

(1980) 01 AHC CK 0075

In the Allahabad High Court

Case No : Income-tax Reference No. 102 of 1978

Commissioner of Income Tax

APPELLANT

Vs

Krishna Steels

RESPONDENT

Date of Decision : 23-01-1980

Acts Referred:

Income Tax Act, 1961 — Section 184

Income Tax Rules, 1962 — Rule 22, 23, 24

Citation : (1980) 15 CTR 354 : (1980) 124 ITR 47

Hon'ble Judges : R.R. Rastogi, J;C.S.P. Singh, J

Bench : Division Bench

Advocate : R.K. Gulati and A. Gupta, for the Appellant; None, for the Respondent

Final Decision : Dismissed

Judgement

Rastogi, J.—This is a reference u/s 256(1) of the I.T. Act, 1961. It relates to the assessment year 1971-72. The assessee is a partnership firm which was formed on September 1, 1969, for running a re-rolling mill and for manufacture, purchase and sale of certain kinds of iron and steel. A partnership instrument was drawn up on September 15, 1970. The partners are Smt. Sabaz Mala Jain and Sarvasri Sushil Chand Jain, Satish Chand Jain, Ramesh Chand Jain and Anil Agarwal. The accounts were to be closed on the 31st of March each year and for the year under consideration the accounts were closed on March 31, 1971. The assessee filed an application for registration along with a certified copy of the partnership deed on March 16, 1971. The ITO refused to register the firm on the grounds that the assessee had not applied for registration in the proper and the prescribed form, that the original partnership deed had not been filed within the prescribed time, that there was no mutual agency and privity amongst the partners, that the firm had not distributed the loss as required in the partnership deed and, lastly, that the relationship between Rarnesh Chand Jain and Sri Agarwal was that of servant and master.

2. The assessee appealed. The AAC did not agree with the reasons given by the

ITO except one and that was that the loss of the year under consideration had not been divided amongst the partners in accordance with the terms of the partnership deed. The AAC found that for the first year the accounts were closed on March 31, 1970, and there was a loss of Rs. 14,653. For the assessment year 1971-72, again, there was a loss and it was Rs. 1,39,096. Thus, the total loss of these two years amounting to Rs. 1,54,749 was shown in the balance-sheet filed by the assessee along with the return of income. Subsequently, a revised balance-sheet was filed showing the allocation of the loss and that too on the assets side in the following manner :

" Profit & Loss Account "

As per last balance-sheet

Add: Loss during the year

Rs.

Rs.

Suit. Subaz Mala Jaia

3,713.33

34,973.98

= 38,687.31

Sri Sushil Chand Jain

3,713.33

34,973.97

= 38,687.30

Sri Satish Chand Jain

3,713.33

34,973.97

= 38,687.30

Sri Ramesh Chand Jain

3,713.32

34,973.98

= 38,687.30

1,54,749.21 "

3. In the opinion of the AAC, the above treatment of the loss could not be regarded as distribution of loss amongst the partners. That should have been

done by debiting the proportionate loss to the partners' accounts in the books. On this view of the matter, he confirmed the order of the ITO refusing to register the firm. Being aggrieved, the assessee filed a further appeal before the Appellate Tribunal. The Appellate Tribunal referred to the certificate contained in the application for registration in Form No. 11 which was to the effect that the loss of the previous year "will be divided" and in its opinion the allocation of loss before the completion of assessment was sufficient for the purpose. As for the mode of allocation of loss, in its opinion, no particular mode is prescribed in the Act and that such an allocation had been effected in the revised balance-sheet and the fact that loss had not been debited to the partners' individual accounts did not make any difference. On this view, the Appellate Tribunal accepted the assessee's claim and granted registration to it.

4. Now, at the instance of the Commissioner, the following two questions have been referred to this court for its opinion :

"(1) Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that the loss of the assessee-firm for the assessment year 1971-72 was divided amongst the partners in accordance with the partnership deed?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was correct in directing the grant of registration to the assessee-firm for the assessment year 1971-72?"

5. It would be seen that the facts found and about which there is no dispute are that for the first year the accounts were closed on March 31, 1970, and there was a loss of Rs. 14,663, but for that year registration was not claimed. For the second year which was the previous year relevant to the assessment year 1971-72, the accounts were closed on March 31, 1971. The application was given in Form No. 11 on March 16, 1971. The return was filed on March 31, 1971, with the balance-sheet attached to it. In this year also there was a loss of Rs. 1,39,096. The previous year's loss or this year's loss was not allocated amongst the partners. The assessment was completed on March 29, 1974, but before that the assessee filed a revised balance-sheet in which the allocation of loss of both these years was shown. This allocation was shown on the assets side and was not debited to the individual accounts of the partners. On these facts, the question that falls for our consideration is as to whether the distribution of loss after the close of the relevant previous year but before the completion of the assessment would or would not amount to a proper distribution of loss as required by law as also as required by the relevant provisions of the Partnership Act. In this behalf, it was urged on behalf of the department that it was only in the consolidated loss account in the ledger that the entire loss was shown and the same was reproduced in the revised balance-sheet and that this did not amount to allocation of loss amongst the partners. We had not the advantage of hearing the counsel for the assessee-respondent because none appeared on its behalf. However, after considering the arguments made before us on behalf of

the department, we do not think that there is much substance therein.

6. Part B of Chap. XVI of the Act provides for registration of firms. Section 184 prescribes several requirements for the grant of registration. Under this section an application for registration of a firm may be made if the partnership is evidenced by an instrument and the individual shares of the partners are specified in that instrument. Such application may be made either during the existence of the firm or after its dissolution. It shall be made to the ITO having jurisdiction to assess the firm and shall be signed by all the partners (not being minors) personally or in the case of a dissolved firm by all persons (not being minors) who were partners in the firm immediately before its dissolution and by the legal representatives of any such partner who is deceased. The application shall be made before the end of the previous year for the assessment in respect of which registration is sought. The ITO may entertain an application made after the end of the previous year if sufficient cause is shown to him. Further, the application shall be accompanied by the original instrument evidencing the partnership together with a copy thereof. It shall be made in the prescribed form and shall contain the prescribed particulars. Sub-section (7) of Section 184 provides for an application for the grant of benefit of continuance of registration. Section 185 provides for procedure to be followed on receipt of application u/s 184. Rule 22 of the I.T. Rules, 1962, prescribes the form in which the application should be made. The application shall be made in Form No. 11. This form, in para, 4, contains a certificate to be given on behalf of the firm. It reads :

"We do hereby certify that the profits (or loss, if any) of the

Previous year were/will be _____
Period up to the date of dissolution were/will be divided or credited as shown in the Schedule and that the information given above and in the Schedule is correct."

7. As noted above, an application u/s 184 for the grant of registration is to be given before the close of the previous year for the assessment year in respect of which registration is sought and that being so, in the ordinary course, profits or loss, if any, would not be distributed by the time the application is made. In the certificate, therefore, for the allocation of profits or losses the words are "were/will be divided or credited". In case profit or loss have not been divided by the time such application is made, there is no further provision regarding the time by which such division can be made. It is in this context that we have to see as to whether the division of profits or loss before the completion of the assessment for the year concerned would be regarded as sufficient.

8. The conditions essential to the registration of a firm in brief are : that an application on behalf of the firm should be made to the ITO before the end of the accounting year and the application should comply with the requirements of Section 184 and Rules 22 to 24. The firm should be evidenced by an instrument of partnership. The instrument should specify the individual shares of the

partners and, lastly, the partnership should be valid and genuine and should actually be constituted as specified in the instrument. If all these conditions are fulfilled the ITO is bound to register the firm unless the assessee has committed any of such defaults as entail a best judgment assessment u/s 144 for which he may refuse registration u/s 185(5). In the present case, at the time, when the application for registration was given all the conditions stood fulfilled. Subsequently, the assessee filed its return and it was found that the division of loss had not been made in the balance-sheet and before the assessment could be completed a revised balance-sheet showing such division was filed. In *VARIETY HALL AND RAMAKRISHNA TEXTILES Vs. COMMISSIONER OF Income Tax, A. P.*, an almost similar question came up for consideration before the Andhra Pradesh High Court. In that case, the assessee, a partnership firm, applied for registration for the assessment year 1960-61 u/s 26A of the 1922 Act. A return was also filed for that year. The assessing authority found several unledgered cash credits in the accounts and treated Rs. 15,000 being the aggregate of the same as the assessee's concealed income from undisclosed sources. He also refused registration to the firm on the ground that even according to the assessee's own showing the undisclosed profit had not been divided amongst the partners. On appeal, the AAC reduced the concealed income to Rs. 10,000 and also granted registration to the firm. On an appeal preferred by the department, the Appellate Tribunal restored the order of the ITO. On reference, the Andhra Pradesh High Court upheld the addition on account of unexplained profits, but on the question of grant of registration held (p. 205) :

"The failure to divide a portion of the profits amongst the partners in accordance with the terms of the partnership deed does not by itself disentitle the firm to be registered so long as the partnership is evidenced by an instrument of partnership and there is no reason to doubt the genuineness of the partnership and the Income Tax Officer is satisfied that there is a firm in existence constituted as shown in the instrument of partnership."

9. In the instant case as well, the genuineness of the partnership has not been disputed. Further, it is a firm in existence constituted as shown in the instrument of partnership. Necessary particulars prescribed by the rules were furnished and we do not think that merely because the loss was allocated subsequent to the making of the application but before the completion of the assessment, the firm can be refused registration.

10. On behalf of the department, reliance was placed on certain decisions, but in our opinion they are distinguishable. In *Shere-e-punjab Silk Stores Vs. Commissioner of Income Tax, New Delhi*, for the assessment year 1958-59 the assessee had applied for renewal of registration u/s 26A of the 1922 Act. The relevant previous year ended on March 31, 1958, and it was stated therein that the previous year's income had been divided amongst the partners. The ITO, however, found that the previous year's income had not been divided and hence he refused registration. The AAC and the Appellate Tribunal agreed with the ITO.

Before the Tribunal it was, however, contended that at any rate the partners had divided the income of the previous year before the assessment was made. The Tribunal did not go into that question. The High Court agreed with that view and on further appeal the Supreme Court confirmed that view holding that in case of an application for renewal it was incumbent on the part of the assessee to have divided the previous year's profits. It would be seen that in that case the application for renewal of registration had been made after the end of the relevant previous year and further it had been mentioned in that application that income had been divided amongst the partners. As noted in the present case the application for registration was given before the end of the relevant previous year and what was stated in the application was that the previous year's loss will be divided. Apart from that, now an application for renewal of application is to be made in Form No. 12 u/s 184(7) and this section does not specifically mention the failure or absence of ascertainment or distribution of profits amongst the partners of the firm as one of the requisite conditions for the continuation of registration of the firm in the subsequent years : vide Commissioner of Income Tax Vs. Voleti Veerabhadra Rao and Sons, .

11. Khanjan Lal Sewak Ram Vs. Commissioner of Income Tax, U.P., is another case on which reliance was placed on behalf of the revenue. That was also a case where an application for renewal of registration u/s 26A of the 1922 Act was given and in the certificate it was stated that the profits of the previous year had been divided. It was found that the firm had earned profit in the black market and though it had distributed its book profit amongst the partners according to the partnership deed, it had not distributed the profits earned by it in the black market amongst the partners. It was held that the application for renewal of registration did not comply with the conditions prescribed in para. 3 of r. 6 of the Indian I.T. Rules, 1922. It would be seen that that case also proceeded on a different set of facts. Similarly, in GANESH LAL LAXMI NARAIN Vs. COMMISSIONER OF Income Tax [1968] 68 ITR 969 (ALL) TREATED AS OVERRULED BY THE FULL BENCH DECISION IN BADRI NARAIN KASHI PRASAD v. ADDL. COMMISSIONER OF Income Tax [1978] 115 ITR 858 (ALL) : SEE COMMISSIONER OF Income Tax v. BAJAJ and CO. [1983] 143 ITR 218 (ALL), , it had been mentioned in the application made u/s 26A of the 1922 Act that the profits had been divided between the partners while it was found that the profits had neither been divided nor credited between the partners and it was held that in order to enjoy the benefit of registration u/s 26A it is necessary that the assessee should strictly comply with all the requirements of Income Tax law pertaining to the grant of registration. The law requires that the profits should be divided or credited annually between the parties and it is necessary for a firm applying for registration to state that fact in the application for registration. As noted above, now in Form No. 11 there is no such requirement that the profits should be divided or credited annually between the partners. All that is required is that if the profits have been divided before making the application it should be so stated and if they are to be divided later on, it is to be stated that the "profits"

will be divided.

12. Surajmalls Vs. Commissioner of Income Tax, Madras, is also distinguishable on the same ground. The view taken was that even after the amendment of r. 6 of the I.T. Rules in November, 1952, in the case of a continuing firm, the profit or loss of the firm during the previous year relevant to the assessment year should have been actually divided or credited to the accounts of the partners before a valid application for renewal of registration is made. We have already indicated above that now there is no such requirement for granting the benefit of continuation of registration u/s 184(7).

13. The next case to which our attention was invited is another decision of the Madras High Court in E. S. Haji and Co. Vs. Commissioner of Income Tax, Madras, . In that case, a firm applied for registration enclosing a copy of the profit and loss statement in which the profits were estimated at a certain percentage on the gross turnover and the share of each partner in such profit was also stated. The application was rejected on the ground that it did not comply with the rules, The view taken by the Madras High Court on reference was that as profits of the firm were not properly ascertained and there was also no statement that the profits were divided or credited to the accounts of the partners as required by Rules 2 and 3 of the I.T. Rules, the application for registration was rightly rejected.

14. We agree that the registration of a firm under the I.T. Act is not a general right. It is a privilege given to the firm in order that the individual partners may get the benefit of the lower rate of assessment in addition to the tax payable by the firm directly on its total income. The income of the firm would be apportioned amongst the partners and their share income would be included in their total income and assessed to tax accordingly. The deed of partnership sets out the share to which each partner is entitled. The department is certainly entitled to enquire whether the profit-sharing ratio as specified in the deed is in fact adhered to. The profit actually distributed to the partner determines the rate at which he is to be assessed. In our opinion, therefore, if before the completion of the assessment distribution is actually made, the purpose of the Act would be fulfilled, particularly when there is nothing to cast any doubt on the genuineness of the firm. We are, therefore, of the opinion that if it is stated in the application for registration that the profit/loss would be divided amongst the partners and if before the completion of the assessment such division is actually made, registration cannot be refused, if the other requirements stand duly satisfied. As for the mode of distribution of profit/ loss there is no particular provision made in the Act or the rules and, therefore, if it is made in a manner which may indicate that the division has been made in accordance with the shares specified in the partnership deed, we do not think that any fault can be found with such division. For these reasons, therefore, we agree with the view taken by the Tribunal.

15. Our answers to the questions referred, therefore, are in the affirmative, against the department and in favour of the assessee. Since nobody appeared for

the assessee, there shall be no order as to costs.