

(1956) 12 CAL CK 0038
In the Calcutta High Court
Case No : Matters No's. 117 to 120 of 1956

DAWJEE DADABHOY and CO.

APPELLANT

Vs

S. P. JAIN AND ANOTHER.

RESPONDENT

Date of Decision : 04-12-1956

Acts Referred:

Income Tax Act, 1961 — Section 26A

Citation : (1957) 31 ITR 872

Hon'ble Judges : Sinha, J

Bench : Division Bench

Judgement

SINHA, J. - These four matters have been heard together and the questions of fact and law are common. The facts are briefly as follows :

The petitioner in all these applications is a partnership firm duly constituted under the Indian Partnership Act. It is stated that the firm was established was early as 1894 and has continued all along except for constitution of the personnel from time to time, with the death or retirement of a partner and/or admission of a new partner or legal heir of a deceased partner. It appears also that the partnership deed was accordingly changed from time to time. A partnership deed was executed on or about November 14, 1949, and another on or about July 2, 1953. The latest partnership deed is dated 31st August, 1954. In these applications we are concerned with the Income Tax Act and assessment years, 1950-51, 1951-52, 1952-53 and 1953-54. For all these years, the firm has been assessed as a registered firm, that is to say, registered under the Indian Income Tax Act. In other words, it was registered u/s 26A of the Indian Income Tax Act and assessed as a registered firm in accordance with section 23 (3) read with section 23 (5) (a) of the said Act. The registration of a firm is for the period of one year on each occasion, and the registration had been renewed from year to year until on or about September 30, 1955, an order had been passes by which renewal of registration has been refused. The petitioner firm has filed an appeal u/s 30 of the said Act against the order refusing registration. This appeal is

pending before the Appellate Assistant Commissioner of the Income Tax, Range C.

Before I proceed further it will be necessary for me to advert to the law of registration of firms under the Indian Income Tax Act. Under the said Act, a firm can be assessed as a separate entity. In the normal course, therefore, a firm would be assessed on its total income. The Act, however, provided for registration of firms. This is done u/s 26A which runs as follows :

"(1) An application May be made to the Income Tax Officer on behalf of any firm, constituted under an instrument of partnership specifying the individual shares of the partners, for registration for the purposes of this Act and of any other enactment for the time being in force relating to Income Tax or super-tax.

(2) The application shall be made by such person or persons, and at such times and shall contain such particulars and shall be in such form, and be verified in such manner, as May be prescribed; and it shall be dealt with by the Income Tax Officer in such manner as May be prescribed."

Section 59 of the Act confers powers upon the Central Board of Revenue to make rules for carrying out the purposes of the Act, and rules have been framed known as the Income Tax Rules, 1922. Rule 2 of the said rules lays down as to how application for registration should be made. Rule 3 lays down that the application should be made in a particular form and verified in the manner stated therein. It must be remembered that u/s 26A of the Act, registration can only be granted to a firm which is constituted under an instrument of partnership, that is to say, a written document, which document must specify the individual shares of the partners. That being one of the essential ingredients of registration, it is not surprising that in rule 3 it has been laid down that the application in the prescribed form is to be accompanied by the original instrument of partnership. The form of an application for registration of a firm contains a clause whereby an application has to certify that the profits or losses, if any, of the previous year were, or will be, divided or credited as shown in the schedule, and that the information given in the schedule as also in the body of the application were correct. In the schedule, particulars have to be given, including the names of the partners, and their respective shares in the balance of profit or loss. Particulars have also to be given of the apportionment of the income, profits or gains or loss in the previous year between the partners who are entitled thereto, or liable therefore. Rule 4 states that there is or was a firm in existence, constituted as shown in the instrument of partnership, and that the application had been properly made, he should register the firm and grant a certificate of registration. Sub-rule (2) states that if the Income Tax Officer was not so satisfied he should pass an order in writing refusing to recognise the instrument of partnership or the certified copy thereof. Under rule 5 the certificate of registration has effect only for one year. Under rule 6 any firm to whom a certificate of registration had been granted under rule 4 May apply to the Income Tax Officer to have the certificate of registration renewed for a subsequent year. The form of such an

application for renewal is also prescribed and is analogous to the form prescribed for an original application. Such an application also contains provision for furnishing particular and also for a certificate that profits or losses of the previous year were or will be divided or credited according to the manner as shown in the application. Under rule 6A, on receipt of such an application the Income Tax Officer May if he is satisfied that the application was in order and that there is or was a firm in existence constituted as shown in the instrument of partnership, grant to assessee a certificate signed and dated by him in the form prescribed. If the Income Tax Officer was not so satisfied he is entitled to pass an order refusing to renew the registration. Rule 6B is important and is set out below :

"In the event of the Income Tax Officer being satisfied that the certificate granted under rule 4, or under rule 6A, has been obtained without there being a genuine firm in existence he May cancel the certificate so granted."

Since the petitioner firm was registered during the relevant time, it follows that applications had been made and verified in accordance with the rules mentioned above, and the assessment of the partners was made in accordance with section 26A read with section 23 (3) and 23 (5) (a). There can be no doubt that the system of registration of a firm confers great benefit on the partners of a partnership firm. If the firm is to be assessed as a whole, upon its total income, it is likely that the rates would be higher. It has now been held that the provision of section 26A must be strictly followed. The matter is now placed beyond doubt by *Others v. Commissioner of Income Tax, Madras*. There Venkatarama Ayyar, J., said as follows :

"Thus, if a firm is registered, it ceases to be a unit for the purpose of taxation and the profits earned by it are taken, in accordance with the general law of partnership, to have been earned by the individual partners according to their shares, and they are taxed on their individual income including their share of profits. The advantages of this provision are obvious. The rate of tax chargeable will not be on the higher scale provided for incomes on the higher levels but on the lower one at which the income of the individual partner is chargeable. Thus, registration confers on the partners a benefit to which they would not have been entitled but for section 26A, and such a right being a creature of the statute can be claimed only in accordance with the statute which confers it, and a person who seeks relief u/s 26A must bring himself strictly within its terms before he can claim the benefit of it. In other words, the right is regulated solely by the terms of the statute and it would be repugnant to the character of such a right to add to those terms by reference to other laws. The statute must be construed as exhaustive in regard to the conditions under which it can be claimed."

In that case, the question was whether in view of the provision of the rules that an application must be signed by a partner, it was possible for a duly authorised agent of the partner to append his signature. In spite of the fact that under the common law as well as under the powers of Attorney Act, a man can do through

an agent what he can do himself, it was held that the rules must be strictly applied and an application could only be signed by a partner himself and not through his duly authorised agent.

Bearing this in mind, we must go back to the order mentioned above, which has been made sometime in September, 1955, refusing renewal of registration. The order has been annexed to the petition and in the petition in Matter No. 117 to 1956, it is marked as annexure D. The grounds for refusing the renewal has been stated therein. Shortly put, it is stated that while going through the accounts of the individual partners it was found that the profits of the previous years were not credited in the books in accordance with the shares specified in the partnership deed, or in accordance with the particulars given in the application forms, or in accordance with the certificates appended thereto. It appears that according with the certificates appended thereto. It appears that according to a practice followed by the firm, profits and losses were not divided in accordance with the provisions of the partnership deed, but it was done in manner which it is said had been agreed upon between the partners. Thus, the profits appear to have been taken to a reserve account and distributed from time to time but not strictly in accordance with the shares, e.g., in some cases the actual amount distributed is less and in some cases more. Since the matter is pending in appeal it is not right that I should indicate my views about the merits but I have referred to it just to show the stand which has been taken by the authorities in respect of the registration, stand, which cannot be held to be erroneous on the fact of the record. It has been strenuously contended before me that there are answers to such charges. If there are answers, doubtless they would be properly investigated in the appeal.

I now come to the more immediate circumstance which has rise to these applications. On or about June 18, 1956, the petitioner firm was served with notices issued by the Commissioner of Income Tax, Calcutta. A set of two notices have been issued for each assessment year, copies whereof are annexed to the several petitions. Copies annexed to the petition in Matter No. 117 of 1956 are marked as F. These notices show that the Commissioner was acting under the provision of that section runs as follows :

"(1) The Commissioner May call for and examine the record of any proceeding under this Act and if he considers that any order passed therein by the Income Tax Officer is erroneous in so far as it is prejudicial to the interests of the revenue, he May, after giving the assessee an opportunity of being heard and after making or causing to be made such enquiry as he deems necessary, pass such order thereon as the circumstances of the case justify, including an order enhancing or modifying the assessment, or cancelling the assessment and directing a fresh assessment."

The first notice states that under the power conferred by section 33B, the Commissioner had called for and examined the records of the assessment proceedings of the petitioner firm and it appeared to him from the said records

that the order u/s 26A passed by the Income Tax Officer for the respective assessment years were erroneous in so far as they were prejudicial to the interest of the revenue. The Commissioner, therefore, by the first notice called upon the assessee to appear before him on June 23, 1956, and show cause why the order passed u/s 26A should not be cancelled or such other order made as the circumstances may justify. The second notice called upon the assessee to appear on the same date and show cause why the Income Tax Officers order passed u/s 23 (3) read with section 23 (5) (a) should not be cancelled or such other order made as the circumstances may justify. Certain legitimate grievances have been put forward in respect of these notices. There is no doubt that these notices were quite sudden and gave little time to the assessee to come prepared for its defence. Secondly, it is rightly stated that no particulars have been given in the notices showing the grounds on which the Commissioner considered that the interest of the revenue had been prejudiced. If the matter stood there, it could certainly be said that the petitioner was not placed in a position to defend itself. As appears from the affidavits in opposition affirmed by the Commissioner, the petitioner firm appeared on the 23rd and a weeks time was prayed for. It was first adjourned to the 26th, then to the 28th and finally to the 29th June, 1956. It is pointed out, however that in the application made for adjournment on the 22nd June, 1956, the petitioner wanted a weeks time and that in fact it got a weeks time, namely, up to the 29th. On the 29th June, 1956, these rules were issued. In effect they called upon the respondents to show cause why these notices should not be quashed and why they should not be prevented or restrained from taking any further steps with regard to them. In these applications I am not concerned with the proceedings with regard to the refusal to renew the registration. That is a matter which is pending appeal and is not the subject matter of these applications. It appears that some time on the 21st September, 1956, the Commissioner furnished particulars of the reasons or the basis for holding the impugned orders as erroneous and resulting in prejudice to the revenue. A copy thereof has been furnished to me and I direct that it be kept on the record. Virtually the grounds are the same for which the renewal of registration has been refused.

Several grounds have been taken before me in support of these rules. The first ground taken by Dr. Pal is the ground of ultra vires. It is argued that section 33B of the Act is ultra vires. It is firstly stated that this section grants the Commissioners a wholly arbitrary power to call for and examine the records of any proceedings ex parte and behind the back of the assessee and thereafter to make orders which are also arbitrary. It is next stated that there was no reason for the introduction of this section, regard being had to the provisions of section 34. Finally it is said that there is discrimination in violation of the guarantee given by article 14 of the Constitution. Dr. Pal relied on the recent Supreme Court decision : Bidi Supply Co v. Unison of India and Others. In the decision, sub-section (7A) of section 5 of the Income Tax Act was under challenge. It was held by the majority decision that the order of transfer which was expressed in

general terms without any reference to any particular case (i.e., assessment year) and without any limitations to time was not contemplated by section 5 (7A) and was beyond the competence of the Central Board of Revenue, and the sub-section contemplated only the transfer of an assessment case for a particular year actually pending before the Income Tax Officer. Bose, J., although concurrent in the conclusions arrived at by the majority of Judges, held that section 5 (7A) of the Act was wholly ultra vires. Dr. Pal particularly relies on this decision of Bose, J. The learned Judge held that the power of transfer could only be conferred if it was hedged round with reasonable restrictions, the absence or existence of which could in the last instance be determined by the courts; and the exercise of the power must be heard when that is reasonably possible, and the reasons for the orders must be reduced to writing, so that one might know that the powers conferred on these quasi-judicial bodies were being justly and properly exercised. Dr. Pal argues that just like section 5 (7A), equally arbitrary powers were granted to the Commissioner u/s 33B. In my opinion a reference to section 5 (7A) would at once show the difference between the two provisions of law.

Section 5 (7A) is as follows :

"The commissioner of Income Tax May transfer any case from one Income Tax Officer subordinate to him to another, and the Central Board of Revenue May transfer any case from any one Income Tax Officer to another. Such transfer May be made at any stage of the proceedings, and shall not render necessary the reissue of any notice already issued by the Income Tax Officer from whom the case is transferred."

It will thus be seen that the procedure contemplated is different from the procedure laid down u/s 33B. u/s 5 (7A) there is no question of the assessee being heard at any stage. Further, there is no question of preferring any appeal. Coming now to section 33B, it is true that in the first instance the Commissioner calls for and examines the record ex parte. It has been strenuously argued by Mr. Banerjee appearing on behalf of the petitioner that the Commissioner acts behind the back of the assessee, looks into the papers, and makes up his mind and this is contrary to the laws of natural justice. I am afraid this is not a ground of substance. If the provisions of section 33B were analogous to those of section 5 (7A) of the Act, a criticism of this description would be justified. Here, however, what happens is that the Commissioner looks into the records of the proceedings and if he consider that any order passed by the Income Tax Officer is erroneous in so far as it was prejudicial to the interest of the revenue, then he can initiate a certain proceeding. Naturally, in order to initiate such proceedings he has to come to a tentative appraisal of the facts that appear from the record. It is however by no means final, since, he must under the law give an assessee an opportunity of being heard. This enquiry is not optional but compulsory and he can pass no order unless he gives the assessee an opportunity of being heard, and it is only after hearing the assessee that he can pass an order enhancing or

modifying the assessment etc. Then again, the order made has expressly been made appealable by sub-section (4) of section 33B. An appeal lies to the Appellate Tribunal and thereafter to the Board of Revenue. As has been pointed out, it does not also preclude a reference to this Court u/s 66 of the Act. The compliant therefore that section 33B gives an arbitrary power cannot be accepted. Section 33B came into operation some time in 1948, but section 33A had already been in operation since 1941. There also, the Commissioner May of his own motion call for the record of any proceedings and make enquiries and pass orders. It is next said that section 34 being there, it was wholly unnecessary to make special provisions contained in section 33B. A comparison of the provision of section 33B with that of section 34 shows that although there is much overlapping, the one is not identical with the other. u/s 34 an assessment made in any particular year can be reopened if there has been under assessment or if there has been an escape of assessment. There are however conditions which have to be satisfied, and an assessment can be reopened only if those conditions are fulfilled. The provisions of section 34 have progressively been enlarged, until now they cover a wide field indeed. It is however not possible to say that the provisions of section 34 and 33B are identical. Mr. Banerjee has argued that the only instance in which an order can be held as prejudicial to the interests of the revenue is when there has been an under-assessment or an escape of assessment. How else, he argues, could the interests of the revenue be prejudiced ? In a sense it is true, but the orders which are brought within the fold of section 33B need not strictly be under-assessment of assessment which has escaped. There May be orders which May relate to stages which are certainly connected with either under-assessment or escape of assessment but May not strictly be called orders as contemplated in section 34. For example, take the order of registration. Although, such an order in the intimate analysis leads to the question of under-assessment or escape of assessment, it is by itself not an order which would come within the purview of section 34. In my opinion, it is not valid argument to say that because section 34 exists it was not necessary to impose section 33B. Therefore, if the provisions of section 33B are neither arbitrary nor unnecessary, I fail to see how the provision can be declared as ultra vires. As Bose, J., has pointed out in the decision mentioned above, it is not an easy matter to decide whether a particular enactment is discriminatory or not and the tests laid down are not uniform. It is however generally agreed that in order to pass the test two conditions should be fulfilled, namely, that the classification must be founded on an intelligible differentia which distinguishes those that are grouped together from others, and secondly, that differentia must have a rational relation to the objects sought to be achieved by the Act. There is no doubt about the object to be achieved by the Act, namely, to see that the State is enabled to raise the maximum revenue and that the revenue is collected according to law. Section 33B, like the other sections, namely, sections 33A or 33B, is calculated to stop the gaps through which there May be escape of realisation of the revenue. Obviously it was considered that the other provisions in the Act-wide as they are-did not properly

attain this object. Section 33A granted a power of revision to the Commissioner but it was subject to the condition that the order should not be prejudicial to the assessee. Section 33B confers power which enables the Commissioner to interfere with the orders of the Income Tax Officer, where such orders are considered prejudicial to the interests of the revenue. The power under section 33B can only be invoked in the case of persons in whose favour orders have been made or assessments have been effected which are considered prejudicial to the interests of the revenue. The words "prejudicial to the interests of the revenue", have not been defined, but it must mean that the orders or assessment challenged are such as are not in accordance with law, in consequence whereof the lawful revenue due to the State has not been realised or cannot be realised. It can mean nothing else. If this is so, the class of persons in respect of whom such orders can be passed is a well-defined class in respect of whom there is an intelligent differentia. It is next said that the section is discriminatory because it provides for two appeals, whereas in the normal case there would have been three appeals. Here again I am unable to agree. As I have already held in the case of *Laduram Taparia v. D. K. Ghose and others*, there can be no discrimination if there is no cutting down of the higher court of appeal. There can be no prejudice simply by providing for a number of appeals, somewhat less in one case than in another, by which an appeal to a lower Court is not provided for.

In my opinion, the section is intra vires and valid. It is next said that; the Commissioner has been proceeding wholly on an illegal basis, since upon a consideration of the Act and the rules, a cancellation of registration can only be made on one ground, namely, if the Income Tax Officer came to the conclusion that there was no genuine firm in existence. Strong reliance is placed on rule 6B which has been set out above. It is true that rule 6B confers the power of cancellation on the Income Tax Officer on the specified ground that the registration had been obtained without there being a genuine firm in existence and on no other ground. In other words, the Income Tax Officer himself cannot cancel a registration except on that ground, although he could have refused registration in the first instance if the application was not in proper form. I do not see how it follows that the Commissioner is equally powerless in view of the provisions of section 33B. On the other hand, it might be argued that the absence of power in the Income Tax Officer by itself is a strong ground for the exercise of power by the Commissioner u/s 33B. In other words, if a wrong has been perpetrated, it can only be remedied by the Commissioner taking steps u/s 33B. I have already stated above why the Commissioner intends to cancel the registration of the firm for the relevant years and the assessments that have followed therefrom. The question is whether I should at this stage of the proceedings go into the question and decide as to whether the Commissioner, even if he is satisfied that the facts are as he has stated, should as a matter of law cancel the registration or not. I have already indicated that it has now been held by the highest Court in the land that the provisions of section 26A of the Act must be strictly followed. The question is whether I should go into the merits and

decide here as to the validity of the charges and the legal results of the application of the petitioner being found to be inaccurate, of the legal results of the petitioner not having acted in accordance with the certificate granted in such applications. At the present moment, all that has happened is that the Commissioner has issued notices u/s 33B to show cause. These notices read with the particulars supplied show that he has discovered a certain set of facts upon which he wishes to base his order for the cancellation of registration and the reopening of the assessment. The facts have been stated by the Commissioner are not accepted by the respondents. In other words, even the facts upon which the orders is to be made are disputed. It is obvious that the facts will have to be investigated and the correct facts ascertained. I will give one example. It is admitted that one of the partners who had ceased to be a partner has withdrawn more than his due. Mr. Banerjee argued that this was done because he went out in the middle of the accounting year and it was not possible to ascertain with strict accuracy the amount which should be paid to him. Thus, the payment was rough and ready calculation and has been subsequently adjusted. Mr. Banerjee also argues that it is not correct to say that the profits have been distributed in accordance with the shares specified in the deed. He argues that in the certificate it was not merely stated that the profits have been distributed, but it was also stated that the same "will be distributed." He says that in fact it has been distributed in accordance with the share, and where it has not been so distributed, there is a perfectly good explanation which should be acceptable to the Commissioner. If that is so, clearly the matter involves an investigation, an inquiry into the facts which it is not possible for me to accomplish in these applications. Of course, the petitioners could not have advanced the point of ultra vires before the Commissioner of Income Tax. But apart from this point, the other points are such that they cannot be conveniently investigated at this stage, in application under article 226. Beyond what I have stated above, it would be prejudicial to the petitioner if I say more, either on the merits or on the law application to the investigations held u/s 33B. In my opinion that should only be done at an appropriate stage. I have already indicated that the time that was granted and the mode in which the notice was served left much to be desired. Mr. Banerjee has rightly pointed out that it was scarcely commendable for the State to wake up at the last moment and harass the assessee simply because the Income Tax authorities with their wide resources had not discovered defaults on the part of the assessee which they should have discovered long ago. Regard being had to the fact that by virtue of the issue of these rules a sufficient time has expired, the prejudice with regard to shortage of time, or the absence of particulars are no longer of much relevance. The petitioner knows exactly what the authorities have discovered, what they propose to do and why. The petitioner, therefore, should now pursue his remedies in the usual way. Mr. Banerjee has incidentally pointed out an aspect of the matter which according to him puts his clients in great jeopardy. He argues that in making the assessment of the partnership u/s 23 (3) read with section 23 (5), firstly the profit of the whole firm has to be ascertained. He says that this ascertainment stands, and

the result is that although the partners will go on contesting the proceedings before the Commissioner, immediate proceedings will be taken by the service of a demand notice on the firm in respect of the assessment already made. Mr. Meyer has pointed out that this could never happen because the firm has hitherto been assessed on the footing of a registered firm and if it was now going to be assessed on the footing of a registered firm and if it was now going to be assessed as an unregistered firm, the Income Tax authorities could not rely on the previous assessment of the firm when it was registered, and proceed at once to serve demand notices. He has no objection to this going on record that the Income Tax authorities contemplate no such action. The proceedings u/s 33B will have to be completed and if the assessment is reopened and the registration cancelled, then the firm will have to be re-assessed on the footing of an unregistered firm. Dr. Pal had argued that these applications were maintainable even before the investigations have taken place, because notices had been issued which were bad because the section was ultra vires and the view of law taken was wrong view. He has made reference to the Bengal Immunity case. It was held there that where a notice has been served intending to charge a citizen with tax based upon a law which is ultra vires, it was not to be expected that the citizen should ignore the notice. It has been held that in such a case he is entitled to come to the Court and get relief. This proposition is now well-established. If the petitioner could show that section 33B was ultra vires, or if the notice showed on the face of it that it was illegal or without jurisdiction, when there is no doubt that the Court has power to intervene. In the present case, however, I have held that section 33B is not ultra vires and so far as the illegality of it is concerned it by no means appears on the face of the notices. In fact, as I have shown above, the illegality cannot be finally determined without ascertainment of facts which have not yet been finally investigated. Next Dr. Pal points out that even if the profit or loss was not properly divided amongst the partners in accordance with the deed of partnership, the assessment is not affected because the assessment was on the share of profits and not on the profits as allocated. This however is an over-simplification of the law. One of the grounds taken is that the provisions of the rules have not been complied with, and therefore the registration was bad. If the registration can be avoided, it is not denied that the actual revenue that will be realised will be more than what has hitherto been available to the State. These are matters which cannot be decided at this stage, and if I decide them one way or the other, the hearing before the Commissioner might be prejudiced. The result is that at this stage of the proceedings I am unable to interfere, and in my opinion I should not interfere, and that the applications are premature. I also make it clear that I do not express any opinion on the question as to whether after the decision of the Commissioner, the petitioner should avail himself of the remedy open to him under the Income Tax Act, or whether he should come up again to this Court. It would not be proper for me to express any opinion on that point at this stage.

The result is that these applications fail and the rule must be discharged. All

interim orders are vacated. Regard being had to the facts and circumstances of the cases, I make no order as to costs.

Rule discharged.