

**(1984) 12 RAJ CK 0009**

**In the Rajasthan High Court**

**Case No : Income Tax Reference No. 4 of 1974**

Additional Commissioner of Income Tax

APPELLANT

Vs

Emery Stone Mfg. Co.

RESPONDENT

**Date of Decision : 05-12-1984**

**Acts Referred:**

Income Tax Act, 1961 — Section 187(2)  
Partnership Act, 1932 — Section 42

**Citation : (1985) 47 CTR 204 : (1985) 153 ITR 150 : (1985) RLW 31**

**Hon'ble Judges : S.S. Byas, J; S.K. Mal Lodha, J**

**Bench : Division Bench**

**Advocate : J.P. Joshi, for the Appellant; S. Gupta, for N.P. Gupta, for the Respondent**

## **Judgement**

Mal Lodha, J.—The Income Tax Appellate Tribunal, Jaipur Bench, Jaipur (hereinafter referred to as "the Tribunal") has referred the following question for our decision :

"Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that Section 187(2) of the Income Tax Act, 1961 (No. XLIII of 1961) (for short "the Act"), was not applicable in this case, and further that two separate assessments be made on the firm for the assessment year 1969-70?"

2. The assessee-firm, M/s. Emery Stone Mfg. Co., Kuchaman Road, derived income from manufacture and sale of chakkies. The assessment year in question is 1969-70. The assessee-firm consisted of six partners as is evidenced from the partnership deed dated April 12, 1965 :

1. Kanhaiyalal Saboo ;
2. Durgaprasad Saboo ;
3. Ramprasad Saboo ;
4. Madanlal Saboo;

5. Mohanlal Saboo;

6. Radheyshyam (minor).

3. Kanhaiyalal Saboo expired on March 12, 1968. A deed of dissolution of the partnership was executed on March 12, 1968. After that, a new partnership deed dated March 27, 1968, was executed by Durgaprasad Saboo, Ramprasad Saboo, Madanlal Saboo and Mohanlal Saboo. Radheyshyam, minor, was also admitted to the benefits of the partnership. This partnership deed was to be operative from March 13, 1968. The assessee-firm filed two returns : (i) for the period ending on March 12, 1968, and (ii) for the period from March 13, 1968, to October 21, 1968. The Income Tax Officer, vide his order dated December 18, 1969, determined the income of assessee-firm for the two periods in question at one piece. An appeal was taken and the Appellate Assistant Commissioner in appeal held that the ITO should have treated the firm as dissolved on the death of Kanhaiyalal and, therefore, the old firm ceased to exist and a new firm was formed under a new deed of partnership dated March 27, 1968, which was a different and independent entity. He, therefore, allowed the appeal in part and granted the following reliefs :

"1. Income of the first period, viz., Rs. 41,618, vide para. 4 to be deleted.

2. The addition on account of alleged excess price of Rs. 2,650 added by the ITO is directed to be deleted, vide para. No. 6.

3. A reduction in the travelling expenses of Rs. 300 is allowed, vide para. 7. "

4. Aggrieved, the Department filed an appeal before the Tribunal and the Tribunal, vide its order dated November 18, 1972, found that with the death of Kanhaiyalal, the firm automatically stood dissolved by operation of law and any change in the constitution of the firm or the shares of the partners could not be attributed to the old firm as it was non-existent. As a necessary consequence of that, the Tribunal opined that an altogether new firm came into being and to such a firm, the provisions of Section 187 of the Act did not apply. The Tribunal, therefore, while agreeing with the AAC, held that there being two firms, separate assessments had to be effected. An application u/s 256(1) of the Act was moved by the Additional Commissioner of Income Tax, Rajasthan, Jaipur. In these circumstances, the Tribunal has referred the aforesaid question for our decision.

5. We have heard Mr. J. P. Joshi, learned counsel for the Revenue, and Mr. Sudesh Gupta for Mr. N. P. Gupta, learned counsel for the asses-see-firm.

6. The partnership deed dated April 12, 1965, inter alia, provides that the partnership shall be "at will". Clause (15) of the partnership deed dated April 12, 1965, is as follows :

"(15). The provisions of the Indian Partnership Act, 1932, and the statutory modification thereof shall govern the relationship between the partners on the matters not provided for in these presents."

7. Section 42 of the Partnership Act deals with dissolution on the happening of certain contingencies. The relevant part of Section 42 is as follows :

"Section 42. Dissolution on the happening of certain contingencies.-

Subject to the contract between the partners, a firm is dissolved,--...

(c) by the death of a partner ; and ...",

8. Dissolution u/s 42 of the Partnership Act is subject to the contract between the partners. If the partnership deed provides for the continuance of the partnership after the death of a partner, then the firm will not be dissolved. From the partnership deed dated April 12, 1965, no such contract for the continuance of the partnership after the death of a partner can be inferred. In the case on hand, after the death of Kanhaiyalal (partner) a deed of dissolution of the partnership was executed by the remaining partners. The dissolution deed dated March 12, 1968, provides that as Kanhaiyalal (partner of the assessee-firm) suddenly expired on March 12, 1968, Durgaprasad Saboo, Ramprasad Saboo, Madanlal Saboo and Mohanlal Saboo amicably agreed to dissolve the partnership with effect from March 12, 1968, on the terms mentioned therein. Clause (3) thereof is as follows :

"(3) That a new partnership firm has been constituted from today and this new firm has agreed to take over all assets and liabilities of the old firm."

9. Thereafter, on March 27, 1968, a new partnership deed was executed by the four partners. Radheyshyam (minor) was also admitted to the benefits of the partnership.

10. The question before the Tribunal was whether there was any change in the constitution of the firm within the meaning of Section 187(2) of the Act. Section 187 of the Act deals with change in the constitution of a firm. The material portion of Section 187 of the Act is as follows :

"Section 187(1). Where at the time of making an assessment u/s 143 or Section 144, it is found that a change has occurred in the constitution of a firm, the assessment shall be made on the firm as constituted at the time of making the assessment :

Provided that--...

(2) For the purposes of this section, there is a change in the constitution of the firm-

(a) if one or more of the partners cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change ; or

(b) where all the partners continue with a change in their respective shares or in the shares of some of them."

11. Section 188 of the Act deals with succession of one firm by another firm and Section 189 deals with firm dissolved or business discontinued. After taking into consideration the provisions of Section 187 of the Act and Sections 31 to 38 of the Partnership Act, the Tribunal has observed in para. 13 of its order dated November 18, 1972, as follows :

"We are, therefore, of the considered opinion that when the Legislature eliminated the words "or that a firm has been newly constituted" (of the old Section 26(1)) while enacting the new Section 187, it was not without meaning. This necessarily implied that the case of a change in the constitution of the firm would not include those of dissolution and constitution of new firms. In our view, a change in the constitution presupposes that the firm continues to subsist. On the other hand, in cases where the firm has stood dissolved, the question of change in the constitution does not arise."

12. It held that with the death of one partner, the firm automatically stood dissolved by operation of law and that any change in the constitution of the partnership or their shares, therefore, could not be attributed to the old firm, as it was non-existent. It further held that an altogether new firm came into being and to such a firm, the provisions of Section 187 did not apply. u/s 42 of the Partnership Act, on account of the death of Kanhaiyalal, the partnership stood dissolved and after his death on March 12, 1968, on the same day, a deed of dissolution of partnership was executed and thereafter, on March 27, 1968, a new partnership deed was executed by the four partners and minor, Radheyshyarn, was admitted to the benefits of the partnership. When a firm has been dissolved and a new partnership has come into existence and that partnership consists of the remaining partners, it cannot be a case of change in the constitution of the firm as envisaged by Section 187(2) of the Act. The new firm had come into existence after the death of Kanhaiyalal. After execution of the dissolution deed dated March 12, 1968, though the partners are common between the old and new firms, the new firm will be considered to succeed to the old firm attracting the application of Section 188 of the Act. The expression "change in the constitution of the firm" used in Section 187 of the Act presupposes that the firm continues to subsist but when a firm has been dissolved, it cannot be said that it is still continuing.

13. Sections 25(4) and 26(2) of the Indian I.T. Act, 1922 ("the old Act") were examined in Jittanram Nirmalram Vs. Commr. of Income Tax, . In that case, a firm carrying on a business consisted of four partners. The deed of partnership empowered each of the partners to exercise the right of dissolving the partnership at will. One of the partners gave notice and severed his connection with the firm and commenced a new business of his own. His share in the profits and assets was paid to him partly in cash and partly by allotting to him a shop owned by the firm. The remaining three partners continued to carry on the same old business under the old firm name. The question arose whether there was a succession to the business within the meaning of Section 25(4) of the old Act. It

was held by the Patna High Court that the old firm stood dissolved as a result of the notice given by the partner and the new firm consisting of the remaining three partners must be treated as a different entity. It was further held that there was, therefore, a succession to the business within the meaning of Section 25(4).

14. In *Bhauasa Ganusa Pawar and Co. Vs. Commissioner of Income Tax, Poona*, it was held as under (headnote) :

"The mere circumstance that the business has continued without interruption and the new firm has come into existence from the moment of the death of the deceased partner of the old firm is not sufficient to hold that there has been a mere change in the constitution of the old firm. The legal effect of the death of the partner of the old firm was dissolution and the firm thereafter constituted is a new firm. The firm which existed during the year of account was the old firm and the proper procedure, therefore, was to ask for the renewal of the registration of the old firm." (emphasis\* supplied).

15. In *Dahi Laxmi Dal Factory Vs. Income Tax Officer and Another*, the partnership consisted of two partners and three minors were also admitted to the benefits of the partnership. One of the partners died and after his death, his son and the other partner took over the business of that firm and a fresh partnership deed was executed and three minors were also admitted to the benefits of the firm. A contention was raised that on the death of J, the old firm stood dissolved and as after his death, the new firm took over the business, two assessments should be made ; one against the old firm and the other against the new firm for the respective periods during which they were in existence during the relevant previous year. On those facts, it was held (p. 526) :

" .....that Section 187 applies only where a firm is reconstituted in accordance with Sections 31 and 32 of the Indian Partnership Act, namely, when a new partner is taken or an existing partner retires with the consent of all the partners or without their consent if the contract of partnership so provides."

16. It was further held as under (p. 526) :

"But where a firm is dissolved either by agreement of the partners or by operation of law and another firm takes over the business, that will be a case of succession governed by Section 188 of the Act even though some of the partners of the two firms are common."

17. *R.B. Jessa Ram Fateh Chand Vs. Commissioner of Income Tax*, was dissented from. Seth J., however, did not subscribe to the view taken by the other two learned judges of the Allahabad High Court. *Dahi Laxmi Dal Factory Vs. Income Tax Officer and Another*, was followed by *C. S. P. Singh and K. C. Agarwal JJ. in Addl. Commissioner of Income Tax Vs. Dilsukh Rai Madho Prasad*,

18. Sections 187 and 188 of the I.T. Act, 1961, and Section 42(c) of the Partnership Act were considered by a Full Bench of the Andhra Pradesh High

Court in Addl. CIT v. Visakha Flour Mills [1977] 108 ITR 466 . Even according to this ruling, when there is only a change in the constitution but not dissolution and succession by another firm, the assessment must be made as a single unit for the entire period. The Full Bench did not subscribe to the view taken in Dahi Laxmi Dal Factory Vs. Income Tax Officer and Another,

19. Sections 187 and 188 of the I.T. Act, 1961, were examined in Addl. Commissioner of Income Tax, Gujarat Vs. Harjivandas Hathibhai, In that case, one of the partners died and a new partnership was entered into between the three surviving partners and the widow of the deceased partner. The question regarding dissolution of firm and applicability of Section 187 arose for determination. The Division Bench of the Gujarat High Court observed as under (headnote) :

"On general principles unless the words of the Income Tax Act compel us to do so, it would not be correct to depart from the well-known principles of partnership law. Under partnership law, even though a partner retires, the firm continues as before. What is meant by a change in the constitution of the firm is the coming in of a new partner with the consent of all the existing partners or the retirement of a partner with the consent of all the partners ; in such cases there is a mere change in the constitution of the firm and nothing more. The same firm continues as before. The question of dissolution of a firm either by operation of law or by act of parties is a different thing altogether. When a firm is dissolved, the old relationship comes to an end and a new relationship comes into existence and if the succeeding partnership firm continues the old business, then there is succession of one firm by another as contemplated by Section 188. Section. 187(2) merely specifies two kinds of changes in the constitution of the firm. Section 187(2)(a) refers to the continuance of the firm on one or more of the partners ceasing to be partners or one or more new partners being admitted. It deals with cases of retirement of partners and introduction of new partners but the firm under the Indian Partnership Act would continue in such a case. Therefore, all that Section 187(2) points out is that with the retirement of one or more of the partners, so long as one of the old partners continues and with the introduction of new partners so long as one of the old partners continues, there is a mere change in the constitution of the firm. Again, u/s 187(2)(b), by a mere variation in the respective shares of the partners or shares of some of the partners, there is no change in the firm itself. The old firm still continues and that is emphasised by Section 187(2)(b)." (emphasis\* supplied).

20. The learned judges agreed with the reasoning of the majority in Dahi Laxmi Dal Factory Vs. Income Tax Officer and Another,

21. In I. RAMAKRISHNAIAH and SONS Vs. COMMISSIONER OF Income Tax, ORISSA., it was observed that (headnote) : "Where a partner dies and there is no clause in the original deed or other implied agreement to continue the firm despite such death, there is a dissolution of the partnership u/s 42(c) of the Partnership Act and the mere fact that the business has been continued would

not lead to the inference that there has been only a change in the constitution of the firm."

22. In *Mathurdas Govardhandas Vs. Commissioner of Income Tax*, difference between dissolution and change in the constitution of the firm was pointed out. In that case, the partnership deed did not provide for the continuation of the partnership in the event of the death of any of the partners. One of the partners died and the remaining partners entered into a fresh partnership with a change in the division of profits. The same business was carried on with the same sets of books. The new firm applied for registration of the firm. In these facts, it was held that two assessments are to be made, one till the death of the partner and the other for the specific period. *Dahi Laxmi Dal Factory Vs. Income Tax Officer and Another*, and *Addl. Commissioner of Income Tax, Gujarat Vs. Harjivandas Hathibhai*, were followed. *Addl. CIT v. Visakha Flour Mills* [1977] 108 ITR 466 was dissented from.

23. A similar question also arose in *Additional Commissioner of Income Tax Vs. Thyagasundara Mudaliar and Munuswami Mudaliar and Co.*, . In that case, the question that came up for consideration was as to whether the assessment should be made in respect of the firms u/s 187 of the Act, viz., by a single assessment for the year 1969-70, or separate assessments in respect of the two firms. One of the partners died and new deeds of partnerships were drawn up with effect from the next day of the death of the partner in respect of both the firms. The claim of the two firms that two separate assessments one up to October 17, 1968, the date of death and the other from October 18, 1968, would have to be made was negatived by the ITO and the AAC on the ground that what had happened was only a change in the constitution of the firm and hence Section 187 of the Act applied and as such, only a single assessment should be made. The Tribunal, however, took the view that Section 187 had no application and separate assessments for the two periods should be made u/s 188. On a reference, it was held that as far as the firm of two partners was concerned, on the death of one of the partners, it automatically stood dissolved and hence no question of change in the constitution of the firm arises. It was further held that the Tribunal was right in its view that two separate assessments would have to be made. While considering Section 42(c) of the Partnership Act, it was observed as under (head-note) :

"...that with regard to the other firm of four partners, since the partnership deed did not contain any provision that the firm would continue undissolved notwithstanding the death of any of the partners, Section 42(c) of the Partnership Act came into operation and the death of one partner brought about the dissolution of the firm. Once the firm came to an end, what happened subsequently was merely succession of a new firm to the business and hence in this case also, there was no change in the constitution of the firm as contemplated u/s 187. "

24. In the case on hand, the partnership deed dated April 12, 1965, did not

provide for the continuance of the partnership firm after the death of one of the partners and the provisions of the Partnership Act were made applicable. u/s 42(c) of the Partnership Act, the firm stood dissolved on the death of Kanhaiyalal and had become non-existent. A deed of dissolution was executed on the same day, i.e., March 12, 1968. After the dissolution, the old firm could not continue. Thus, the firm stood dissolved by operation of law as per the provisions of Section 42(c) of the Partnership Act. The books of account were closed and a separate profit and loss a/c and balance-sheet for the period ending on March 12, 1968, were drawn up. Subsequently, on March 27, 1968, a new partnership deed was executed. This firm was constituted by the five old partners and the minor, Radhey-shyam, having benefits of the partnership. We respectfully differ from the view taken in Addl. CIT v. Visakha Flour Mills [1977] 108 ITR 466 by the Full Bench of the Andhra Pradesh High Court. Keeping in view the language used in Section 187(2) of the Act and the principles laid down in Dahi Laxmi Dal Factory Vs. Income Tax Officer and Another, Addl. Commissioner of Income Tax Vs. Dilsukh Rai Madho Prasad, I. RAMAKRISHNAIAH and SONS Vs. COMMISSIONER OF Income Tax, ORISSA., Mathurdas Govardhandas Vs. Commissioner of Income Tax, and Addl. Commissioner of Income Tax, Gujarat Vs. Harjivandas Hathibhai, we are of the opinion that the Tribunal was right in holding that with the death of Kanhaiyalal (one partner), the firm automatically stood dissolved by operation of law and that a new firm came into being and to such a firm, Section 187(2) of the Act is not applicable and that two separate assessments are to be made on the firm for the assessment year 1969-70.

25. We answer the question referred to us in the affirmative, i.e., in favour of the assessee and against the Revenue. There will be no order as to costs of this reference.

26. Let the answer be returned to the Tribunal in accordance with Section 260(1) of the Act.