

(1978) 12 MAD CK 0017

In the Madras High Court

Case No : Tax Case No's. 387 of 1974 and 497 of 1978 (Reference No's. 200 of 1974 and 317 of 1978)

Additional Commissioner of Income Tax

APPELLANT

Vs

Thyagasundara Mudaliar

RESPONDENT

Date of Decision : 06-12-1978

Acts Referred:

Constitution of India, 1950 — Article 226
Income Tax Act, 1961 — Section 143, 144, 170, 187, 187(2)
Partnership Act, 1932 — Section 31, 35, 4, 42, 42(c)

Citation : (1981) 127 ITR 520

Hon'ble Judges : Sethuraman, J;Ismail, J

Bench : Division Bench

Advocate : J. Jayaraman and Mrs. Nalini Chidambaram, for the Appellant; K. Srinivasan, for the Respondent

Judgement

Ismail, J.—Though these two tax cases raise a similar question and deal with the same assessment year 1969-70, the facts are slightly

different, and we shall deal with the facts separately. Tax Case No. 387 of 1974 is concerned with a partnership firm by name M/s. D.

Thiagasundara Mudaliar. Under a deed of partnership executed on February 11, 1966, the firm came into existence and consisted of two partners,

viz., D. Thiagasundara Mudaliar having 60% share and M. Govindaraja Mudaliar having 40% share. Govindaraja Mudaliar died on October 17,

1968. On January 17, 1969, a new deed of partnership was drawn up which recited that the new partnership came into effect from October 18,

1968, consisting of D. Thiagasundara Mudaliar with 70% share, M.G. Kannan, the major son of the deceased, Govindaraja Mudaliar, with 15%

share, and M.G. Subramaniam, the minor son of the deceased, Govindaraja

Mudaliar being admitted to the benefits of the partnership to the extent of 15% share. Admittedly, the partnership deed dated February 11, 1966, did not contain any provision that, in the event of any of the partners ceasing to be a partner, the partnership shall not stand dissolved, but shall continue.

2. T.C. No. 497 of 1978 is concerned with a firm by name M/s. V. Muniswamy Mudaliar & Company, which came into existence under a deed

of partnership dated September 4, 1965, consisting of V. Muniswamy Mudaliar with 40% share, D. Thiagasundara Mudaliar with 21% share, M.

Govindaraja Mudaliar with 21% share and V. Munirathnam with 18% share. This partnership deed also did not contain a clause that the firm shall

continue un dissolved notwithstanding the death or retirement of any of the partners. On the death of Govindaraja Mudaliar on October 17, 1968,

a new deed of partnership was drawn up on December 15, 1968, with effect from October 18, 1968, consisting of the following persons: V.

Muniswamy Mudaliar with 40% share, D. Thiagasundara Mudaliar with 20% share, V. Munirathnam with 20% share and M. G. Raman, the

major son of the deceased, Govindaraja Mudaliar with 10% share, and M.G. Manoharan, the minor son of the deceased, Govindaraja Mudaliar,

being admitted to the benefits of the partnership with 10% share.

3. The question that came up for consideration was as to whether the assessment should be made in respect of these firms under s. 187 of the I.T.

Act, 1961 (to be referred to hereafter as "the Act"), viz., by a single assessment for the year 1969-70, or separate assessments in respect of the two firms in both these cases.

4. The ITO as well as the AAC took the view that what had happened was only a change in the constitution of the firm, and, therefore, s. 187 of

the Act applied and consequently a single assessment alone has to be made in respect of both the firms.

5. However, on appeal, the Tribunal took the view that s. 187 had no application, and, therefore, the assessment had to be made under s.188 of

the Act, with the result, in respect of these firms, separate assessments had to be made, one on the firm as it stood before the death of Govindaraja

Mudaliar, and another on the firm as reconstituted after the death of Govindaraja Mudaliar. It is this decision of the Tribunal which has given rise to

the following common question being referred for the opinion of this court on an application being made by the department to the income tax

Appellate Tribunal under s. 256(1) of the Act:

Whether the Appellate Tribunal was right in holding, in the facts and circumstances of the case, that the provisions of section 187(2) of the income

tax Act, 1961, were not applicable and that for the assessment year 1969-70, two separate assessments had to be made for the periods from

April 1, 1968, to October 17, 1968 (i.e., the date of the death of Govindaraja Mudaliar) and from October 18, 1968, to March 31, 1969, on the

ground that consequent to the death of Govindaraja Mudaliar there was a succession by a new firm to the predecessor firm?

6. We shall now set out the terms of s. 187 as well as s. 188 of the Act. Section 187 of the Act reads as follows:

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--

(i) the income of the previous year shall, for the purposes of inclusion in the total incomes of the partners, be apportioned between the partners

who, in such previous year, were entitled to receive the same; and

(ii) when the tax assessed upon a partner cannot be recovered from him, it shall be recovered from the firm as constituted at the time of making the

assessment.

(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.

7. Section 188 of the Act reads:

188. Where a firm carrying on a business or profession is succeeded by another firm, and the case is not one covered by section 187, separate

assessments shall be made on the predecessor firm and the successor firm in accordance with the provisions of section 170.

8. The question is, whether s. 187 of the Act applies at all. Sub-section (2) of that section has more or less denned the expression ""a change in the constitution of the firm"" for the purpose of that section. Under s. 187(2)(a) of the Act, the primary requisite for constituting a change in the constitution of the firm is the continuance of one or more of the persons who were partners of the firm before the change as partners after the change. It is desirable to deal with the case of the two firms separately.

9. As far as the firm, M/s. D. Thiagasundara Mudaliar is concerned, the firm consisted of only two partners. As soon as Govindaraja Mudaliar

died on October 17, 1968, the firm came to an end, and, therefore, the question of there being merely a change in the constitution of the firm does

not arise as on the death of Govindaraja Mudaliar, the surviving sole partner, viz., D. Thiagasundara Mudaliar, became the absolute and exclusive

owner of the business. As we have pointed out already, admittedly, the partnership deed dated February 11, 1966, did not contain any provision

enabling the firm to continue undissolved notwithstanding the death of one of the partners. As a matter of fact, that cannot be the position in law

where the firm consisted of only two partners even if there had been such a provision in the partnership deed. That was the view taken by the

Supreme Court in Commissioner of Income Tax, Madhya Pradesh, Nagpur and Bhandara Vs. Seth Govindram Sugar Mills, .

10. Section 42 of the Partnership Act, 1932, reads:

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

(a) if constituted for a fixed term, by the expiry of that term;

(b) if constituted to carry out one or more adventures or undertakings, by the completion thereof;

(c) by the death of a partner; and

(d) by the adjudication of a partner as an insolvent.

11. Thus, under this provision, in the absence of a contract to the contrary, the death of a person automatically brings about a dissolution of the

firm. However, the very section contemplates the existence of a contract to the contrary which will have the effect of the firm continuing

notwithstanding the death of a partner. But, such a situation will have no application to a case where the firm consisted of only two partners,

because the moment one partner dies, the firm automatically and inevitably comes to an end, and the surviving partner becomes the absolute owner

of the property. It is in this context only the Supreme Court in the decision referred to above pointed out thus (page 514):

Partnership, u/s 4 of the Partnership Act, is the relation between persons who have agreed to share the profits of a business carried on by all or

any of them acting for all. Section 5 of the said Act says that the relation of partnership arises from contract and not from status. The fundamental

principle of partnership, therefore, is that the relation of partnership arises out of contract and not out of status. To accept the argument of the

learned counsel is to negative the basic principle of the law of partnership. Section 42 can be interpreted without doing violence either to the

language used or to the said basic principle. Section 42(c) of the Partnership Act can appropriately be applied to a partnership where there are

more than two partners. If one of them dies, the firm is dissolved; but if there is a contract to the contrary, the surviving partners will continue the

firm. On the other hand, if one of the two partners of a firm dies, the firm automatically comes to an end and, thereafter, there is no partnership for

a third party to be introduced therein and, therefore, there is no scope for applying clause (c) of section 42 to such a situation. It may be that

pursuant to the wishes or the directions of the deceased partner the surviving partner may enter into a new partnership with the heir of the

deceased partner, but that would constitute a new partnership.

12. Thus, it is clear that as far as the firm, M/s. D. Thiagasundara Mudaliar, is concerned, the moment Govindaraja Mudaliar died on October 17,

1968, the firm came to an end and the firm that was brought into existence by the deed dated January 17, 1969, with effect from October 18,

1968, was entirely a new firm. In fact, a decision of this court, to which one of us was a party, viz Kaithari Lungi Stores Vs. Commissioner of

Income Tax, has taken the same view apart from holding that the expression ""partners ceasing to be partners"" in s. 187(2) of the Act would include

a case of death of a partner. In that decision, it was held by this court thus (page 163):

Change in the constitution of a firm may arise in the following cases: By admission, retirement, expulsion, insolvency or death of one or more partners, subject to the conditions referred to in sections 31 to 35 of the Partnership Act. In the case of death of a partner, there shall be a contract, express or implied, between the partners that the firm shall not be dissolved by the death of a partner. Under the ordinary law, every change in the constitution of a firm amounts to a dissolution of the old firm and bringing into existence of a new firm. In law the firm also has no legal existence apart from its members and it is merely a compendious name to describe a collection of persons who are partners. But the mercantile usage recognises the firm as a distinct person. The Partnership Act struck a medial note as between these two extreme propositions and recognised the continued existence of the firm in spite of the change in the constitution. The income tax Act went a little further and recognised the firm for the purpose of assessment as a unit independent of the partners constituting it.

13. The court further observed (p. 164):

We have already noticed that if there is a contract to the contrary against dissolution of a firm by the death of a partner, a change in the constitution of the firm also occurs by reason of death of a partner provided there are at least two surviving partners. In our opinion, therefore, the words "ceasing to be partners" in section 187(2) would also include a case of death of a partner when such death, by reason of a contract to the contrary or by reason of any law, did not bring about the dissolution of the partnership. But we are not prepared to accept the further argument of the learned counsel for the revenue that for the purpose of section 187 even in cases where there is no contract to the contrary against the dissolution of the firm by death of a partner it will amount to a change in the constitution of the firm within the meaning of section 187.

14. The same question of all the partners excepting one retiring from the partnership and the reconstitution of the partnership with the surviving partner came to be considered by this court again in MAVUKKARAI (N) ESTATE TEA FACTORY Vs. ADDITIONAL COMMISSIONER

OF Income Tax, MADRAS-II., In that case, four out of five partners retired from the partnership on June 30, 1970, after executing a release

deed under which the remaining partner, viz., T.K. Joghee Gowder, took over the rights and liabilities of the firm. On the same day, T.K. Joghee

Gowder formed a new partnership with the same name as the old firm by taking in three new partners. The new firm filed two separate returns of

income, one for the period September 1, 1969, to June 30, 1970, in respect of the old firm and for the period July 1, 1970, to March 31, 1971, in

respect of the newly constituted firm and claimed that two separate assessments should be made. The ITO was of the view that there was only a

reconstitution of the old firm, and accordingly made a single assessment on the new firm for the entire period. However, when the matter was taken

to the High Court in proceedings under art. 226 of the Constitution of India, this court held that even if the extinction of the old firm and the

constitution of the new firm took place simultaneously, in law it must be presumed that the retirement of the partners of the old firm preceded the

constitution of the new firm, for, unless the old firm ceases to exist, a new firm cannot come into being; further, the terms of the release deed

indicated that at least for a moment, the business had become proprietary in the hands of the remaining partner, viz., T.K. Joghee Gowder, and it

was only thereafter that the new firm of partnership was constituted; merely because there is a common partner in the two firms, it cannot be said

that the old firm continued with a mere change in the constitution and, however small or minute the interregnum may be, there is an extinction of the

old firm preceding the constitution of the new firm; the two firms are separate entities and the new firm cannot be said to be a continuation of the

old firm; and the contingency of a partnership ceasing to exist and a new partnership coming into existence with the remaining partner and others

does not fall within the purview of s. 187(2) of the Act.

15. In view of this legal position, as far as the firm, M/s. D. Thiagasundara Mudaliar is concerned, the Tribunal was right in holding that s. 187 of

the Act was not attracted, and consequently there could not be a single assessment and there must be two assessments for the two periods on the

two firms referred to.

16. As far as the firm of M/s. V. Muniswamy Mudaliar & Company is concerned, of course, there were four partners originally, and, therefore, the

position will be slightly different. But here again, as we have pointed out already,

the partnership deed dated September 4, 1965, did not contain any provision that the firm will continue undissolved notwithstanding the death of any of the partners. The result of it was that s. 42(c) of the Partnership Act, 1932, came into operation, and the death of Govindaraja Mudaliar brought about the dissolution of the firm. Once the firm came to an end, what happened subsequently was merely the succession of a new firm to the business in question, and will not constitute a change in the constitution of the firm as contemplated by s. 187 of the Act. Therefore, even with regard to the firm of V. Munuswamy Mudaliar & Company, the Tribunal was right in holding that no single assessment could be made under s. 187 of the Act, and only two assessments could be made for the two periods on the two firms. In these circumstances, we answer the question referred to this court in the affirmative and in favour of the assessee. The assessee is entitled to its costs from the department. Counsel's fee Rs. 250 in each reference.