Central Bank of India.

It was observed that the karta did not receive any particular training for the purpose out of Hindu Undivided Family Funds, nor was his appointment the result of any investment to the detriment of the Hindu Undivided Family property. Giving the joint family property in security for the good conduct of a member of the family employed in a post of trust was not sufficient to make the emoluments of the post joint family property and it was not to the detriment of Hindu Undivided Family property. Thus the salary of the karta could not be considered as Hindu Undivided Family income on the mere basis that the Hindu Undivided Family had given a security for the honesty, integrity and good conduct of its members.

The principles governing the taxability of the remuneration have been laid down by the Supreme Court in the case of Raj Kumar Hukam Chandji v. CIT,\textsuperscript{120} where the salary was held as individual income for the following reasons:

(i) The finding of fact was that karta was appointed as managing director not as a result of any outlay or expenditure or by detriment to the family property.

(ii) Appointment as managing director was not because of the purchase of considerable share capital in the company.

(iii) The appointment was an employment involving personal responsibility and ability and salary was received for personal service. The tests to be applied were:

1. Is there any real connection between salary income and investment of funds?
2. Whether the remuneration received is but one of the modes of return made to the family for its investment in business. If so, it is income of family?
3. Whether the remuneration was compensation made for the services rendered by the individual coparcener. If so, it is the income of individual.
4. It was further held that if the income was essentially earned as a result of the funds invested by the family, then the fact that a coparcener has rendered some service would not change the character of the receipt. But if on the other hand it is essentially a remuneration for services rendered by the coparceners, the circumstance that his services were availed of because of investment of funds by one Hindu Undivided Family would not make the receipt the income of the Hindu Undivided Family.

In *S.R. Palaniappa Chettiar v. CIT*, the family through the karta,
had acquired 90 out of 300 shares of the limited company. Subsequently the karta was appointed Managing Director. The remuneration earned by the karta as Managing Director of the company was held to be assessable in the hands of the individual in as much as:

(i) The purchase of shares was for an investment and not for the purpose of qualifying the karta to become managing director.
(ii) The karta became a managing director eight years after the purchase of shares.
(iii) there could thus be no real connection between the investment of the Hindu Undivided Family funds in share capital and the appointment of karta as managing director.
(iv) Remuneration was not earned by any detriment to the joint family assets.

In CIT v. Gopal Narain Singh, properties were willed by the grandfather to the grandsons but a subsequent decree quashed the will and held that the properties belonged to the Hindu Undivided Family. It was held that the allotment of properties as per will became non-est and the income from shares was liable to be taxed in the hands of Hindu Undivided Family. The assessee was a director in receipt of remuneration. The Court held that there was nothing to show that the assessee had been appointed director because of his holding shares which were the properties of the Hindu Undivided Family and not on account of his special skill and acumen. It was held that in these circumstances director's salary be taxed in the hands of the individual.

In *CIT v. Kalu Babu Lal Chand*,¹²³ the Supreme Court, however, came to a different conclusion on the following facts:

1. Acquisition of business, floating of the company and appointment of the assessee as managing director were inseparably linked together.
2. Almost the entire capital of the private limited company was invested by Hindu Undivided Family.
3. Karta was appointed managing director as he held almost the entire capital on behalf of the Hindu Undivided Family. Thus his earning or remuneration was due to the investment made by the Hindu Undivided Family.
4. The Hindu Undivided Family assets were used for acquiring the concern and for financing it and in lieu of all the detriment to the joint family properties, the family got not only the shares standing in the names of two members of the family but also, as part and parcel of the same scheme, the managing directorship of the company.

Thus, in this case remuneration was held to have been received because of the investment of Hindu Undivided Family funds and to the detriment of Hindu Undivided Family property and therefore, considered as income of the Hindu Undivided Family and not that of individual. There were no facts to show that any personal skill or expertise was involved in the appointment of managing director.

---

In *CIT v. K.S. Subbiah Pillai (HUF)*,\(^{124}\) the Madras High Court has held that where ancestral funds were invested in tobacco business, later converted into a Private Limited Company (having karta and his wife as the only shareholders) the remuneration and commission received by the karta in his capacity as managing director were property assessable in the hands of his Hindu Undivided Family and not in his individual hands. This was based on the following findings:

1. The shares were obtained in the name of the assessee with the aid and assistance of the Hindu Undivided Family funds and to the detriment of joint family funds.
2. The karta was managing director because he held shares which had come out of joint family funds.
3. The fact of his rendering substantial service to the company was not relevant, as it was his duty to do as the karta of the Hindu Undivided Family.
4. The fact that remuneration and commission had not been disallowed in the hands of the company under Section 40(c) was also not relevant.

They reiterated as follows:

The principles that emerges from the various decisions is that if the remuneration or income that is received by coparcener or the karta of a Hindu Undivided Family is received because of the aid or assistance of joint family funds and to the detriment or at the expenses of joint family assets, then it would

be the income of the joint family and it will be so notwithstanding the fact that the karta or the coparcener renders some service. However, if the remuneration is essentially for the services done by the coparcener or the karta and if the same is not received because of the investment of joint family funds in the business or to the detriment or at the expenses of the joint family assets then it would be his individual income.

In *P.N. Krishna Iyer v. CIT*,125 where the assessee was appointed a governing director for life of a company, the entire shares of which were purchased by the Hindu Undivided Family from out of its funds and where the dividend income from the shares had been considered to be the income of the Hindu Undivided Family, the remuneration received by the assessee from the company was held to be the income of the Hindu Undivided and not of the individual.

The Supreme Court observed that, in such a case, the mere fact that an element of personal service, skill or labour was involved did not alter the character of the income. The Court held that in this type of cases the character of receipts must be determined by reference to its source, its relation to the assets of the family and the proximity of the connection between the investment from the joint family funds and the remuneration paid.

In *CIT v. V.S. Thyagaraja Mudaliar*,126 the Madras High Court was concerned with claim of a karta appointed as managing director of a company in which family funds had been invested in floating the company. The Tribunal

126. (1983) 148 ITR 128 (Mad.).
had held that the remuneration paid to the karta was commensurate with his past experience and service rendered by him to the company. They had directed the assessment to be made in the hands of the individual. On these facts the Court noticed that investment of the family funds in the business did not play any part in making the assessee the managing director and therefore, remuneration received by him could not be traced to the joint family funds and remuneration was properly assessable in his individual assessment. They applied the test whether the remuneration in substance though not in form was but one of the modes of return made to the family because of the investment of family funds in the business or whether it was compensation made for the services rendered by the individual coparcener. They found that assessee had considerable experience and the fact that he happened to be the karta of Hindu Undivided Family cannot cloud the issue.

In *CIT v. Pratap Veer Kapoor*,127 the Allahabad High Court held that the remuneration of the director was on account of his experience and qualification and the income could not be held to be Hindu Undivided Family income only because the shares of the company were held by the Hindu Undivided Family. This was inspite of the fact, that the private limited company had taken over the business of partnership of the Hindu Undivided Family

Where Hindu Undivided Family of D held 750 shares of the Company, it was held that setting fees of D and commission received by him as director were not connected with the holding of shares and could not be assessed in the hands of the Hindu Undivided Family.128

127. (1980) 125 ITR 598 (All.).
When Hindu Undivided Family funds are invested in a company and the remuneration received by karta as director is not connected with the investment, it was held that the income of the director could not be assessable as income of the Hindu Undivided Family.\textsuperscript{129}

In \textit{CIT v. G.V. Rattaiash},\textsuperscript{130} it has been held that where there is clear evidence of the karta having rich experience in the line of business carried on by the company, it cannot be said that services rendered by the karta were of routine character. These services required managerial ability and considerable skill in arranging commercial and financial transactions in the domestic as well as international markets. In this case as there was no connection between the investment of the funds by the family and the remuneration paid to the karta, it is not possible to consider the remuneration paid to the karta as income of the joint family. Such remuneration cannot be regarded as a detriment to the interest of the family.

On the facts of the particular case before them, they found that Hindu Undivided Family had withdrawn all the funds before the appointment and the director was qualified to look after the business of the company and so salary received was his individual income and not Hindu Undivided Family income.

Where the facts of the case showed that the remuneration was for services rendered by the karta and there was no connection established between the joint family funds and the remuneration to the karta, the remuneration was excluded from the assessment of the Hindu Undivided Family.\textsuperscript{131}


\textsuperscript{130} (1986) 159 ITR 945 (A.P.).

\textsuperscript{131} Second ITO v. K.A.S.A. Arunachal Nadar, 17 ITD 1070 (Mad.).
Where karta had basic commercial qualification and was well experienced in business as well as he gave his whole time to the business, it was held that the remuneration was not a return of investment of family funds but was only compensation for the services rendered by the individual.\textsuperscript{132}

Thus we can conclude that where karta or coparceners earn salary, remuneration or commission in a partnership or company it will be his separate individual property if it is proved that there is no sufficient connection between the investment of the Hindu Undivided Family funds and earning of income and the karta or the coparcener has personal skill, ability and expertise for the office he is appointed to and for the services for which he is drawing salary and there is no detriment to the family funds in the earning of the remuneration. On the other hand if the earning of salary depends upon the investment of the family funds in the enterprise, firm or the company this remuneration will constitute Hindu Undivided Family income.

(l) \textbf{Remuneration Paid by Hindu Undivided Family To Its Karta Or Member:}

If the Hindu Undivided Family pays some remuneration to its karta or one of its members for services rendered by him to the business of the family, a question arises as to whether such a payment is an admissible expenditure in the assessment of the Hindu Undivided Family.

\textsuperscript{132} \textit{ITO v. M. Jayabalan}, 17 ITD 1118 (Mad.).
In Jugal Kishore Baldev Sahav v. CIT, there was an agreement between the karta who was managing the business on behalf of the Hindu Undivided Family and his brother who was the only other adult coparcener that the karta should be paid Rs. 12,000 per annum as remuneration for managing the Hindu Undivided Family business and the remuneration was duly debited to Hindu Undivided Family account and credited to the individual account of the karta. It was held that the remuneration paid to the karta was an admissible deduction under Section 10(2)(xv) of the Income Tax Act, 1922 corresponding to Section 37(1) of the Income Tax Act, 1961. The Supreme Court observed that:

If a remuneration is paid to a karta of the family under a valid agreement which is bonafide in the interest of and expedient for the business of the family and the payment is genuine and not excessive, such a remuneration must be held to be an expenditure laid out wholly and exclusively for the purpose of the business and must be allowed as an expenditure under Section 10(2)(xv) of the Act.

Thus, the karta of a family can be paid remuneration for carrying on family business provided it is under some agreement. In this case the agreement was held to be executed in the interest of the family and not prejudicial to the interest of minors. The Supreme Court held that:

In judging what is a valid and proper agreement which would justify the payment of remuneration to a karta of the Hindu Undivided Family for managing, the business of the family to be deductible as an expenditure under Section 10(2)(vi) of the Income Tax Act, 1922, the test, we think which should be

applied is whether the agreement has been made by or on behalf of all the members of the Hindu Undivided Family and whether it was in the interest of the business of the family, so that it could be justified on the grounds of commercial expediency.

The Supreme Court referred to its earlier decisions,\textsuperscript{134} and said:

There seems to be no reason at all why, if a karta is paid remuneration he should be in a position different from that of any junior member. It is true that a karta has right to manage the property of the Hindu Undivided Family on behalf of all the coparceners, but there is no obligation or duty on him to carry on a particular business of the family. It is well established that any member of a Hindu Undivided Family including a karta, can have a separate personal source of income if that income is earned independently of the Hindu Undivided Family assets or business. It is primarily on this basis that it has been held that salary or remuneration paid to the junior member of the family for services rendered to the family business becomes his separate income and consequently a deductible expenditure under Section 10(2) (vi) of the Act when computing the income of the family. In similar circumstances, if a karta offers his services to the family instead of choosing an independent career to earn his separate income and receives remuneration from the family, there is no reason why remuneration so paid cannot be treated as an expenditure for carrying on business of family and deductible under Section 10(2) (vi).

\textsuperscript{134} Jit Mai Bhuramal v. CIT (1962), 44 ITR 887 (S.C.).
In *Jitmal Bhuramal v. CIT*,\(^{135}\) the karta of Hindu Undivided Family represented the family in a firm and entered into agreements under which junior members of the family agreed to serve the Hindu Undivided Family on monthly remuneration and to look after the interest of Hindu Undivided Family in the firm, the Supreme Court held that the salary paid by the Hindu Undivided Family to one of its junior members for looking after the affairs of the business, was deductible from the total income of the Hindu Undivided Family. It held:

A Hindu Undivided Family can be allowed to deduct salary paid to a member of the family, if the payment is made as a matter of commercial or business expediency.

The Supreme Court further held:

All the cases show that if the junior members of the coparcenary were serving the partnership, they were serving an entity which was separate and distinct from the Hindu Undivided Family. If the coparcenary had no place in the partnership, any service to the partnership cannot be described as service to the Hindu Undivided Family and it is sufficient to attract the application of Section 10(2)(xv) of the Income Tax Act, 1922, because it cannot be said to be wholly and exclusively for the Hindu Undivided Family.\(^{136}\)

In *Shanker Lal Dave v. CIT*,\(^{136}\) the Hindu Undivided Family was a partner in five firms through its karta. The karta and his wife entered into an agreement which recited that in consideration of the karta, in his personal capacity, rendering service to the Hindu Undivided Family in managing and

\(^{135}\) (1962) 44 ITR 887 (S.C.).

\(^{136}\) (1980) 124 ITR 733 (Guj); *Jugal Daldeo Sahai v. CIT*, (1967) 63 ITR 238 (S.C.).
looking after the affairs and interest of the Hindu Undivided Family in the various business of the Hindu Undivided Family, the karta was to be paid a salary.

It was held that remuneration paid to the karta was an allowable deduction as he rendered service to the family and not to the firm. The Court held that it is necessary that before a karta is paid a remuneration by a Hindu Undivided Family, there should be a valid agreement. In judging what is a valid agreement, the test which should be applied is whether the agreement had been made by or on behalf of the members of the Hindu Undivided Family and whether it is in the interest of the business of the family so that it may be justified on grounds of commercial expediency. If the remuneration to the karta under the agreement in question is not for services to the partnership firm but for looking after the interests of the Hindu Undivided Family in the partnership business, that would be distinct legal category of services rendered to the Hindu Undivided Family, because it is for managing the affairs of the Hindu Undivided Family by looking after the interest of the Hindu Undivided Family in those other partnership businesses.

In *S.P. Chandrakanth v. CIT*, a deduction was claimed by the Hindu Undivided Family on account of remuneration paid to the karta for services rendered to the family in earning its income as partner in certain firms. The family consisted of karta; his wife and minor children. The High Court observed:

There can, therefore, be no doubt or dispute that for claiming deduction under Section 37(1) in respect of the remuneration paid to the karta for services

---

rendered, there shall be an agreement between the parties for payment of such remuneration. But such an agreement need not be written. It may be inferred from the course of conduct of the parties. Mr. Raghavendra Rao for the Revenue urged that the Tribunal has recorded a finding that there was no proof of any consultation between the husband and the wife in regard to payment of remuneration, for services rendered by the former and therefore, we cannot infer anything to the contrary in this advisory jurisdiction. It is true that there is no evidence of consultation between the husband and the wife as to the payment of remuneration for services rendered but that is not the only thing which is needed to be looked into a case like this. There are other circumstances which are of equal importance between the husband and the wife. The fact remains that there was no other male member except the karta to do the business of the Hindu Undivided Family. The wife ordinarily to the exclusion of her husband would not attend the business in another firm where the Hindu Undivided Family is a partner. The children are all minors. The karta, therefore, is the only person who is charged with the duty to look after the business of the Hindu Undivided Family. In the previous accounting year, the karta was paid remuneration for services rendered. Such a payment was conceded to by the other members of the Hindu Undivided Family and deduction was claimed under Section 37(1). The fact that the Hindu Undivided Family claimed deduction of the remuneration paid to the karta in the previous assessment years is itself a clear indication that there was an implied understanding or agreement between the parties for payment of such remuneration.
If the remuneration paid is under a valid agreement which is benafide and in interest of the business of the family and payment is genuine and not excessive then such remuneration must be held to be an expenditure laid out wholly and exclusively for the business of the family.

In *CIT v. P. Nirmal Rao*,\(^\text{138}\) it is held that in the absence of prohibition in any law, if members of the Hindu Undivided Family decided to pay some remuneration to the karta who is manager for having taken up responsibility of the business, the same cannot be refused. The payment being genuine, and quantum being reasonable, the salary paid is admissible.

In *Gopinath Seth v. CIT*,\(^\text{139}\) it was held on facts that the payment of salary by the Hindu Undivided Family to the karta for managing its affairs was not an admissible expense. Here the family derived income from a number of partnerships and certain investments. It was urged that these were managed by the karta who was paid remuneration by virtue of an agreement between the karta and his wife. It was held that the karta was not required to perform any special and specific service, that the agreement between him and his wife was not dictated by commercial expediency.

**Partition of Share in a Firm:**

After the partition of Hindu Undivided Families interest in a firm, sometimes the karta continues to be a partner in his individual capacity but the capital of the Hindu Undivided Family is divided amongst members of the Hindu Undivided Family who are to receive interest from the former Karta on the

---

\(^{138}\) Taxation 100 (3) 328 (Ori.)

\(^{139}\) (1982) 135 ITR 365 (All.).
amounts lying in the firm. Book entries are made in support of the partition, and separate accounts are opened and also payment of interest made to erstwhile members of the family by the partner concerned. In such a case it has been held that this interest has an overriding title over the income of the partner and he received the income subject to payment of interest thereof. Interest payable to erstwhile members is deductible against the share of profits from the firm. In such a case the interest never belonged to partner. In *CIT v. Rupchand Prabhudas*,140 the partition deed had declared that though R would continue as a partner in the firm in his individual capacity he was saddled with the liability to pay interest on the amount of capital received on partition by the other erstwhile coparceners and members. The Court held that by making the book entries, the firm had accepted liability to pay interest as between the members of erstwhile Hindu Undivided Family and R.

As between firm and R, the liability to pay this amount was treated to be that of R personally. Share income received by R, included interest payable to other members and this interest never belonged to him and there was an overriding title in their favour in respect of the amount of interest.

In *CIT v. Pabbati Shankaraiah and Others*,141 on a partial partition in respect of interest of a family in a firm, the capital standing in the name of the Hindu Undivided Family was divided into four equal shares. Agreement of partial partition required the karta to continue as partner in the firm and divide the profit between himself and his sons. The Income Tax Officer originally assessed the karta and his sons separately but later attempted to assess the whole of the profit in the hands of a “body of individuals consisting of karta and his

140. (1982) 134 ITR 632 (Bom.).
141. (1984) 145 ITR 702 (A.P.),
sons. The High Court held that the Income Tax Officer was not justified in doing so and that the mere fact that the karta held the entire share in his name and thereafter distributed the profits to the other coparceners would not militate against the share in the firm being held by them as tenants in common. The Court held that this arrangement in fact created an overriding obligation on the karta to make over the income in favour of minor sons. The Court observed:

When once the family had disrupted, the position under the partnership remained as before, but the position under the Hindu Law changed. Then there was no Hindu Undivided Family as a unit of assessment. For an asset of the kind in this case, there was no other mode of partition open to the parties if they wished to retain the property and yet hold it not jointly but in severaly. The documents being genuine, the family took the fullest measure possible for dividing the joint interest into separate interest. So there was practically no Hindu Undivided Family in respect of the assets of the firm. The documents effectively divided the income. In fact the agreement created an overriding obligation on Shankaraiah to make over the income in favour of the minors and, therefore, the income corresponding to the share of each minor right from inception accrued to each minor creating thereby superior title in favour of the minors.

It was thus held that kara was holding the income received by him as a constructive trustee under Section 81,90 and 94 of Trust Act in favour of the two minors for whose benefit he holds it. He and his sons did not constitute a 'body of individual'.

In *CIT v. Ram Narain and Others*,142 it was held that "as a consequence of partition between the members of a Hindu Undivided Family each member of the Hindu Undivided Family gets the share in his own right." In this case share of karta in a firm was divided between members of Hindu Undivided Family and capital standing to the credit of the family in the book of the firm was divided and amount falling to the share of members, others than karta was treated as loans to the firm and karta alone remained partner of the firm. The Court held that there was no evidence to show that partial partition of the share of Hindu Undivided Family in the firm brought into existence a sub-partnership. Therefore, members would be assessable for their shares of income in the firm in the status of individuals and not as an association of persons.

In *CIT v. Nem Kumar Porwal and Others*,143 a Hindu Undivided Family consisting of the karta, his wife and five minor sons, represented by the karta, was a partner in a firm. Under an agreement of partial partition among the members of the Hindu Undivided Family its share of income from the firm was partitioned among the members of the Hindu Undivided Family and each member got 1/7th share of which each was the absolute owner and each member was free to enjoy the same as per his or her own free will. Under the agreement the share of income from the firm accruing to the karta had ceased to be joint property. It was held that the effect of the partial partition was that though, the karta continued to be a partner in the firm, it was not in his capacity as the manager of the Hindu Undivided Family but he represented the interests of all the seven members independently among whom there was a partial partition. Further, there was a positive declaration in the partition deed that the share income from the firm had ceased to be joint property and the respective

members had become owners of their individual shares in the income. The agreement of partition created on overriding title in favour of the divided members and hence the erstwhile members of the Hindu Undivided Family couldn't be assessed in the status of an association of persons.

In *CWT v. J.K.K Angappa Chettiar*,¹⁴⁴ it was held that on and from the date of the partition the karta becomes liable to render an account of the profits and the liability to such account is that of a trustee or agent. Therefore, on and from the date of partition, the assessee was not entitled to the profits in its entirety but was entitled to only that portion of the profit referable to his share in the capital investment and the minors were entitled to the profit referable to their shares. Accordingly, the share of future profits from the firms was held by the assessee and his two divided sons and was not vested in the assessee wholly and exclusively and hence the profits attributable to the interest of the two minor sons in various partnership cannot be treated as the wealth of the assessee but will have to be treated as the wealth of the minors. In this case also the claim of the karta that after partial partition two thirds of the capital in various partnerships and two third shares of the profit from the same firm belonged to the divided minor members was accepted.

In *CIT v. Virendra Kumar Gupta*,¹⁴⁵ there was a partial partition of the share capital of the Hindu Undivided Family in the firm between karta, his wife and two minor children under a finance agreement which provided that the said share capital was to remain invested in the firm as it was before the partition and further that it was agreed that one fourth of the share would go to the assessee and three fourths to wife and minor children. Accepting partial partition the

¹⁴⁴ (1979) 116 ITR 456 (Mad.).
¹⁴⁵ (1988) 170 ITR 473 (All.).
Income Tax Officer assessed him in the status of individual but blubbed the share of others with his income. The tribunal held that finance agreement was genuine and so was partial partition and so the share income as a whole never reached the assessee. The High Court upheld the view of the Tribunal.

In *CIT v. Narinder Kumar*,\(^{146}\) there was a partial partition of Hindu Undivided Family's share in two firms and the share of income of his wife and minor son was received by the assessee. The same was included in the hands of the assessee on the ground that division of shares in partnership amounted to creation of sub-partnership and so Section 64 read with Section 183(b) applied. It was held that no sub partnership had come into existence on partial partition and hence the shares of the wife and minor son could not be included in the total income of the assessee under Section 64. Thus there was a diversion by overriding title.

In *CIT v. Rajinder Pal Jain*,\(^{147}\) was held that declaration dated 3rd December 1969 and partition deed dated 1st April 1970 had the effect of diversion by an overriding title of share income from the firm to the hands of individual family members and so income of each was assessable separately.

(IX) Section 64: Clubbing of Income:

This provision has been deleted by Finance Act 1922 w.e.f. 1.4.93. But for the purpose of this research study it is necessary to give briefly the position which existed prior to the omission of the said sub-section of the Income Tax Act, 1961. Section 64 (i) of the Income Tax Act, 1961 provided that in


\(^{147}\) (1989) 180 ITR 262 (P & H).
computing the total income of any individual there shall be included all such income as arises directly or indirectly 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. The question, therefore, arose as to whether in a case where karta of a Hindu Undivided Family represents the Hindu Undivided Family as a partner and his wife is also a partner in the same firm, will her share of profit be clubbed in the hands of Hindu Undivided Family or not.

In *Madho Prasad v. CIT*, while dealing with Section 64(1) (iii) of the Income Tax Act, 1961 in the case of a minor being partner in the same firm in which the father was partner representing the Hindu Undivided Family, the Court held:

Since the joint family, as such, cannot be a partner of a firm, and only an individual can be a partner of a firm, the word occurring in Section 64 merely refers to the father of the minor and indicates that such share income of the minor will be treated as the individual income of the joint family of which the father is karta.

The Court referred to the views expressed in the case of *Firm Bhagat Ram Mohal Lal v. C.E.P.T.*, that when the karta of a joint Hindu Family enters into a partnership with the strangers, the members of the family do not ipso facto become partners in the firm and the observations made in *CIT v.*

148. (1978) 112 ITR 492 (All.).

149. Section 64(1) (iii) has been omitted by Finance Act, 1992 w.e.f. 1.4.1993.

Bhagyalakshmi and Co.\textsuperscript{151} that "qua the partnership he functions in his personal capacity, qua the third parties, in his representative capacity. The third parties, whom one of the partners cannot enforce their rights against the other partners nor the other partners can do so against the third party." The High Court, therefore, held that such a karta is a partner as an individual and the clause in which 'such individual' is a partner occurring in Section 64(1) applies and income is to be clubbed.

In CIT v. Sanka Sankariah,\textsuperscript{152} the Court dissented from the view of Allahabad High Court and held:

The expression 'individual' only takes in a person in his individual capacity and does not take in the karta of a Hindu joint family or a trustee or one who acts as representative of others." It was held that where a person is a partner representing the Hindu Undivided Family, the share income from the firm derived by his wife or minor children could not be included in the individual assessment of the partner under Section 64.

In CIT v. Anand Sarup,\textsuperscript{153} it was held that if an individual represents the Hindu Undivided Family as its karta in a partnership and income in his hands goes to the Hindu Undivided Family, then the income of the spouse cannot be clubbed with the income of the individual. The income of the karta cannot be treated as income of the individual under Section 64(1) and (ii).

\textsuperscript{151} (1965) 55 ITR 660 (S.C.).


\textsuperscript{153} (1980) 121 ITR 873 (P & H).
In *Dinubhari Ishavarlala Patel v. K.D. Dixit*, the Gujrat High Court was of the opinion that:

In view of the explanation of Section 64, it is clear that an individual who is referred to in Section 64(1) can only be assessee who is being assessed in his individual capacity and not one who is being assessed in a representative capacity such as karta of a Hindu Undivided Family.

The Court also held:

In Section 64(1) (i) of the Income Tax Act, 1961 the word 'individual' and the words "such individual" must be confirmed to a person who is being assessed in his individual capacity and none else. Therefore, where the assessee is a partner in a firm in his capacity as a karta of a Hindu Undivided Family, the share income of his wife or son as partners of the firm cannot be included in the assessment of the assessee as a Hindu Undivided Family. When Section 64(1) (i) of the 1961 Act talks of an individual, it is only in restricted sense that the word has been used viz that of an individual capable of having a wife or minor child or both and it, therefore, necessarily excludes from its purview a group of persons forming a unit or a corporation created by a statute and is confirmed only to human beings who in the context would be comprised within that category. That individual must be an assessee and it is in computation of his total income for the purpose of assessment that the income of the persons have got to be included. It is clear that in so far as a partner is

---

concerned, qua his partners, he is an individual and qua them he functions in his personal capacity. However, when it comes to a person who represents a Hindu Undivided Family in the affairs of a partnership firm, qua the members of the Hindu Undivided Family he is in his representative capacity. He represents them in so far as outsiders are concerned but qua them, he is merely their representative. If he is a representative, he is not an individual person. In neither case, qua the wife or qua the minor child, is he any one else than a representative. It is just by chance that he happens to be the very individual whose spouse is also a partner in the same firm or whose minor child has been admitted to the benefits of that partnerships firm but the word individual occurring in Section 64 (1) (i) must be given the meaning as a person who is capable of having a spouse or minor child.

In *CIT v. Anand Sarup*,¹⁵⁵ it was observed that:

If such an 'individual' represents a Hindu Undivided Family as its karta and income in his hands goes to the Hindu Undivided Family, then for the purposes of Section 64(1) (i) and (ii), it cannot be held that it is the income of an individual. If the contention of the Revenue is correct, then there can be no income from the partnership to the Hindu Undivided Family whose karta as such is the partner thereof. This position as such is not tenable and cannot be accepted.

This view is now before the Supreme Court for a final decision.

In *Prayag Das Rajgarhia v. CIT*,156 the Delhi High Court has held that the share of profits of the minor children of the assessee from a firm in which the assessee is a partner representing his Hindu Undivided Family cannot be included in his personal assessment.

In *CIT v. Basant Kumar Agarwalla*,157 the Court has taken the view that income of the spouse of an individual is to be clubbed with the income of the husband under Section 64(1) (i) only if he is a partner in the firm as an individual. They refused to refer under Section 256 (2) of Income Tax Act, 1961, the question whether share of minor from the partnership could be clubbed with that of Hindu Undivided Family partner as they observed that reply was self evident and did not call for any debate.

Where the assessee was a partner in a representative capacity on behalf of the Hindu Undivided Family, then income of his wife and minor children from the firm could not be clubbed in his income under Section 64(1).158

In *CIT v. Abhay Kumar*,159 it was held that where the minor child's parent is the assessee in representative capacity as karta of the Hindu Undivided Family and not as an individual, Section 64(1) (iii), cannot be applied to club the income of the minor in computing the total income of assessee Hindu Undivided Family

Where the assessee was a partner in a firm as karta of Hindu Undivided

156. (1982) 138 ITR 291 (Del.).
157. (1983) 140 ITR 418 (Gau.).
159. 40 Taxman 220 (Raj.); *Arunachalam v. CIT*, (1985) 159 ITR 172 (Ker); *CIT v. N.P. Khedkar* (1986) 159 ITR 276 (Bom.) followed.
Family in 1972-73 and his minor sons were admitted to the benefits of partnership, it was held that the income of the minor sons was not liable to be included in the assessee's total income as individual.\textsuperscript{160}

If a smaller Hindu Undivided Family on partition has been allocated a portion of the property of the larger Hindu Undivided Family, then the income derived from such property cannot be included in the hands of the karta of the smaller Hindu Undivided Family in his individual assessments under Section 64(2) (c). The Court relied on circular No. 204 dated 24.7.1976, para 16.7 issued by Central Board Of Direct Taxes under Section 64(2) (c) of Income Tax Act, 1961 and held that on facts no property was allocated on partition to the spouse or minor child of the assessee and the allocation was in fact to the smaller Hindu Undivided Family.\textsuperscript{161}

In \textit{CIT v. Jhabarmal Aggarwalla},\textsuperscript{162} it has been held that where karta is partner in a firm as representative of Hindu Undivided Family, admittedly the income from the firm does not arise to him as individual but to Hindu Undivided Family and is assessable in the hands of the Hindu Undivided Family. The liability of such a partner to Revenue would be determined under Income Tax Act keeping in lien his representative status. Therefore Section 64(1) cannot apply and income of the wife as partner in the same firm cannot be clubbed with that of the husband as he is not assessable as individual but Hindu Undivided Family.


\textsuperscript{162.} (1990) 183 ITR 431 (Gau.).
The view of Allahabad High Court,163 was considered at length in all the judgments of Andhra Pradesh,164 Gujrat,165 Punjab,166 and Gauhati167 High Courts and they dissented from the same after examining all aspects. Further, in fiscal statutes when it is propose to take a decision adverse to the assessee, the words of the statute must be strictly construed. This has been done by Gujrat, Punjab and Andhra Pradesh High Courts and they have applied the test strictly that the word 'individual' should be construed to apply only if that individual is a partner in his personal individual capacity and not in a representative capacity. They had held that since the assessment of partner in the firm had been made in the status of Hindu Undivided Family; the income of the minor children of the karta could not be included in the income of Hindu Undivided Family. On the same analogy income of a spouse cannot be included in the hands of the karta of Hindu Undivided Family who happens to be her husband.

In Sahu Govind Prasad v. CIT,168 the Court held that though karta is representative of the Hindu Undivided Family, qua other partners the functions in his personal capacity. As regards the relationship between the partner karta and other partners including the wife or minor child the Court observed:

Section 64 requires an individual and his wife and her minor children to be partners to each other. That is enough. Their other relationship inter se are not

163. Madho Prasad v. CIT, (1978) 112 ITR 492 (All.).
165. Dinubhai Ishwar Lai Patel v. K.D. Dixit, (1979) 118 ITR 122 (Guj.)
167. CIT v. Basant Kumar Aggarwalla, (1983) 140 ITR 418 (Gau.)
relevant. The fact that he is also the karta, guardian or trustee or benamidar etc., is irrelevant.

It was further observed that the karta is also assessable in his individual status. Section 64 confines itself to such individual assessment. Though share income of the karta from the firm is not assessable in his individual income but in the hands of the Hindu Undivided Family nonetheless the share income of the spouse or the minor children from that firm is liable to be included while computing the total income of such individual in his assessment in the status of an individual. Thus in their view where A as karta of Hindu Undivided Family is a partner in a firm representing his Hindu Undivided Family and his wife is also a partner in the same firm, the share income of A will be assessed in the hands of Hindu Undivided Family as hitherto but the share income of his wife Mrs. A will be taxed in the individual hands of A, the spouse. Thus the share of Mrs. A will not be assessed in her hands but will be clubbed with the income of her husband A as individual. This view of the Allahabad High Court is opposite to the view of Delhi, Punjab and Haryana, Gujrat and Andhra Pradesh High Courts and is applicable to the State of U.P. only.

In CIT v. B. Balasubramanium,\(^{169}\) it has been held that Section 64(1)(ii) as it prevailed then had no precondition or other stipulation except that the parent and the minor child should be partners in the same firm and that there is no condition that the partner's share income from the firm should be assessable personally in his hands for the sub-section to apply. It was held that the question as to where the share income of a partner should be assessed, whether in his own hands or in somebody else's is in no way connected with the interpretation of Section 64(1).

\(^{169}\) (1984) 147 ITR 732 (Mad.).
It is thus evident from the above case law that most of the High Courts have taken the view that income of wife or minor child cannot be clubbed with the income of the individual or the Hindu Undivided Family.

As Section 64 stood before its amendment by Taxation Laws (Amendment) Act, 1975 which came into effect w.e.f. 1.4.1976, the income arising to a minor child from its admission to the benefits of a partnership would be clubbed with the income of its parent only if that parent was a partner in that firm. The income of the minor could be included in the assessment of the Hindu Undivided Family of which he was a member only if there was a finding of fact that the investment so made on his behalf came out of Hindu Undivided Family funds. They could not be so included in the assessment of the Hindu Undivided Family only on the ground that a parent of his was a partner of the firm representing the Hindu Undivided Family. There has been significant change in this provision with effect from 1.4.1976. Section 64 (1) (i) now speaks of the income arising to a minor child of such individual from the admission of the minor to the benefits of partnership in a firm and has dropped the words "in a firm in which such individual is a partner" from the corresponding provision of Section 64((1) (iii) before the amendment. The effect of amendment is two fold: (i) the income arising to a minor from his admission to the benefits of a partnership would be included in the individual assessment of his parent, irrespective of whether this parent is partner in the same firm or not and (ii) there is no question of such an income being considered as the income of the Hindu Undivided Family of which such a minor is member. The ambiguity which had earlier crept in because of the requirement of the parent being a partner of the same firm and the possibility of the parent representing the Hindu Undivided Family has automatically disappeared.
In *CIT v. Mai Chand*[^170^] it was held for 1979-80 that where three minor sons of the assessee were admitted to the benefits of the partnership in the firm in which assessee was a partner as karta of the Hindu Undivided Family, the share income had to be assessed in the hands of the assessee in his individual capacity. It was held that "even if the assessee does not have any income in his individual status, under the amended law, the income of the minor child is to considered as his income." Therefore, income of minor son was to be included in the hands of father as individual under Section 64(1) (iii).

Where the assessee as karta of Hindu Undivided Family and wife are partners in a firm, whether the income of the assessee's wife from the firm is taxable in the hands of the assessee is a debatable question.

(X) **Right to Get Set off or Carry Forward Loos:**

In the hands of a son, the share of profit in the firm will be assessable as business profit as was the case in the hands of the father. As this was income from profit and gains, an assessee would be entitled to claim the benefit of carry forward and set off the loss of past years which represented his half of the share of the profit or loss arising to his father in the partnership. Therefore he will be entitled to carry forward and set off of any unabsorbed loss of the past years under Section 72 of the Income Tax Act.

In *Keshri Chand Bhanabhi v. CIT*[^171^] the Bombay High Court had decided that loss sustained by a Hindu Undivided Family cannot be set off against the income of a firm constituted by the erstwhile members of the same

---


[^171^]: (1951) 20 ITR 201 (Bom).
family subsequently disrupted. However, if such a karta carrying on business for the Hindu Undivided Family as sole proprietor incurs a loss and subsequently vests his business in a registered firm, then, such a Hindu Undivided Family does not lose the right to set off its unabsorbed business loss and subsequently vests his business in a registered firm then, such a Hindu Undivided Family does not lose the right to set off its unabsorbed business loss (relating to the period of the proprietorship) against profit share allotted to in the same business carried on by and assessed as, a registered firm in a subsequent year.

However, Hindu Undivided Family business of an association of persons in which Hindu Undivided Family is a member, cannot be held to be the same business and Hindu Undivided Family is not entitled to unabsorbed loss of the association of person in the later year.

If Hindu Undivided Family is a partner in a registered firm which has incurred losses and the registered firm is succeeded by the Hindu Undivided Family partner, then the Hindu Undivided Family as successor can carry forward his share of loss in the firm and set it off against the profit of the business after it became his sole proprietary business.


Where a managing member of a joint family enters into a partnership with a stranger, the other members of the family do not ipso facto become partners in the business so as to clothe them with all the rights and obligations of a partner. In such a case the family as a unit does not become a partner but only such of its members as infact inter into a contractual relation with the stranger,
the partnership will be governed by the Act.\textsuperscript{172}

When a partition of Hindu Undivided Family takes place, the Hindu Undivided Family ceases to exist in so far as the capital investments of the family are concerned. If the capital is not divided and is held by the divided members as tenants in common, the divided units will be entitled to the profits arising from such investments in accordance with their shares in the investment. In \textit{Approver v. Rama Subba},\textsuperscript{173} the Privy Council held:

After such partition the produce is no longer to be brought to the common chest as representing the income of an individual property, but the proceeds are to be enjoyed in six distinct equal shares by the members of the family, who are thenceforth to become entitled to those definite share.

It was further held:

As from the date when the right to partition accrues, however, the manager will be bound to render an account of the same nature as could be demanded from a trustee or agent. The time from which such an account can be demanded of would seem to be the date of severance.\textsuperscript{174}

Thus, the karta on and from the date of partition becomes liable to render an account of the profits and this liability is that of a trustee or agent. The assessee who was holding the profits as karta before partition holds the same

\begin{thebibliography}{9}
\bibitem{172} Pichappa Chettiar \textit{v.} Chokalingam, \textit{AIR} 1934 P.C. 192.
\bibitem{173} (1866) 11 MIA 75.
\bibitem{174} Myne's Hindu Law, 11 Ed. 518.
\end{thebibliography}
after partition as trustee. In *Charandas Haridas v. CIT*,175 the Supreme Court observed that:

After partition of family's interest in partnership "there is then no Hindu Undivided Family as a unit of assessment in the point of fact and the income which accrues cannot be said to be of a Hindu Undivided Family. There is nothing in the Indian Income Tax Law or the Law of Partnership which prevents the members of a Hindu Undivided Family from dividing any assets. Such division must be of course be effective so as to bind the members.

In *CIT v. Duduwals and Co.*,176 it was held that after partition, the karta as partner would be liable to render account in respect of his share on a different basis. But still he would continue to be a member of that firm and partnership would not be in any way affected by the partition. The Court held that the partnership shall be continued after the Court decree "In the firm of Dudwwala and Co., the parties there to have 12 annas share and it shall remain joint and the parties shall be entitled thereto according to the shares mentioned in Clause 3 hereof". According to clause 3 each one of the plaintiff and the defendants were entitled to 1/6th share of the joint family properties. The Court observed:

Therefore, the mere mention that the parties would be entitled to twelve as share of the firm of Duduwala and Company according to the share specified in the terms of settlement did not make any alteration to the real character of the property. The family ceased to be joint and the shares were defined and the necessary

176. (1950) 18 ITR 653 Cal.
consequence is that any property e.g. the twelve annas shares in that firm, would be held by the members of the family as tenants in common.

In *CWT v. J.K.K. Angappa Chettiar*, the Court held that on and from the date of the partition, the assessee was not entitled to the profit in its entirety but was entitled to only that portion of the profit referable to his share in the capital investment and the minors were entitled to the profit referable to their shares. Accordingly the share of further profits from the firm was held by the assessee and his two divided sons and was not vested in the assessee wholly and exclusively and hence the profits attributable to the interest of the two minor sons in various partnerships cannot be treated as the wealth of the assessee but will have to be treated as wealth of the minors.

Where a Hindu Undivided Family is a partner in a firm, the karta enters into the partnership with outsiders on behalf of the Hindu Undivided Family and share income is included and taxed in the hands of Hindu Undivided Family and not in the hands of any individual. If and when a partial partition takes place by which capital of the Hindu Undivided Family in the partnership is divided among the members of the Hindu Undivided Family, the Hindu Undivided Family then no longer owns the share in the business and share income cannot be included in its income after partition.

In *CIT v. M.D. Kanoria*, the memorandum of partition expressly divided the capital standing in the name of the karta in the firm, among the members of the joint family with the result that though the capital stood in the assessee's name in the account books of the firm, the capital was severally

177. (1979) 116 ITR 456 (Mad.).

178. (1982) 137 ITR 137 (Bom.).
owned by the erstwhile members of the joint family in definite shares with a further agreement, that the assessee was to receive the profits for and on behalf of the contracting parties severally. Hence, the share incomes of the assessee in the firm was subject to an overriding title in favour of the other members of the Hindu Undivided Family in proportion to the shares allotted to them in partial partition. This was according to the agreement in the memorandum of partition that assessee was to remain a partner in the firms but the profits falling to the share of the assessee were to be the profits of the members of the family severally in their own respective individual right and interest. On these facts the Tribunal held that there was an overriding diversion of profits which were not assessable in the hands of the assessee. The Tribunal also held that the partition did not result in creation of a sub-partnership consisting of assessee, his wife and therefore, Section 64 was not applicable. The High Court held that in any event the Tribunal had found as a fact that the partition did not bring about any partnership. Applicability of Section 64 was wholly independent of the question referred and the share income could not be taxed in the hands of the assessee. It was observed that there was nothing in the Income Tax law or the Law of Partnership which prevented the member of a Hindu Joint Family from dividing any asset.

In CIT V. Indira Mohan Sharma,179 the Bombay High Court held that in such cases income cannot be wholly taxed in the hands of the erstwhile karta because the income received by him is subject to an overriding title in favour of the other members of the erstwhile family. The Court further held that the right to receive the stipulated share of profits from the firm where the erstwhile karta continued to be a partner, did not flow from any agreement between the parties to carry on any common venture but it flowed from the right as a separate

179. (1992) 138 ITR 696 (Bom.).
member of a Hindu Undivided Family, as a result of partition. The divided members of the erstwhile Hindu Undivided Family could not be assessed as an association of persons.

In *Shanti Kumar Magan Lal Jain v. CIT*, the Bombay High Court held:

It cannot be disputed that by mere partition and division of share but in the absence of unity of possession for a common venture, there cannot be an association of persons. The recital in the agreement that Shanti Kumar will continue to be a partner in the said firm and profit and loss of every year shall by apportioned amongst the members of the family equally, in the books of the Hindu Undivided Family, in the context of the whole agreement, can not even remotely suggest the intention to have a unity of possession. Similarly, it is difficult to see how non intimation to the partnership is a circumstance against the assessee, especially when in the books of the Hindu Undivided Family relevant entries were made.

It is, therefore, apparent that in case of such partial partition and division of share among the erstwhile members.

(i) no part of income from the firm is taxable in the hands of the erstwhile Hindu Undivided Family;
(ii) there is no sub-partnership owing the share and hence Section 64 does not apply;
(iii) the share is not held by any association of persons and is not taxable in the hands of any association of persons.

---

(iv) On the other hand the share is includable in the hands of each member in proportion to his share in the family partition.

It follows from the above said discussion that the share from the firm is to be taxed in the hands of the karta and his minor sons separately for income tax and wealth tax purposes. The character of the share income allocated to the father in the concerned firm does not change because of the overriding title of the assessee. The share income allocated to the father is business income. The partition results in a sort of sub-partnership so that the business profit which gets allocated to the father in the firms get divided and equally belong to the father and his sons. Share in the profits of a partnership is business income and share after partition of a father and sons will be also assessed as business income in the hands of father and sons.

In Rajendra Nath v. CIT,\textsuperscript{181} it is reiterated that right of a karta/father to effect partition between himself and the other members of the family is not affected by the presence of minor members in the family or even of a member being of unsound mind. On a partial partition of the capital of the Hindu Undivided Family in the partnership the indenture of partition brought into existence a sub-partnership wherein the minors were admitted to the benefit of partnership and so this was caught within the mischief of Section 64(1). In this case the minors were not to bear any share of loss of the business.

In CIT v. J.K.K. Sundararajah,\textsuperscript{182} the partition between father and minor son was recognized under Section 171 of the Income Tax Act, 1961, the capital investment in the firm was held to be owned by the father and the son as

\textsuperscript{181.} (1991) 188 ITR 753 (All.).

\textsuperscript{182.} (1986) 160 ITR 370 (Mad.); CWT v. J.K.K. Angappa Chettiar, (1979), 116 ITR 456 (Mad.).
tenants-in-common and they were separately entitled to the profits arising from such investments. In the same case the Tribunal had given a finding that the funds of the Hindu Undivided Family before its partition had been invested in the export firm. As the correctness of the finding on the ground of no material before the Tribunal was not referred as such to the High Court, it was held that there was no reason to reject the Tribunal's finding, and therefore, as income had arisen by utilizing the son's's funds also, only half of the income could be taxed in the hands of the father. The Supreme Court,\(^{183}\) has dismissed the special leave petition filed by Revenue against Madras High Court's order wherein they had declined reference on the question whether the entire share income of a firm in which the assessee was a partner was assessable in between him and his two minor assessee hands or only one third as claimed by the assessee because of overriding title created by a partition deed.

In \textit{CIT v. S. Subba Reddy},\(^{184}\) there was a partial partition of Hindu Undivided Family's capital and share of profit in a firm between the two coparcener i.e. the father and the minor son where the two agreed to share the capital in equal parts. Half of the interest received from the firm on the capital invested in the name of the karta was claimed to belong to the minor son and the Tribunal deleted the same from the income of the father. The High Court agreed with the Tribunal's finding that there was an overriding title in respect of half of the interest received by minor son and therefore held that this half of interest was deductible from the income of the father. Thus the finding that there was an overriding title not only in respect of share of profit but also in respect of interest received was upheld.


\(^{184}\) (1986) 150 ITR 120 (A.P.)
In *ITO v. Shri Chaman Prakash and Sons*, the memorandum of partial partition recited that:

(i) The capital belonging to the Hindu Undivided Family and invested in the firm (after providing for marriage expenses of the daughter) was divided equally between karta, his wife and minor son and would no longer be property of the Hindu Undivided Family but distributed amongst the family members.

(ii) The karta continued to be the partner and the entire capital continued to stand in his name. He was entitled to the share in partnership firm while he paid interest on loans taken from the other members of the family. Thus the entire share of profit is enjoyed by the karta and his obligation was to pay interest on the amounts deemed to have been taken as loan from other members of the family in view of partial partition. The partial partition was duly recognized under Section 171 by the Income Tax Officer and proper entries regarding division of capital were made in the books of the firm and the personal books of the Hindu Undivided Family.

(iii) The conduct of the family clearly showed that after the partial partition, the right to receive profit or liability for losses accrued to the karta in his individual status.

It was held that memorandum of partial partition read with the conduct of the members as also the entries in the books of firm as also in the Hindu Undivided Family books clearly showed that the right to receive future profit or liability for losses were taken over the karta in his individual capacity. It was

---

further held that the question of unequal partition had no relevance when the family has very substantial impartable assets. The Hindu Undivided Family was thus liable to be assessed for any share of profit and the same was assessable in the hands of the karta as individual.

In *CWT v. J.K.K. Angappa Chettiar*,¹⁸⁶ on a partition between the karta and his two minor sons, the capital account of the Hindu Undivided Family in various partnership firms was equally divided between the assessee and his two sons and partition was recognized by the Income Tax Officer. It was held that on partition the parties held the investment as tenants-in-common and were entitled to the profits arising therefrom in accordance with their shares. The karta now became liable to render an account of the profits and the liability to such account in that of trustee or agent. On and from the date of partition the erstwhile karta was entitled to only that portion of the profit referable to the his share in the capital investment and the minor sons were entitled to 1/3 of their shares. The share of future profits was not vested in the father wholly and exclusively and hence the profits attributable to the interest of two minor sons in the various partnerships could be treated as wealth of minors and not that of father.

(XII) Deductability of Interest Paid to Hindu Undivided Family Partner: Section 40(b)

Section 40(b) of the Income Tax Act, 1961 prohibits the deduction in the case of any firm, any payment of interest, salary bonus, commission, or remuneration made by the firm to any partner of the firm. Section 40(b) of the Income Tax Act, 1961 stops such payments made to any partner and declares

¹⁸⁶. (1979) 116 ITR 456 (Mad.).
them as not deductible from the total income of the firm notwithstanding anything to the contrary contained in Section 30 to 39. The question for consideration is whether interest paid to the Hindu Undivided Family on funds invested by the Hindu Undivided Family in the firm is caught within the mischief of Section 40(b) or not, where the karta or one of the members of the family is a partner in a firm representing the Hindu Undivided Family. Thus when karta or a junior member is a partner in the firm on behalf of the Hindu Undivided Family is interest paid to Hindu Undivided Family to be added back under Section 40(b)?

There is considerable difference of opinion on the answer to this question. On one side, it has been held that the interest paid to such a partner, on capital invested either from out of his individual funds or from out of the funds of Hindu Undivided Family is interest paid to the partner in terms of Section 40(b) and is inadmissible as deduction in the assessment of the firm.

In CIT v. Veeraiah and K. Narshimhulu,187 the interest was first credited to individual account but later transferred to the Hindu Undivided Family account. It was held that by transfer of account, it cannot be contended that what was once capital has now become the investment of the joint family. It was further held that the capital contributed by the partner was as a partner though the funds may have emanated from the joint family, that the joint family which could not itself be a partner has not made any investment in the firm independent of the capital contributed by him as partner and that therefore, it did not cease to have the characteristics of a capital investment by a partner, the interest is not deductible under Section 40(b).

In *CIT v. London Machinery Co.*,\(^{188}\) the interest disallowed under Section 40(b) was interest to individual. If a partner makes a deposit in the firm of monies belonging to his Hindu Undivided Family and also monies belonging to him individually, in fact and in law the partner brings in the money. In both cases the payment of interest by the firm to such a partner is as a partner no matter who really has the beneficial interest in such payments. Section 40(b) applies to interest to partners who were partners in Hindu Undivided Family capacity and had deposited individual funds.

In *CIT v. Brij Mohan Das Laxman Das*,\(^{189}\) it was held that where interest was paid to a person who was a partner and who had invested capital as individual, Section 40(b) of the Income Tax Act, 1961 was attracted, no matter in which capacity the payment was made.

In *Radhey Sham Sri Krishna v. CIT*,\(^{190}\) on facts it was held that partners had invested capital as individual and so Section 40(b) was attracted. Interest was held to be on capital contributed.

In *Jalem Chand Mangi Lal v. CIT*,\(^{191}\) the Court categorically stated that irrespective of the capacity in which a prison becomes a partner of a firm, Section 40(b) is a bar for the allowance of interest paid to him. It really did not matter whether these partners had joined the firm in their individual capacity or as kartas of Hindu Undivided Family. The main point to be considered is not in what capacity the loan was advanced but whether interest was paid to a person.

\(^{188}\) (1979) 117 ITR 11 (All.).
\(^{189}\) (1979) 117 ITR 121 (All.).
\(^{190}\) (1982) 137 ITR 602 (All.).
who is a partner of the firm. It was further reiterated after considering the views of other High Courts that:

Where a person joined as a partner of a firm in his individual capacity and interest was paid to him as karta of a Hindu Undivided Family, then payment of interest was not deductive in the hands of the firm in view of the provisions of Section 40(b).

On the other hand, it has been held in some other cases that the Hindu Undivided Family cannot be a partner in a firm and that legally the karta or any other members of the family is a partner in the firm in his individual capacity and the money advanced by the family could not be treated as capital of the individual partner but as a loan by the Hindu Undivided Family. This view has been advanced in a number of cases.¹⁹²

In *Venkatesh Emporium v. CIT*,¹⁹³ loan were advanced not by partner but the Hindu Undivided Family of which partner was karta. The Court held that:

Section 40(b) only entitled the Income Tax Officer to add back payments of interest made by a firm to its partner. If the payment is made not to a partner but to the partner's joint family, the Section cannot be invoked at all. We are satisfied that the decision of the Tribunal in this case is quite contrary to the plain terms of Section 40(b) of the Act.

---


¹⁹³. (1982) 137 ITR 593 (Mad.).
It was further held that Section 40(b) cannot be invoked even though the interest is paid to a family in which the partner is a karta and even though the tax treatment of the share income of the partner would be considered not in his individual assessment but in the assessment of his joint family.

In *CIT v. Sajjanraj Divan Chand*,\(^{194}\) the Gujrat High Court held that:

It is, therefore, not possible to proceed on the footing that Hindu Undivided Family is a partner in a firm for the purpose of Section 40(b) of the Income Tax Act, 1961.

It was observed that:

In order to disallow a payment of interest by the firm under Section 40(b)..... the test to be applied is as to whether the interest is paid to a partner. If the creditor of the firm is not the partner but the Hindu Undivided Family of which the partner is the karta, then the creditor of the firm is a separate entity and interest paid to that separate entity will not be governed by Section 40(b) and cannot be disallowed.

It was observed that:

The fact that the karta of the Hindu Undivided Family was a partner of the assessee firm was not relevant because under Section 40(b) it is only the interest paid to the partner which is not allowed to be deducted. Interest paid to any other creditor of the firm cannot be disallowed under the provisions of Section 40(b).

This was because there were two separate accounts one in the individual name of the partner and the other in the name of the Hindu Undivided Family of the partner. The interest was paid on account of credit in the account of Hindu Undivided Family who was not a partner. In this view, the partner in the firm is only an individual and therefore, if such an individual has got a loan account with the firm then interest to such individual is covered under Section 40(b) but when the loan is from the Hindu Undivided Family, it cannot be said that interest paid is to a partner. Section 40(b) introduced a fiscal restriction which is to be strictly enforced. Legally speaking interest to the Hindu Undivided Family cannot be considered as interest paid to the partner and therefore, that interest is not caught within the mischief of Section 40(b).

This view of the Gujrat High Court has been overruled by Full Bench of the same High Court in L. Chhotatal and Co., v. CIT\textsuperscript{195}. The Court applied the decision in CIT v. Pannatal Hiralal and Co.\textsuperscript{196}, in which the Bombay High Court had held that interest paid to U was clearly in his capacity as an individual and as he was not a partner in his individual capacity but as representative of the Hindu Undivided Family, interest paid to individual was not interest paid to a partner and could not be disallowed. The full Bench of the Gujrat High Court observed:

Once we accepted the situation that contracting partners alone are bound by the terms of the contract and it is open to the Revenue to see the partner as he really is, it goes without saying that when he represents a Hindu Undivided Family, that has to be disallowed and not any interest paid into his

\textsuperscript{195} 19 Taxman 169 (F.B.); \textit{Dimtbhai Ishvaried Patel v. K.D. Dixit}, (1979) 1 118 1TR 122. applied.

\textsuperscript{196} (1984) 146 ITR 549 (Bom.).
individual account as interest in lieu of advance made by him personally. Even if he happens to be the karta of the Hindu Undivided Family, if he becomes partner in his own account, and amounts are advanced to the firm by him from his individual account and also by the Hindu Undivided Family, the amount of interest paid to the Hindu Undivided Family account can not be disallowed, while the interest paid in his 'individual' account has to be disallowed. That is not the situation here. We are not persuaded to agree with the approach made in the case reported in *Sajjanraj Divan Chand's Case* (Supra), for the reasons we have explained herein. We think that decision has necessarily to be overruled.

The Full Bench, therefore, overruled its earlier judgment and held that where karta is partner in a representative capacity, interest paid to him as Hindu Undivided Family is interest paid to partner but interest paid in his individual capacity cannot be disallowed. An interesting legal question arose in so far as the decision in the case of *Sajjanraj Divan Chand* is concerned. A Full Bench of the same High Court in *L.Chottalal and Co.*, (Supra) overruled the views expressed in Sajjanraj's Case but he Supreme Court rejected the special leave petition against the decision in Sajjanraj's case. A question arose whether the rejection of Special Leave petition by the Supreme Court tantamounts to the confirmation of that decision and whether the full bench was competent to overruled this judgment in view of the Supreme Court refusal to admit an appeal against the judgement. This aspect was examined in *CIT v. Indradaman Amrat Lal*, and the Court held that the decision in Sajjanraj Divan Chand's case has been overruled as clearly directed by the full bench. They further held on the facts of the case, that the interest paid to the Hindu Undivided Family by the

197. (1985) 156 ITR 493 (Guj.)
assessee firm in which A was partner in his individual capacity could not be

In Hindustan Steel Forgings v. CIT,\textsuperscript{198} it was held that if a karta on
becoming a partner lends to the firm monies belonging to him individually, then
interest paid by the firm is deductible in computing firm's income.

In Balchand Hashmatrai and Co. v. CIT,\textsuperscript{199} it was reiterated that no
disallowance, can be made under Section 40 (b) if the interest paid by the firm to
the partner is in a capacity other than the capacity of a partner. The partner in
this case did not represent the Hindu Undivided Family but was a partner in his
individual capacity and interest paid was to Hindu Undivided Family of which
the partner was karta. The interest paid to the Hindu Undivided Family in these
circumstances, it was held, cannot be disallowed.

In CIT v. Khoday Eswarasa and Sons,\textsuperscript{200} it was held that interest paid
to the assessee on amounts advanced to the firm in her individual capacity was
not an allowable deduction, even though the assessee had become a partner on
the death of her husband as the executrix of the estate.

\textsuperscript{198} (1989) 179 ITR 280 (P & H); CIT v. Narbheram Papatbhai and Sons, (1987) 166 ITR 534
(M.P.); Chhotalal and Co. v. CIT, (1984) 150 ITR 276 (Guj.), followed circular of Central
Board of Direct Taxes reported in (1984) 149 ITR 127 relied upon CIT v. Nitro Phosphatic
v. Khoday Eswarasa and Sons, (1985) 152 ITR 423 (Kar.) and Chandmul Rajarahia v. CIT, 164
ITR 86 (Pat.), disagreed with

\textsuperscript{199} (1966) 61 ITR 121 (M.P.).

\textsuperscript{200} (1985) 152 ITR 423 (Kar.).
In CIT v. Narbheram Popatbhai and Sons, it was held that interest paid by a firm to partner on loans given by him as individual (he being a partner in the capacity of Hindu Undivided Family) is deductible, in computing firm’s income.

In CIT v. Kishan Lal and Bros, it was held that where K was a partner in the firm in his individual capacity, payment of interest to the Hindu Undivided Family represented by K as the karta was not payment of that amount to a partner of the firm and the interest to Hindu Undivided Family could not be disallowed under Section 40(b). It was observed that:

Explanation 2 and 3 which cover both the situations are clarificatory of the law as it existed prior to their insertion by the Taxation Laws (Amendment) Act 1984 with effect from 1.4.85 and that the prohibition contained in Section 40(b) even without the aid of the explanation is attracted only to the situation when payment of interest in the very same capacity in which a person is partner in the assessee firm.

Following the decision it was held in CIT v. Jankidass Ram Pratap, that payment of interest to Hindu Undivided Family was not payment to a partner of the firm and interest was allowable as deduction.


203. Taxation 98 (3) 486.
In CIT v. Nitro Phosphatic Fertilizer,\textsuperscript{204} the Court held that no distinction can be made in respect of deposits made by a partner in his capacity as karta of Hindu Undivided Family and that made in his individual capacity and thus interest paid on both deposits has to be disallowed under Section 40(b). It was further held that Explanation to Section 40(b) by Amending Act of 1984 was not retrospective. It was made effective from 1985-86 and in the absence of any indication either in the statement of objects or reasons, it is difficult to hold that the said Section was retrospective. They held that a karta when enters into a partnership in a representative capacity has no distinct and separate personality with that of the Hindu Undivided Family and therefore, monies invested by him from his individual account could not be treated as distinct and separate for the purposes of Section 40(b).

In Bombay Cycle Importing Co. v. Ninth Income Tax Officer,\textsuperscript{205} it was held following NTR Estate v. CIT,\textsuperscript{206} that Explanation to Section 40(b) was introduced to avoid inconvenience and was clarificatory in nature. Interest paid to individual was held deductible where these individuals were partners in the firms as representatives of Hindu Undivided Family. Meanwhile the Supreme Court had dismissed special leave petition filed by Revenue against the judgement in NTR Estate v. CIT.\textsuperscript{207}

In CIT v. Jain Hardware Stores,\textsuperscript{208} it has been held that interest paid by the firm to the karta partner on his individual investment in the firm cannot

\begin{itemize}
  \item \textsuperscript{204} 40 Taxman 280 (All.).
  \item \textsuperscript{205} 33 ITD 79 (Mad.).
  \item \textsuperscript{206} (1986) 157 ITR 285 (A.P.).
  \item \textsuperscript{207} (1991) 187 ITR (St) 38 (S.C.).
  \item \textsuperscript{208} (1990) 186 ITR 272 (Guj.).
\end{itemize}
be disallowed under Section 40(b).

Thus the question regarding allowance of interest to Hindu Undivided Family when karta is a partner representing the Hindu Undivided Family had become a matter of considerable controversy. Whereas Madhya Pradesh and Allahabad High Courts are of the view that interest paid to the Hindu Undivided Family by a firm in which the karta or a coparcener of the Hindu Undivided Family is a partner representing the family is not to be deducted, an exactly opposite view has been taken by Madras, Gujrat and Andhra Pradesh High Courts, while some other High Courts have not yet taken a considered view. The controversy has not been resolved by legislation. The Taxation Laws Amendment Act, 1984 has inserted Explanation 2 in Section 40(b) from 1.4.1985 which reads as under:

Explanation 2: Where an individual is a partner in a firm on behalf of or for the benefit of any other person (such partner and the other person being hereinafter referred to as "partner in representative capacity" and person so represented respectively).

(i) interest paid by the firm to such individual or by such individual to the firm otherwise than as partner in a representative capacity, shall not be taken into account for the purposes of this clause;

(ii) interest paid by the firm to such individual or by such individual to the firm as partner in a representative capacity and interest paid by the firm to the person so represented or by the person so represented to the firm, shall be taken into account for the purposes of this clause.

The Explanation thus provides that interest paid by the firm to an individual on considerations other than his being a partner in representative
capacity shall not be taken into account for the purposes of Section 40(b) and that the provisions of the Section will apply only if the payments made to him or received from him are in his representative capacity as a partner. It has now been made clear by law that if a karta represents his Hindu Undivided Family, then the interest paid by the firm to such individual otherwise than in his capacity as karta of the Hindu Undivided Family will not be taken into account for the purposes of Section 40(b). Interest paid by the firm to such individual otherwise than in his capacity as karta of the Hindu Undivided Family will not be taken into account for the purposes of Section 40(b). Interest paid by the firm to such individual as representative of Hindu Undivided Family will alone attract the provisions of Section 40(b).

Explanation 3 was also inserted with effect from the same date i.e. 1.4.1985 and reads as under:

When an individual is a partner in a firm otherwise thanks a partner in a representative capacity, interest paid by the firm to such individual shall not be taken into account for the purposes of this clause if such interest is received by him on behalf, or for the benefit, of any other person.

When an individual who is a member of a Hindu Undivided Family enters into a partnership in his individual capacity and not one representing the Hindu Undivided Family the interest payments made to the Hindu Undivided Family by the firm do not attract the provisions of Section 40(b). This Section 40(b) will apply to interest paid to an individual in the capacity in which he is a partner and not to his other accounts.

These are explanatory provisions and are, therefore, retrospective and will apply to earlier years also and to all pending matters before assessing and
In *NTR Estate v. CIT*,\(^{210}\) the High Court has considered the aspect whether Explanation 2 or 3 are retrospective or not. It was held:

We consider that the present amendment to Section 40(b) of the Act through Explanation 2 or 3 above referred to is to avoid inconvenience to tax payers, reduce litigation and in that view, the spirit of explanations 2 or 3 introduced by the Taxation Laws (Amendment) Act, 1984 should be followed with the respect to the preceding assessment years also in order to avoid unnecessary litigation. It cannot be gainsaid that the legislature was fully aware of the conflict of judicial opinion in this matter among the various High Courts in the Country and the present amendment to Section 40(b) through Explanations 2 and 3 is brought about to set at rest the controversy. We see no reason to hold that the principle statutorily recognized by explanation 2 and 3, following the decision of some High Courts, is good only from the assessment year 1985-86 and ceased to be so for the preceding assessment years. In our opinion, explanations 2 or 3 are merely clarificatory in character and must, therefore, govern the assessment prior to the assessment year 1985-86 also.

The High Court held that interest paid by the assessee firm to its partners or monies lent by them in their individual capacity is not liable to be disallowed under Section 40(b) by the Act in as much as the partners were acting in a representative capacity so far as the partnership interest is concerned.

---


In *ITC v. Kanhaya Lal Rameshwar Dass Dass and Co.*,\(^{211}\) it has been held that since explanation to Section 40(b) is procedural and retrospective, interest paid to partner in Hindu Undivided Family capacity would not be admissible under Section 40(b) while interest paid to the individual will not be disallowed.

Section 40(b) was sought to be substituted by a completely new provision by clause 13 of the Direct Tax Laws (Amendment) Act, 1987 to be effective from 1.4.1989. This was in consequence to the charges sought to be made in the manner and nature of assessment of partnership firms. However, the changes made in this regard by the Direct Tax Laws (Amendment) Act, 1987 have been done away with by the Direct Tax Laws (Amendment) Act, 1989, with the result that Section 40(b) remains as it is.

In *CIT v. Onkarmal Nankram*,\(^{212}\) it is reiterated after considering the views of other High Court that Interest paid on loan taken by the firm from the separate and individual fund of the karta and not from joint family fund would not be covered under Section 40(b). However in order to get the deduction, the firm has to clearly proved the source from which loan was taken. However, from 1.4.1993, the law regard allow of salary and interest to partner has been charged by Finance Act, 1992 w.e.f. 1.4.1993.\(^{213}\)

\(^{211}\) 16 ITD 320 (Ch.)

\(^{212}\) 101 Taxation 244 (Ori.).

\(^{213}\) See Section 40(b) introduced w.e.f. 1.4.1993.
(XIII) Effect of Death of Karta on Partnership

In CIT v. Sobha Singh Jai Ram Singh,\(^{214}\) it was held that where H, the karta of Hindu Undivided Family was a partner on behalf of Hindu Undivided Family, there could be an automatic dissolution of the partnership firm on the death of H. Assets of the firm were distributed after his death and there was an effective dissolution of the firm. It was held that no deed of transfer was required to be executed or registered and that the share received by the Hindu Undivided Family, after H's death was assessable in the status of Hindu Undivided Family.

(XIV) Hindu Undivided Family and Company:

Sometimes shares are purchased by a Hindu Undivided Family in a company in the name of the individual members of coparcener of the family. These persons hold the share in a representative capacity and the beneficial interest in the shares is held by the Hindu Undivided Family under Section 2(6A) (e) of the Income Tax Act, 1922 and the corresponding Section 2(22)(c) of the Income Tax Act 1961, dividend includes any payment by a company by way of advance or loan to a shareholder, being a person who has a substantial interest in the company to the extent to which the company possesses accumulated profits. A question arises is to whether in the case of Hindu Undivided Family being a beneficiary or substantial share holder, a loan taken by the Hindu Undivided Family can be considered as a dividend under Section 2(22)(e). This is a complex issue and for an answer some of the judicial decisions in the matter may be considered.

\(^{214}\) (1990) 183 ITR (P & H); CIT v. Juggilal Kamlapat, (1967) 63 ITR 292 (All.)
In *Krishan Chand Lunidasing Bajaj v. CIT*,\(^{215}\) it was decided by the Supreme Court that the dividend on share held by member will be taxable in the hands of Hindu Undivided Family.

In *CIT v. Sarathy Mudaliar*,\(^{216}\) shares were held by the members of the family in their representative capacity but the loans had been given by the company to the Hindu Undivided Family and not to individual members in whose names the shares were standing in the share registers of the company. The question for decision was whether Section 2(6A) (e) of the Income Tax Act, 1922 had to be strictly construed or the Hindu Undivided Family as a beneficiary shareholder was caught within the mischief of the Section. It was held that:

Only loans advanced to shareholders could be deemed to be dividends under Section 2(6A)(e). The Hindu Undivided Family could not be considered to be a shareholder under Section 2(6A) (e) and hence the loans given to the Hindu Undivided Family could not be considered as loans advanced to a shareholder of the company and could not therefore be deemed to be its income.

The Supreme Court held that Section 2(6A) (e) must receive a strict construction when the Section speaks of shareholders, it refers to the registered shareholders and the beneficial owner.

In *G.R. Govindarajula Naidu and Another v. CIT*,\(^{217}\) it was laid down that:

\(^{215}\) (1966) 60 ITR 500 (S.C.)

\(^{216}\) (1972) 83 ITR 170 (S.C.)

The mere fact that the Hindu Undivided Family is beneficial owner of the shares will not make it a registered shareholder. Further by reason of Section 153 of the Companies Act prohibiting recognition of trusts, express, implied or constructive as shareholder, there is a specific prohibition for the Hindu Undivided Family being a shareholder of a company. In these circumstances Section 2(6A) (e) cannot be invoked unless the legislature introduces a further deeming provision to the effect that the joint family which is the beneficial owner of the share shall be deemed to be the registered shareholder of the company.

In CIT v. R. Doraisami Naidu and Sons and Other,218 it was reiterated that unless the advance of a loan is to shareholder, the provision of Section 2(6A) (e) will not apply. Though the Hindu Undivided Family was beneficial shareholder of the company, the individual alone is to be recognized as shareholders. The loan given to Hindu Undivided Family could not be considered a deemed dividend as Hindu Undivided Family is not a registered shareholder.

In the corresponding Section 2(22)(e) of the Income Tax Act, 1961, the words `for individual benefit of any such shareholder' have been added to the wording as contained in Section 2(6A) (e) of the Old Act. The Parliament has thus expressly provided that what is relevant for determining whether the individual has a substantial interest in a company or not is the beneficial ownership of the share and not necessarily the registered ownership. In

218. (1979) 120 ITR 896 (Mad.).
Rameshwar Lal Sanwrmal v. CIT,\textsuperscript{219} the Supreme Court held that although normal dividend would be taxable as that of Hindu Undivided Family the deemed divided representing loans given by the closely held company cannot be subjected to tax as Income of the Hindu Undivided Family. Where the loan is given by the company to the beneficial owner of the share i.e. Hindu Undivided Family. In other words this liability would arise only if loan is given to the registered holder of the shares but not to the beneficial holder of shares. The Court accordingly held that such loans could not be regarded as loans advanced to a shareholder and could not be taxed in the hands of Hindu Undivided Family as deemed dividend.

Section 2(24)(iv) of the Income Tax Act, 1961 defines income to include the value of any benefit or perquisite obtained from a closely held company by a person who has a substantial interest in the company. In CIT v Prem Narain Aggarwal,\textsuperscript{220} it has been held that even in the personal assessment of a director or managing director rights and bonus shares received by him in respect of his own shares would not be perquisite within the meaning of Section 2(24)(vi). It was further held that the bonus shares received by the karta director in respect of shares owned by him in his representative capacity as the karta do not constitute a perquisite or income within the meaning of Section 2(24)(iv) in the hands of Hindu Undivided Family and consequently there would be no question of treating the value of the bonus shares as the income of the Hindu Undivided Family. The Court held that if the income or perquisite in question is not taxable in the hands of the director who happens to hold the shares in his own right, it would follow that the rights or bonus shares cannot be taxed in the hands of the Hindu Undivided Family which the director may represent for the

\textsuperscript{219} (1980) 122 ITR 1 (S.C.).

\textsuperscript{220} (1982) 136 ITR 407 (Del.).
purpose of holding the shares.

Under Section 23 A of the Income Tax Act, 1922, the word shareholder meant the shareholder registered in the books of the company or the registered shareholder and not the beneficiary shareholder. Therefore, when the question was whether notional income deemed to be dividend declared under Section 23 A of the Income Tax Act, 1922 could be assessed as income of Hindu Undivided Family or as income of the registered shareholders, it was held by the Supreme Court in CIT v. Shakuntala and Others,\textsuperscript{221} held that:

The word shareholder in Section 23 A of 1992 Act meant the shareholder registered in the books of the company. The amount appropriate to the shares had to be included in the income of members of the family in whose names the shares stood in the register of the company; and as the Hindu Undivided Family was not a registered shareholder of the company, the amount could not be assessed in the hands of the Hindu Undivided Family under Section 23 A.

In Howrah Trading Co. v. CIT,\textsuperscript{222} it was held that a person purchasing the shares under a blank transfer is not a shareholder within the meaning of Section 18(5) of the Income Tax Act, 1922 notwithstanding the equitable right to the dividend on such shares. Such a person with blank transfer is not entitled to have the dividend grossed up under Section 16(2) of the Income Tax Act, 1922.

Only the registered shareholder will get the benefit of tax deductions at

\textsuperscript{221} (1961) 43 ITR 352 (S.C.).

\textsuperscript{222} (1959) 36 ITR 215 (S.C.).
source on the dividend.\textsuperscript{223}

In \textit{CIT v. Siksha Debi Bhagat},\textsuperscript{224} the Calcutta High Court held that where a Hindu Undivided Family was partner in a firm which held shares in a limited company it had to be held that assessee Hindu Undivided Family was the beneficial owner of the income, profits and gains which its karta D was entitled to from the firms and his half shares including deemed dividend was taxable in the hands of the Hindu Undivided Family.

\textbf{(XV) Diversion of Income by Overriding Title:}

Whenever by a legal and binding obligation, income is diverted before it reached the tax payer, it cannot in law be considered as income belonging to the assessee as it never reaches him. However, the income should be diverted by a overriding title. In \textit{Raja Bejoy Singh Dudhurian v. CIT},\textsuperscript{225} the assessee on the death of his father succeeded to the family ancestral estate but had to face a suit for maintenance brought in by his stepmother. A consent decree was passed under which the assessee was bound in law to make a monthly payment of fixed sum to his stepmother. The consent decree declared that the maintenance of the stepmother was a charge on the Hindu Undivided Family estate in the hands of the assessee. The Privy council held:

\textbf{The decree of the Court by charging the appellant's whole resources with a specific payment to his step mother, to the extent to which he received for her was not his income. It was not a case of the}

\begin{itemize}
  \item \textsuperscript{223} \textit{ITO v. Arvind N. Mafatlal and other}, (1962) 45 ITR 271.
  \item \textsuperscript{224} (1980) 124 ITR 765 (Cal.).
  \item \textsuperscript{225} (1933) 1 ITR 135 P.C..
\end{itemize}
application by appellant of part of his income in a particular way, it was rather the allocation of a sum out of his revenue before it became income in his hands.

Thus, in this case the Hindu Undivided Family was held not to be assessable for the income diverted to the stepmother and she was separately taxed as the amount received by her was not of the Hindu Undivided Family or as member of Hindu Undivided Family but had its source in a Court decree. However, where maintenance is paid to wife and children under a decree of Court but the payment of maintenance has not been made a charge on the property, there is no overriding charge or diversion of income before it riches the husband or karta of Hindu Undivided Family. In CIT v. Sitaldas Tirathdas,226 the Supreme Court observed:

This was a case in which the wife and children of the assessee who continued to be members of his family received a portion of the assessee's income after he had received it as his own, therefore, was one of application of a portion of the income to discharge an obligation and not one in which by an overdoing charge the assessee became only a collector of another income. The assessee was not, therefore, entitled to the deduction claimed by him.

A private arrangement for paying maintenance to members of the family or even a payment by decree does not automatically assume the character of overriding obligation.

In *K.A. Rameachar and Other v. CIT*\(^{227}\) the Supreme Court was dealing with a case where the assessee who was a partner in firm executed three irrevocable deeds of settlement in favour of his wife, a married daughter and a minor unmarried daughter assigning to each of them one fourth of his share of profits in the firm payable to him during a period of eight years from the date of the settlement to be enjoyed by them absolutely and exclusively. On these facts the Court held that the profits first accrued to the assessee and after accrual were applied for payment to the beneficiaries. What he paid was in law a portion of his income but by these deeds he had allowed payment to his wife and daughter as a valid discharge in favour of the firm. They held that; "the disposition were in law and in fact portions of the assessee's income after it had accrued to him and tax was payable by him at the point of actual. The amounts had, therefore, to be included in the assessee's total income."

In *Bipin Bhai Vadilal v. CIT*\(^{228}\) the assessee holding certain share in a company as an individual threw the share in the hotchpot of Hindu Undivided Family consisting of himself, his wife, and children. The declaration referred to only the shares but did not refer to the vesting of his remuneration as managing director in the Hindu Undivided Family. He however, wrote to the company to credit the remuneration drawn by Managing Director to the account of the Hindu Undivided Family. It was held by the Gujrat High Court that remuneration received by him was not on account of investment of Hindu Undivided Family funds and that this was not a case of diversion of income by overriding title and therefore, the Hindu Undivided Family could not be made assessable for this remuneration.


\(^{228}\) (1980) 126 ITR 779 (Guj.).
Thus, maintenance expenses will be deductible from the income of the Hindu Undivided Family only in cases where a legal obligation in the form of a charge on property has been created for the payment in CIT v. Bijli Cotton Mills (P) Ltd,229 the Supreme Court held that where extra amount charged by a person is for the sole purpose of paying to charitable purposes of Red Cross Society or Dharmade, their subsequent payments were expenditure under legal obligation and not a case of application of income.

In Moti Lal Chhadami Lal Jain v. CIT,230 karta executed deed stating that expenditure of trust will be met from income of certain properties and he will have no concern with the income. There was a subsequent deed by karta and his son invested specific properties in trust and declared that they shall have no connection or concern with such properties. It was held that the trust was valid and there was effective diversion of income at source. Income from properties was not taxable in hands of family.

(XVI) Assessment After Partition:

In CIT v. K. Satyanarayan Murthy,231 a Hindu Undivided Family was the owner of a business. During the accounting year 1968-69, the assessee, who was the karta, claimed partition of this business among himself and his five sons. As application under Section 171 of the Income Tax Act, 1961, was accepted and partial partition of the Hindu Undivided Family business was allowed. On the question whether the share of profits received by the assessee from the business for the assessment year 1974-75 was assessable in the hands of an

Hindu Undivided Family consisting of himself and his wife, it was held that the property in dispute namely, the share in the business was his personal property and had no longer any joint family character. The assessee's status was that of an individual with reference to the income from business and he was liable to be assessed as much.

This view of Orissa High Court in the above case has been dissented from by the Andhra Pradesh High Court in *Prem Chand v. CIT*, in which there was a partition among the karta, his two sons and wife and wife of karta was given a share on partition. Shri Prem Chand filed returns in respect of income from property allotted to him on partition in the status of a Hindu Undivided Family and the Income Tax Officer accepting the status taxed the Hindu Undivided Family at higher rates of tax as one member of the Hindu Undivided Family, the wife of karta, had been separately assessed and, therefore, Hindu Undivided Family was liable to be taxed at higher rates. Before the Tribunal an additional ground of appeal was allowed to be raised that the correct status was that of an individual. It was contended by the assessee that after the partition of joint family properties between P, Mrs. P, and his sons, there was no Hindu Undivided Family, in the eyes of law even though the petitioner's wife might have been continuing to live with him and even though Mrs. P is taxed in respect of the income of the property allotted to her share. This claim was rejected by the Tribunal holding that as the husband and wife might have continued to live together for purposes of coverture and consortium and that there continued to be Hindu Undivided Family consisting of P and his wife and that P could not be assessed as an individual. It further held that P was karta of Hindu Undivided Family of which at least one member Mrs. P had a taxable income and, therefore, the Income Tax Officer was right in applying the

higher rate of tax. Before the High Court it was contended that the existence of the wife had to be ignored as she had no right to maintenance in the property allotted to her husband P. The High Court agreed with the Revenue and held that the partition at which the assessee's wife was given a share did not snap the marital tie the and the wife was very much in existence as a wife, notwithstanding the partition. Secondly, the existence of the Sapinda relationship is the test for deciding who is a member of the Hindu joint family. The Court quoted with approval the following from *Surjit Lal Chhabda v. CIT*:

> It is the family relation, the sapinda relation, which distinguishes the joint family and is of its very essence. The appellant's wife became his sapinda on her marriage with him. The daughter too on her birth became a sapinda and until she leaves the family by marriage, the tie of sapindaship will bind her to the family of her birth.

The High Court, therefore, held that the partition at which the wife was given a share did not have the effect of wiping out her Sapinda relationship. She, therefore, continued to be a member of the family of her husband not with standing the fact that under the Banaras School of Mitakshara law she was given a share. The Income Tax Officer and Tribunal were, therefore, right in holding against the assessee and in applying the higher rates of tax as per sub-para II of Para A of Schedule 1 to the Finance Act, 1974. It was observed that:

233. *(1975) 101 ITR 776 (S.C.)*.

The legal position can be summarized as follows:

1. Where the property 'was originally' owned by coparcener of a Hindu Undivided Family and later devolved on a sole surviving coparcener who had female members in his family, the character of the property as Hindu Undivided Family does not change inspite of the temporary reduction of the number of coparcener and the sole surviving coparcener has to be assessed as a Hindu Undivided Family as in Gowli Buddanna's Case.235 Similarly, where the property of a Hindu Undivided Family is partitioned, the property so allocated to a single coparcener who has female members in the family has to be assessed as Hindu Undivided Family on the principle of Gowli Buddana's case as applied in Narendra Nath's case.236 Where, however, there is physical absence of female members entitled to maintenance on the property, the sole surviving coparcener in possession of the above mentioned property has to be assessed as an individual till such time that he gets married. That is the exception of the rule in Gowli Buddanna's case, made applicable in Krishna Prasad's case.237

2. But where the property was not owned by a Hindu Undivided Family before it came to be owned by a sole surviving coparcener living with female members of the family entitled to maintenance, the assessment has to be made as individual. The reason is that before it got converted as joint family property it was not owned by coparcener of a Hindu Undivided Family. After conversion too the assessment remains so till

a son is born. Such a conversion as joint family property occurred for the first time in the hands of the sole surviving coparcener by reason of the gift by the father [(in Kalyanji's case 5 ITR 90 (PC)] and by reason of the sole coparcener throwing his separate property into family hotchpot (In Surjit Lal Chhabda's Case, 101 ITR 776 (S.C.) The property would have to be assessed as individual even inspite of the existence of female members, until a son was born who could have a right by birth. That is the rule in L. Kalyanji's Case.\textsuperscript{238} Referring to \textit{Krishna Prasad v. CIT,\textsuperscript{239}} it was observed:

The emphasis is more on the existence of the wife than on her rights. The share given to the assessee's wife in the present case may be in lieu of maintenance. But the female here is very much in existence in the family even after partition as the assessee's wife and that distinguishes when no female at all was in existence. Unlike the son who goes out of the family after partition, or the daughter on marriage, the wife continues to be a member of the Hindu Joint Family of her husband as long as the marital tie lasts, inspite of taking a share in the partition. We are, therefore, of the opinion that Krishna Prasad's case- the exception to Gowli Buddanna applies only to a sole surviving coparcener who is without any other female member in the family. He, must be all alone solitary.

The High Court has, therefore, held that when on a partition in the family, the mother gets a share along with her husband, and son, she does not go out of the family of the husband and the share accrued to the husband is ancestral

\textsuperscript{238} (1937) 5 ITR 90 (P.C.)

\textsuperscript{239} (1974) 97 ITR 493 (S.C.).
and income from the same is assessable as of a Hindu Undivided Family. Further
the wife continues to be member of the family and if she has taxable income,
even though the husband may not have taxable income, then the husband’s
Hindu Undivided Family is assessable for the income at higher rate.

In *Jeetmal Nagri v. CWT*, 240 a business was carried on by a Hindu
Undivided Family till Diwali 1965, when partition was effected among the karta
(the assessee), his wife and two sons. Thereafter, the assessee continued to
carry on the business. On the question whether the assessee was assessable as an
Hindu Undivided Family for the assessment Year 1975-76, it was held that in
view of the finding that there had been a partition between the assessee, his wife
and sons, the assessee was assessable in the status of an individual. This
decision was later followed in *CIT v. Dhanammal*, 241 where equal shares were
allotted to each member of the family including D, Mrs. D and their minor
children on a partial partition. A partnership was constituted wherein equal
shares were given to each member of the family including Mrs. D. It was held
that Mrs. D had also been allotted a share in the partition and the income arose
from the subject matter of partial partition which was invested in the partnership.
It was impossible to hold that D and his wife constituted an Hindu Undivided
Family in respect of this property. The share income of D from the firm was his
individual income and share of minors from the firm was liable to be included in
the total income of D under Section 64.

In *P. Pavanasa Nadar v. CIT*, 242 after partition the coparcenary was
left with only female members including mother, wife and daughters. It was held

distinguished.


that income is to be assessed in the hands of Hindu Undivided Family and not individual.

In *Seethammal v. CIT*,\(^\text{243}\) it was held that where after partition family consisting of S, Mrs. S and four sons was reduced to karta S and his wife, the death of the karta brings an end to the family. Even though during his life time S was assessed as Hindu Undivided Family, after his death the status of Hindu Undivided Family is not available to the wife of S as a single individual, Section 171 (1) had no manner of application.

In *CIT v. Basant Singh*,\(^\text{244}\) it has been reiterated that the income earned on the amount which fell to the share of the wife of the karta of an Hindu Undivided Family on partition cannot be included in the income of the Hindu Undivided Family since the amount, on partition, belongs to her and she being a female member cannot throw her share into the hotchpot of the Hindu Undivided Family. Further, amounts set apart on partition for marriage expenses of three unmarried daughters of the karta were exclusively given to the daughters and same could not belong to Hindu Undivided Family. Therefore, income from these assets could not be taxed in the hands of Hindu Undivided Family.

In *N.B. Mohan Naryanaswami v. State of Tamil Nadu*,\(^\text{245}\) assessee received properties on partition of Hindu Undivided Family, it was held that property received on partition of Hindu Undivided Family ancestral property constituted Hindu Undivided Family property and the Revenue was directed to allow an opportunity to assessee to substantial his claim.


\(\text{244. (1983) 140 ITR 937 (P & H).}\)

\(\text{245. Taxation 99(3)-220 (Mad.).}\)
In CIT v. Dara Seshavataram,\textsuperscript{246} one of the sons being a coparcener of the family relinquished his right in the Hindu Undivided Family property and he was allotted a medical store out of the properties of the joint family. No order was passed under Section 171 recognising the partial partition. It was held that medical stores having gone out of the family properties by virtue of a registered deed, ceased to be property of the Hindu Undivided Family and therefore, income from the same should be excluded from the Hindu Undivided Family. However, the position has changed with the Supreme Court’s judgement in the same case.

In G.E Thippaieh v. Ag. ITO,\textsuperscript{247} it has been held that on the death of karta of Hindu Undivided Family consisting of karta and his wife the Hindu Undivided Family ceases to exist and the son cannot be assessed as legal heir of the Hindu Undivided Family

In S. Sivasankaran v. Income Tax Officer,\textsuperscript{248} on partition a property was allotted to father for life and after him to the mother for life and after her death the property was to pass on to the assessee absolutely with full rights of alienation. It was held that at the time of partition itself, the remainder man's interest came to the assessee. This became a complete interest in the property on the demise of the parents: The parents had only a limited interest in the property by way of partition, which interest in terms of the partition deed itself passed on to the assessee after the interregnums of the remaining life time of the father and thereafter of the mother. Hence, what the assessee obtained was property by way of partition and it would take the character of a Hindu Undivided Family

\textsuperscript{246} (1981) 129 ITR 339 (A.P.).

\textsuperscript{247} (1991) 187 ITR 668 (Kar.), Seethammal v. CIT (1981) 130 ITR 597 (Mad.). followed

\textsuperscript{248} 15 ITD 364 (Mad.).
property.

In *Gangamma v. Agri. Income Tax Officer*, a Hindu Undivided Family consisted of the karta, his wife and son. There was a partition in the family between the father and his son on April 25, 1973. Subsequent to the partition, the karta and his wife constituted a smaller Hindu Undivided Family and this Hindu Undivided family was assessed from the assessment year 1974-75 onwards. The karta died on May, 12, 1980. The Agricultural Income Tax Officer issued notices to the widow and son of the karta, treating them as legal heirs of the deceased for assessment for the assessment year 1979-80 under the Karnataka Agricultural Income Tax Act, 1957. On a writ petition challenging the issue of the notices, the petitioners contended that after the death of the karta, there was no family in existence and the income for the assessment year 1979-80 could not be brought to tax either in the hands of the widow of the karta or in the hands of the divided son and that there was no provision in the Karnataka Agricultural Income Tax Act, 1957, to assess a sole surviving member of the family treating him/her as a Hindu Undivided Family. It was held that the notices issued to the petitioners were liable to be quashed.

(XVIII) Disrupted Hindu Undivided Family and Back Taxes:

A question which sometimes arises is the liability to tax on back income of a Hindu Undivided Family which has disrupted by the time it comes to the notice of the authorities that taxes have not been paid by the Hindu Undivided Family in the past. The Revenue can invoke the provisions of Section 171 of the Income Tax Act only if the Hindu Undivided Family had been previously assessed to tax but the Section is of no use held in cases where the Hindu

---

249. (1991) 188 ITR 133 (Kar.).
Undivided Family though liable to tax, had not been assessed, and had disrupted before the omission or non-assessment was noticed. Income Tax Officers and Wealth tax Officers have attempted to tax the income and wealth of such disrupted Hindu Undivided Family which has however been successfully challenged in appeal before the High Courts.

In *K.Madhavan Nambiar v. Wealth Tax Officer*,\(^{250}\) the Wealth Tax Officer instituted proceedings against the Hindu Undivided Family under Section 17 of the Wealth Tax Act when it came to his notice that the 106 members of a disrupted tarward had received their proportionate share from out of a compensation of Rs. 60 Lakhs determined to be payable by the Hindu Undivided Family before disruption in respect of the forest land owned by the family which had been acquired under land acquisition proceedings. It was claimed that the family had disrupted on 1.12.1976 long before assessment proceedings were instituted. The Kerala High Court held that as Hindu Undivided Family had never been assessed, re-assessment proceedings could not be initiated against it under Section 17 of the Wealth Tax Act. These proceedings were illegal. It was further held that if a Hindu Undivided Family, was to be assessed under Section 17 of the Wealth Tax Act, notice under Section 17 was to be given to the karta and not to any junior member of the family.

In *Income Tax Officer v. Ram Prasad and Others*,\(^{251}\) the Supreme Court held that the Excess Profits Tax Officers is not competent to take proceedings under the provisions of Section 13 and 15 of Excess Profits Tax Act, 1940 in respect of a Hindu Undivided Family which has disrupted by a complete partition. They held that a Hindu Undivided Family is neither firm

---

250. (1982) 134 ITR 695 (Ker.)

nor an association of person. It is a separate entity by itself and Section 44 of Income Tax Act, 1922 which provides for discontinuance of firm or association of persons discontinuing its business, cannot apply in relation to a Hindu Undivided Family which has disrupted. Similar view has been expressed by Madras High Court.\textsuperscript{252} It has been held that the joint family which carried on business must continue to exist at the time of assessment. If the Hindu Undivided Family had disrupted, there is no joint family, subsisting on the date of assessment to E.P.T. The person who carried on the business does not exist and there cannot be an assessment on the Hindu Undivided Family.

In \textit{Shyam Sunder Bajaj v. Income Tax Officer},\textsuperscript{253} it was found that the family had already disrupted and that there was no material for the Income Tax Officer to hold that the so called disruption was fraudulent or colorable and that family had continued in existence. It was further found that Hindu Undivided Family had never been assessed prior to disruption. The Court held that assessment of the said family could not be initiated after disruption for the period when it was joint.

In \textit{Sri Lal Bagri v. CWT},\textsuperscript{254} it was held that Section 20 of the Wealth Tax Act is only a machinery Section directed towards assessment. Where the family has never been assessed as a Hindu Undivided Family and a preliminary decree for disruption was passed before the valuation date, Section 20 does not authorize the assessment of the members of the family as a Hindu Undivided Family.

\textsuperscript{252} S. Chattanatha Karyalan v. E.P.T.O., (1973) 92 ITR 384 (Mad.).

\textsuperscript{253} (1973) 89 ITR 317 (Cal.). See also Rameshwar Sirkar v. ITO, (1973) 88 ITR 374 (Cal.).

\textsuperscript{254} (1970) 77 ITR 902 (Cal.).
In *Roshan Di Hatti v. CIT*, the Supreme Court held that where it is claimed that the joint status of a Hindu Undivided Family was dissolved before the order of assessment was made the decision of Supreme Court in *Kalwa Devadattam’s Case* will have no application. In that case the Supreme Court was not called upon to interpret the expression, 'hitherto assessed as individual'. Section 25 A (1) and (3) did not lay down the proposition that the family not previously assessed to tax may be assessed after partition in the status of Hindu Undivided Family until an order under Section 25 A was passed.

Thus if a Hindu Undivided Family is able to avoid an assessment during the period of its existence and there is total partition, then the Income Tax Officer or Wealth Tax Officer is not competent to issue notices for reassessing income or wealth of the period prior to disruption. Neither Section 171 of the Income Tax Act nor Section 20 of the Wealth Tax Act, being machinery sections, enable the Department to assess such income or wealth.

(XVIII) Income of Hindu Undivided Family Assessed As Income of Individual:

There are cases where income of a Hindu Undivided Family has been assessed as the individual income of the karta of the family. In *CIT v. Thakur Ummed Singh*, it was held that in such a case if and when a return is filed claiming the status of Hindu Undivided Family, assessment should be made in that status irrespective of the fact that returns have been filed and assessment made in the status of individual for many years in the past. The assessments will

255. (1968) 68 ITR 177 (S.C.).


have to be made in the status of Hindu Undivided Family as claimed as the principle of res judicata does not apply where the assessee is able to prove that the correct status is that of Hindu Undivided Family, Similarly if the separate income of individual member of a Hindu Undivided Family has been assessed as the income of the Hindu Undivided Family and no objection has been taken either by the member or the Hindu Undivided Family, then there is no bar on the individual member to claim during the subsequent assessments that such income should be assessed in his hands in the status of individual.\(^{258}\) Of course it will have to be established by evidence that the income really belongs to the individual and not the Hindu Undivided Family.

While there is no bar on the assessee arguing in the course of a later assessment that what was being returned as the income of Hindu Undivided Family was actually his separate income and assessable in the status of an 'Individual' in his hands, yet, in *Dharamadas Agarwal v. CIT*,\(^ {259}\) where income from properties standing in the name of Smt. Manikbai, wife of the karta of the Hindu Undivided Family, were returned and assessed as income of the Hindu Undivided Family from the assessment year 1957-58 to the assessment year, 1964-65, the High Court in an appeal relating to subsequent assessment held on the facts of the case that the income from the properties were correctly assessed in the hands of the Hindu Undivided Family this finding was given on the ground that there was a categorical admission before the Tribunal that the properties standing in the name of Smt. Manikbai belonged to the Hindu Undivided Family and as such the Tribunal's finding of fact that the income was assessable in the hands of Hindu Undivided Family could not be said to be erroneous. The High Court based its finding on the decisions in *CIT v. Durga*

\(^{258}\) See *M. N. Murugappa Chettiar and Sons v. CIT*, (1952) 21 ITR 311 (Mad.).

\(^{259}\) (1934) 2 ITR 244.
Prasad More,\textsuperscript{260} where the assessee Hindu Undivided Family had included the income of the premises in his returns for several years, after objecting to the inclusion of that income in his total income in the assessment year 1942-43 and the Supreme Court held that this fact had to be taken into consideration by the taxing authorities in the absence of any satisfactory explanation and in Narayan Bhagwant Rao Gosain Balajiwale v. Gopal Vinayak Gosavi,\textsuperscript{261} where it was held that an admission is the best evidence that an opposing party can rely upon and though not inclusive is decisive of the matter, unless successfully withdrawn or proved erroneous.

In CIT v. Suresh Chandra Gupta,\textsuperscript{262} the returns had been filed in the status of Hindu Undivided Family but Income Tax Officer assessed it in the status of the individual without giving any notice or even indication to the assessee. The Tribunal held that assessment in the status of individual was not valid. The High Court held:

The assessment of the assessee in the status of an individual when the return was filed in the status of a Hindu Undivided Family is admittedly adverse to the interests of the assessee. Non compliance of this basic requirement is, therefore, fatal. The learned counsel for the Revenue was unable to point out any provision of law which permits such course being taken or which enables the making of such an order without any notice to the assessee.

\begin{itemize}
\item \textsuperscript{260} (1971) 82 ITR 540 (S.C.).
\item \textsuperscript{261} AIR 1960 S.C. 100.
\item \textsuperscript{262} Taxtation 89 (3) 74 (Raj.).
\end{itemize}
The assessment was held to be bad in law.

Deemed Income:

A question had been raised as to whether the considerations which determine the ownership of income by the Hindu Undivided Family or one of its members as an individual are equally applicable to deemed income. It has been held that in CIT v. Siksha Devi Bhagat,\(^{263}\) that where the karta of a Hindu Undivided Family is a partner in a firm representing the family, and the firm holds shares in a company which is closely held, the dividends from which are deemed to have been received by the firm attributable to the accumulated or undistributed profits of the company could be deemed to be the income of the Hindu Undivided Family to the extent of the share of the karta in the partnership. As such the deemed income would be assessed in the hands of the Hindu Undivided Family. The criterion to determine as to whether income belongs to a Hindu Undivided Family or to an individual are thus equally applicable to what is deemed as income under the Income Tax Act. The Court held that dividend income or the deemed dividend income ceases to be a dividend income in the hands of the partner as his share represents his income from the business of the firm.

According to Shastri Hindu Law, a gift cannot be made in favour of a person who was not in existence on the date of gift. A person capable of taking under a will must be in existence either in fact or in contemplation of law at the time of death of testator. This rule still applies to cases which are not covered by the Hindu Transfers and Bequests Act, 1941, Hindu Disposition of Property, Act, 1916 and the Hindu Transfer and Bequests (City of Madras) Act, 1921.

\(^{263}\) (1980) 124 ITR 765 (Cal.).
These propositions, however, have been altered by these Acts. A gift or bequest can be made to a person who was not in existence on the date of gift under the conditions laid down in these Acts if they are made by donor after the dates mentioned in those Acts. In *Raman Nadar v. S. Rosalomman*, the Supreme Court held that Hindu Law also allowed gifts and bequests in favour of unborn persons. The Supreme Court also held that a Hindu can create trust in favour of an unborn person, subject however to the restrictions, contained in the Hindu Law. Therefore, a trust created in favour of a Hindu Undivided Family or its member as a beneficiary of trust through its coparceners is valid even if the settler is another Hindu Undivided Family in view of the fact that there are branch families within the main family and the main family is entitled to create a trust in favour of the branch family. If a valid trust is created by a Hindu Undivided Family the income and wealth of the trust cannot be included in the assessment of the Hindu Undivided Family.

**(XIX) HINDU UNDIVIDED FAMILY AND PENALTIES**

**(a) Position Under Indian Income Tax Act, 1922**

The question as to whether under the Income Tax Income, 1922 penalties could be levied on a Hindu Undivided Family which had disrupted by the time penalty proceedings were initiated in respect of defaults committed before partition, was the subject matter of considerable litigation. The High Courts in a series of cases held that in order to attract the penal provisions of Section 28 of the Income Tax Act, 1922, the Hindu Undivided Family should exist not only at the time of initiation of penalty but also at the time when the orders levying penalty were passed.
In *CIT v. Sanichar Shah Bhim Sah*,265 the family was disrupted on 13th Feb. 1946 and an order under Section 25 A accepting partition was made in March 1949. Proceedings for levy of penalty initiated in March 1949 were completed on 24th April, 1950. Thus, the Hindu Undivided Family was not in existence on the date penalty action under Section 28(1) (c) had been initiated and also on the date penalty was levied. The Court held that penalty levied was neither legal nor valid.

In *S.A. Raju Chettiar v. Collector of Madras*,266 the question raised was of recovery of penalty imposed on 18th March 1948 on the basis of proceedings initiated in September, 1944. The partition of Hindu Undivided Family had taken place on 25th January 1946 but accepted under Section 25 A on 31st December 1948. The High Court held that Section 28 is a complete code in itself, regulating the procedure for the imposition of penalties prescribed and the provisions for the assessment and levy of tax will not apply. The penalty was not valid.

In *M. Subba Rao and Nageshware Rao v. CIT*,267 the Hindu Undivided Family was disrupted on 5th April 1943 and order under Section 25 A accepting partition was made on 6th Feb., 1946. Penalty order was passed in January 1947. It was held that Hindu Undivided Family has ceased to be a person within the meaning of Section 28 by reason of its disruption and no penalty could be levied on the family.

---

265. (1955) 27 ITR 307 (Pat.).
267. (1957) 31 ITR 867.
In CIT v. Mothu Ram Prem Chand,268 an order under Section 25 A accepting partition effected in December 1956 was passed in January 1960. The penalty order has been passed in November 1958. It was held that the mere fact that the disruption of the family was recognized by the Income Tax Officer subsequent to levy of penalty would not disentitle the family to claim that the imposition was illegal. Penalty levied after disruption was held to be illegal.

In CIT v. Tatawarthi Narayan Murthy,269 it was held that Income Tax Officer could not levy a penalty on 4th November, 1957 on a Hindu Undivided Family which had disrupted on 31st October 1957. It was held that Section 25 A does not provide for imposition of any such penalty under Section 28 and that an order to impose penalty under Section 28 on the 'person' which expression includes Hindu Undivided Family must be in existence on the date of such imposition. It was further held that in such cases the date of order under Section 25 A accepting partition is not material and Section 25 A (3) has no application. It is only the date of actual partition as recorded in the order made under Section 25(1) that is material and determines the actual date of cessation of the Hindu Undivided Family within the meaning of Section 28.

In Shriram Dagdulal v. CIT,270 it was found that though there was a factual recital in the statement of the case about the partition of Hindu Undivided Family, there was neither anything to show that there was any order passed under Section 25 A recording any partition nor was there any application on the subject. In the absence of any evidence regarding the application and passing of an order the Court held:

269. (1972) 83 ITR 58 (A.P.).
270. (1986) 161 ITR 42 (Bom.)
We must proceed on the assumption that the Hindu Undivided Family in question before us continued to be joint and was joint at the time when the order for penalty was passed.

Therefore, the Court rejected the contention of the appellant that no penalty could be levied on him since Hindu Undivided Family had disrupted prior to levy of penalty. There was nothing on facts to show that the person constituted by that Hindu Undivided Family had ceased to exist.

In *CIT v. Kiran Charandas M. Patel*, a partition was claimed to have taken place on 12th February 1962 where a penalty notice was served on 15th March 1958. The penalty order was passed on 20th Nov. 1965 Order under Section 171 (3) of the 1961 Act analogous to Section 25 A (1) of the old Act was passed on 21st June 1966 recognizing that partition had taken place on 12th February 1962. In these circumstances the Gujrat High Court held that the order of penalty was valid having been passed before an order under Section 171 was recorded though it was after the partition of the family. This view was justified by reference to Section 297(2)(f) of the 1961 Act, providing for levy of penalty in case the proceedings had been validity initiated under the old Act. The penalty proceedings were initiated on March 5, 1958 while partition was accepted from 12th Feb. 1962 by an order under Section 171 dated 21st June 1956. The proceedings had, therefore, been initiated when the Hindu Undivided Family was in existence and were held to be validly instituted for the purpose of Section 297 (2) (f) of the Income Tax Act, 1961.

The Supreme Court in *Guri Shankar Chandra Bhan v. CIT*,

271. *(1975) 98 ITR 141*.

272. *(1976) 103 ITR 772 (S.C.)*.
clarified that as a Hindu Undivided Family is deemed to continue as such until an order under Section 25(A) (i) accepting the disruption is passed, an order imposing penalty before an order under Section 25A(3) is passed is valid. In the case before them the family claimed to have been partitioned on 22nd June 1956 but an order under Section 25A(1) was passed only on 26th March, 1962. Penally in this case was imposed on 25th March 1958, after disruption of the family but before an order under Section 25A(1) was passed. The Supreme Court held that there was no bar on the imposition of penalty in these circumstances because under Section 25 A, family is deemed to continue to be joint till an order under Section 25(1) recognizing its disruption is passed. Though the family was partitioned as far back as 22nd June, 1956, it is deemed to continue by a legal fiction envisaged in Section 25A(3), till an order under Section 25(1) is passed. Therefore, in law the family was in existence when the penalty proceedings were completed on 25th March 1958.

(b) Position under the Income Tax Act, 1961

The provisions of the Income Tax Act, 1961 now have placed the matter beyond doubt. In view of the specific provision of Section 171 (8) of the Income Tax Act, 1961 there is no bar whatsoever on the levy of penalty after the partition of Hindu Undivided Family in respect of the defaults during the period when the Hindu Undivided Family was joint. Such defaults are subject to penalty even as the income earned before partition is subjected to tax after partition. Thus, it is now settled law that there is no bar whatsoever to the levy of penalty on a Hindu Undivided Family when a total partition has been recognized under Section 171 of the Income Tax Act, 1961.

(c) Penalty After Death of Karta

If a return is filled by the karta of a Hindu Undivided Family, can a
penalty for concealment be levied on the successor karta who was not in the knowledge of any concealment and could not be accused of a guilty mind or mens rea or contumacious conduct. The income tax proceedings are taken against the Hindu Undivided Family but the return is signed by the karta who acts on behalf of the Hindu Undivided Family. He is not an agent or a trustee but acts in a fiduciary capacity. Therefore, there is no difficulty in attributing the consciousness of the karta to the Hindu Undivided Family which he represents considering the Hindu Undivided Family as a unit, there is no doubt that penalty proceedings can be validly continued for concealment of income after the death of the karta of the Hindu Undivided Family.\(^{273}\)

The Court held that penalty proceedings for concealment are taken against the Hindu Undivided Family which is an assessable entity and which shall be deemed to have committed concealment of the income and not against the karta personally. In *G. Krishnaswami Naidu v. CIT*,\(^ {274}\) the Court held that Hindu Undivided Family is a juristic entity and any change in the karta would not affect the legal continuity of the juristic entity which continues to remain the same and hence proceedings for levy of penalty under Section 28(1)(c) of Indian Income Tax Act, 1922, in respect of a return submitted by the previous karta could be initiated even after his death.

However in *Radha Rukmani Ammal v. CIT*,\(^ {275}\) it was held that where the earlier karta had died before filing the return, the penalty for concealment could not be levied as the deceased karta had not concealed any income. This was so as the person who filed the return was not conscious of any concealment.

\(^{273}\) *G. Krishnaswami Naidu v. CIT*, (1973) 89 ITR 202 (Mad.). *Nataraa Goundu v. CIT*, (1963) 50 ITR 487 (Mad.).

\(^{274}\) *Ibid.*

\(^{275}\) (1957) 31 ITR 704 (Mad.).
(XX) Rates of Tax for a Specified Hindu Undivided Family.

While prescribing rates of taxes, the Finance Act have been making a clear distinction between Hindu Undivided Families which may be described as specified and non-specified. Non-specified Hindu Undivided Family is a family none of whose coparceners or members has income above the taxable minimum. Any other Hindu Undivided Family whose member or coparcener is assessable for an income above the taxable minimum is a specified Hindu Undivided Family. Such a Hindu Undivided Family will be governed by rates of taxes which are separately mentioned in sub-paragraph II of para A of Part III of the Finance Act. The non-specified Hindu Undivided Familys are governed by the same rates as apply to any individual or unregistered firm or association of person or body of individuals while specified Hindu Undivided Family are charged to tax at a higher rate.

This discriminatory provision of higher rates of taxes would apply even if none of the coparceners have taxable income or wealth but a female member of Hindu Undivided Family is paying either income tax or wealth tax on her individual income or property. If, however, the said member has relinquished her rights in the property of the Hindu Undivided Family, then it cannot be held to be a specified Hindu Undivided Family. Where none of the coparceners have taxable wealth or income but a female member has such wealth or income, will it constitute a specified Hindu Undivided Family liable to higher rate of tax was the subject matter of decision in S. Venka Reddy v. CIT,276 where only one female member was having income above the minimum exemption limit. The High Court observed:

Learned counsel for the assessee contended that the

higher rates prescribed in sub-para II are applicable only in the case of a joint family where a male member derives the income in excess of the minimum specified therein. We do not see any support for the above plea. The provision is clear that if any member of the family derives income in excess of the minimum specified in sub para II, then the higher rate of tax has to be applied. There are no ground to qualify the expression member as a male member. If the intention of the legislature was to refer to a male member, it would have been more appropriate to use the expression coparcener. On the contrary, the legislature used the expression member advisedly so that every joint family having any member, whether male or female, deriving income in excess of the minimum specified in sub para II will be subjected to tax at the rates specified in sub para II. We are, therefore, unable to accept the contention of the learned counsel that the Revenue erred in taxing the income of the joint family at the rates specified in sub para II.

Thus, even if a female member is the only person in the family liable to tax the Hindu Undivided Family will be liable to tax at higher rates and it is not necessary that a coparcener should be taxed at a income above the minimum exemption limit.

Another question which arises is what is meant by the total income of the previous year, an expression found in sub-para II of Part I of the First Schedule. Does it include the income under Section 64 considered part of total income of a member of Hindu Undivided Family for purposes of defining the specified status of Hindu Undivided Family. In Hindu Undivided Family of
Ganji Krishna Rao v. Income Tax Officer,\textsuperscript{277} the Hindu Undivided Family was held to be specified because a female members' total income exceeded the minimum exemption limit. Though her own income was only Rs. 5730 yet the income of minor son who was not a member of the partitioned Hindu Undivided Family was 1,03,315 and therefore after invoking Section 64, the Hindu Undivided Family was held to be specified.

In \textit{CIT} v. G. Gopal Rao,\textsuperscript{278} it has been held that the income although derived by his minor children is held to be his income and an obligation is imposed on the assessee under Section 139 (1) of the Act to declare such income in the return filed by him. Therefore, income clubbed under Section 64 represented the case of the female member as part of her total income and as this income was above the minimum liable to tax, the Hindu Undivided Family was correctly held to be specified.

(XXI) Detention of Karta for Non-payment of Hindu Undivided Family Taxes:

Under the direct tax laws when a person including a Hindu Undivided Family commits default in payment of taxes due and the officer concerned is not able to recover the same by his own efforts, he may issue a certificate to the Tax Recovery Officer for the recovery of the taxes due. The Tax Recovery Officer has the power to attach the properties of the defaulter and to sell the same by Public auction to realise the taxes. Under Rule 76 of Schedule II of the Income Tax Act, 1961, the Tax Recovery Officer can arrest and detain a defaulter in

\begin{itemize}
\item \textsuperscript{277} 15 ITD 209 (Hyd.).
\item \textsuperscript{278} (1985) Tax L.R. 273 (A.P.).
\end{itemize}
unit prison. In Kapurchand Shrimal v. Tax Recovery Officer, the question for decision was whether Karta of the Hindu Undivided Family could be arrested and detained in civil prison when a Hindu Undivided Family is in default. The Supreme Court laid down the following guidelines in this regard:

1. A Hindu Undivided Family is a distinct taxable entity apart from the individual members who constitute the family.

2. For attachment of properties of Hindu Undivided Family, proceedings may be started against the family and karta manager represents the family in such proceedings before the Tax Recovery Officer.

3. The assessee alone is deemed to be in default for non-payment of tax and liability to arrest and detention on failure to pay the tax due is incurred by the assessee alone.

4. The karta, by virtue of his status, is competent to represent the Hindu Undivided Family but on that account he cannot, for the purpose of Section 222 of the Income Tax Act, 1961 be deemed to be an assessee in default.

5. For the default of the family in payment of tax, the karta cannot be arrested or detained in prison. There is no provision in the Act which deemed the karta to be an assessee for the purpose of assessment and recovery of tax. Nor is there a provision to treat the karta as an assessee in default. The manager signs the return on behalf of the Hindu Undivided Family and receives notices on its behalf but he is not deemed to be the assessee where income assessed is that of Hindu Undivided Family.

6. The expression person in Section 276, 276A and 277 of the Income Tax Act, 1961 is not used in the sense in which it is defined in Section 2(31) of the Act.

Thus the recovery of tax from a defaulter Hindu Undivided Family can be realized by attachment of its properties and the sale thereof. However, there is no power to realise the tax, as in the case of an individual assessee, by arrest and detention in civil prison of the karta of the Hindu Undivided Family. The Supreme Court observed that because the manager of a Hindu Undivided Family is authorized to sign and verify the return of income and a notice under the Act could be served on him when it is addressed to a Hindu Undivided Family and such service is treated as service upon the Hindu Undivided Family for the purpose of the Act, the manager cannot be deemed to be the assessee when the income assessed is of the Hindu Undivided Family.

Section 171(6) of the Income Tax Act, 1961 for recovery of taxes in case of partitioned Hindu Undivided Family applies to a situation where the assessment of a Hindu Undivided Family is complete under Section 143 or 144 of the Income Tax Act, 1961. This power of recovery can have no application where the assessment of a Hindu Undivided Family is completed under Section 23(3) or Section 23(4) of the Income Tax Act, 1922. Such a case would be governed by Section 25 A of the Old Act, which does not impose any personal liability on the member in case of partial partition. Such an action would mean giving retrospective effect to Section 171 (6) which is not warranted either by express language of the Section or by necessary implication. The Court held that Section 171 (6) and Section 171 (7) could not be invoked for recovery of tax for the assessment year 1951-52 to 1956-57 completed under the old Act.