(1987) 01 BOM CK 0047

In the Bombay High Court

Case No : Income Tax Ref. No. 470 of 1977 & Income-tax Reference No. 470 of 1977

Dhanraj and Sons APPELLANT

Vs

Commissioner of Income Tax RESPONDENT

Date of Decision : 29-01-1987

Acts Referred:
Income Tax Act, 1961 — Section 187(2), 188, 256(1)

Citation : (1987) 168 ITR 557

Hon'ble Judges : V.A. Mohta, J;S.P. Bharucha, J

Bench : Division Bench

Judgement

V.A. Mohta, J.—The following two questions are referred at the instance of the assessee under s. 256(1) of the IT Act, 1961 :

"(1) Whether, on the facts and in the circumstances of the case, there was only a change in the constitution of the firm ?

(2) Whether in the facts and circumstances of the case there should have been two separate assessments for periods from 1st January, 1973 to 7th April, 1973 and 10th April, 1973 to 31st December, 1973 ?"

2. This reference is concerned with the asst. yr. 1974-75. The assessee is a partnership firm. On 31st July, 1974 the firm filed two returns one for the period 1st January, 1973 to 7th April 1973 and the other for the period 8th April, 1973 to 31st December, 1973. The partnership was created originally by a deed dt. 5th January, 1971 in which 7 partners were admitted including one Smt. Kanchanbai Hukamchand Parekh who had 20% share in the profit and loss. She died on 7th April, 1973. Clause 13 of the deed provides that the partnership shall not be dissolved on the death of any partner. The books of accounts were closed on 7th April, 1973 by drawing profit and loss accounts. There was an agreement of dissolution of firm dated 15th April, 1973. The assessee drew new deed of partnership on 17th April, 1973 in which Shri Hukam Chand Parekh husband of

deceased Smt Kanchanbai, was taken as a partner. His share was 20% in the profit and loss. There has been variation in the shares of the other partners.

The ITO held that it was not a case of succession under s. 188 of the IT Act, but was a case of a change in the constitution governed by s. 187(2). As a result two separate assessments could not be made. The following undisputed positions were noticed by him :

(1) That partner Smt. Kanchanbai died on 7th April 1973.

(2) That the books of accounts were closed on this date and a new set of accounts was maintained as from the next date.

(3) That a new deed of partnership was drawn up.

(4) That all assets and liabilities of the old firm were taken over by the alleged new firm.

(5) That the bank accounts were continued as they were.

(6) That the business was also continued as it was, in the same name, in the same premises and in the same commodities.

(7) That cl. 13 of the old partnership specifically provided that the partnership shall not be dissolved on the death of any partner.

(8) That the new deed state that : "AND WHEREAS, consequent upon the sad demise of Shrimati Kanchanbai wife of Shri Hukamchand Parekh a change with effect from 10th April, 1973 has occurred in the constitution of the firm .... the partners have decided to continue the business in partnership as before".

(9) That the agencies of the principal companies for which the assessee firm acted as selling agents continued under the same old agreements and no new agreements were executed by the alleged new firm with them.

(10) That the accounts with the principal companies were settled at the end of the year and not separately for the old firm and the new firm.

(11) That in June, 1973 the estimate filed is one for common firm and not for 2 separate firms.

The ITO was particularly influenced by cl. 13 of the old deed and the preamble of the new deed.

3. Aggrieved by the order of the ITO, the assessee filed an appeal to the AAC who was pleased to allow the appeal, taking a view that it was a case of dissolution by agreement of parties and, therefore, a case of succession. Aggrieved by the order of the AAC the department filed an appeal before the Tribunal, which was pleased to allow the said departmental appeal and to restore the order passed by the ITO.

4. Mr. Thakkar, learned counsel for the assessee, has invited our attention to the

following circumstances in support of his contention that it was in reality a case of succession.

(i) There was a deed of dissolution;

(ii) Account of the old firm was closed and account of the new firm was opened;

(iii) There was re-allocation of shares;

(iv) New deed makes reference to the two firms;

(v) Two separate returns were filed.

Strong reliance was placed in support on the case of Commissioner of Income Tax, Poona Vs. E.H. Kathawala and Co., . We will deal with that decision first. In the absence of a contract to the contrary, as contemplated under s. 42(c) of the Partnership Act, the firm stood dissolved on the death of one of the partners and the new firm succeeded to the old firm. There were also re-allocation of shares and under the circumstances the Court held that case to be of succession. The ratio of that decision is that a case of genuine dissolution by agreement or of dissolution by operation of law can be a case of succession. The ratio of that decision is not that whenever there is re-allocation of shares there is succession of old firm by new one, as was sought to be canvassed before us.

5. True it is that there can be dissolution under the provisions of the Partnership Act even by an agreement of partners, even if the firm is not dissolved by death of a partner. But such dissolution has to be real and genuine. Several apparent circumstances indicate that in the present case no genuine dissolution has taken place. The very preamble of the new deed indicates in no uncertain terms that "the partners have decided to continue the business in partnership as before". This recital clearly indicates that there was merely a change in the constitution and there was agreement to continue business as before. Clauses 5 and 9 of the new deed respectively mention that (i) capital of the firm shall in the beginning be contributed by the persons in the form of their old investments being transferred from the old firm and (ii) existing bank account or accounts shall be continued. The new deed has retrospective effect from 10th April, 1973. All these circumstances demonstrate that the partners themselves have accepted the fact that there was only a change in the constitution and that all the partners decided to continue business as before. It is pertinent to notice that even the deed of dissolution refers to "deemed dissolution".

The other circumstances such as (i) close of account-books of the old firm, opening of new account-books, (ii) re-allocation of shares (iii) reference to the two firms in the new deed and (iv) filing of two returns, in our judgment, are not decisive of the matter. It is pertinent to notice that even in June, 1973 the estimate filed is one for a common firm and not tow separate firms.

6. Sec. 187 of the IT Act, 1961 deals with the subject of change in constitution of a firm Sec. 187(2) reads thus :

"(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 partner 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 :

Provided that nothing contained in cl. (a) shall apply to a case where the firm is dissolved on the death of any of its partners."

It broadly contemplates two situations : (a) ceasing of one or more of the partners to be partners or admission of one or more new partners, and (b) where all partners continue with a change in their respective shares or in the shares of some of them. Considering the use of the word "or" at the end of sub-s. (a) one of the points of debate before us was whether even when situations contemplated under sub-ss. (a) and (b) are present simultaneously, s. 187(2) can be attracted. We entertain no doubt, whatsoever, that legislative intent is that even when there is combination of these factors, s. 187(2) would be attracted and the word "or" should be construed to mean "and/or". Other interpretation would, in our judgment, defeat the very object.

7. Sec. 188 refers to succession of one firm by another firm, where who two separate returns can be validly filed. For s. 188 to be attracted, there has to be not only succession of one firm by another, but the case must not be covered by s. 187 sub-s. (2). The present case is squarely covered by s. 187(2).

8. In the result we answer question No. 1 in the affirmative and against the assessee and question No. 2 in the negative and against the assessee. The applicant to bear the cost of the respondent.