
(1961) 03 BOM CK 0011

In the Bombay High Court

Case No : Income-tax Reference No. 56 of 1960

In Re: Parekh Wadilal Jiwanbhai

Date of Decision : 15-03-1961

Acts Referred:

Income Tax Act, 1922 — Section 26A

Citation : (1961) 42 ITR 266

Hon'ble Judges : Y.S. Tambre, J; V.S. Desai, J

Bench : Division Bench

Advocate : R.J. Kolah, for the Appellant; G.N. Joshi, for the Respondent

Judgement

Tambre, J.—This is a reference under sub-section (1) of section 66 of the Income Tax Act, hereinafter called the "Act". We are concerned with the assessment year 1953-54. The assessee is a partnership firm, doing business in jewellery. The partners are three brothers, Nandlal, Tarachand and Rajnikant, sons of one Bhimjibhai. These three partners along with eight other persons were doing business in Bombay, in the name and style "Rajnikant Vithaldas and Company". This firm had two branches of Nagpur also. In this firm, these three brothers had 2 annas share each, and the remaining eight persons had a 10 annas share. That partnership business was dissolved on October 31, 1949, and on its dissolution, the business in Nagpur was allotted to these three brothers. These three brothers then constituted a new firm with effect from November 1, 1949, and a deed of partnership was duly executed on March 19, 1950. The partnership constituted under this deed is the assessee before us. This deed recites that these three brothers have agreed to continue the business of the two branches of Nagpur in Partnership on the terms mentioned in the said deed. For the purpose of this case, it is not necessary to reproduce all the terms. It would suffice to reproduce only four terms, to which a reference was made during the course of argument before us :

"3. The capital of the partnership shall be Rs. 2,40,000 (Rupees two lakhs forty thousand) divided into 15 shares of Rs. 16,000 each. The partners hereby agree that the shares allotted to different partners will be equal, i.e., each partner will

get five shares.

10. After meeting all expenses, interest and other charges, the resulting net profit or loss shall be ascertained and shall be divided amongst all partners.

13. In case of death, or insolvency of any partner, the surviving partners or such of them as are willing shall have the right to purchase the shares of such partners at the valuation of the shares in the preceding balance-sheet.

14. In case of any partner desiring the retire from the partnership be have to give a written notice at at least two months to the other partners of his intention to do so. On receipt of such notice, the remaining partner or partners will purchase the share or shares in proportion to their holding at the time of the valuation in paragraph 13."

2. This deed has been signed by all the three brothers. In the assessment year 1951-52, the aforesaid three partners applied to the Income Tax Officer for registration of the firm under the Act. Along with this application, the aforesaid deed of partnership dated March 19, 1950, was produced. By his order dated March 20, 1956, made u/s 26A of the Act, the Income Tax Officer granted registration, for the assessment year 1951-52. On the same day, he determined the total income of the firm at Rs. 87,172, and, u/s 23(6) of the Act, allocated it between the three partners for tax purposes, each partner getting one-third share of the total income, i.e., Rs. 29,057. On basis of the same deed, an application was also made for renewal of registration of the firm for the assessment year 1952-53. The renewal was granted on March 28, 1957, and the total income of the firm was ascertained at Rs. 67,647, and allocated u/s 23(6) of the Act between the three brothers equally, allocation to each being Rs. 22,549. For the assessment year 1953-54, the partners again applied for renewal on the basis of the same deed. The Income Tax Officer, on scrutiny of this instrument, was of the opinion that there was no clause in the deed specifying the individual shares of each partner as required by the provision of section 26A of the Act. He, therefore, issued notices to the three partners to show cause why the application for renewal of registration of the firm should not be rejected. After hearing the partners, the Income Tax Officer, by his order dated March 28, 1958, rejected the partners' application for renewal of registration of the firm. As the order shows, before the Income Tax Officer reliance was placed on terms 3 and 10 of the deed to show that the requirements of section 26A were satisfied. The Income Tax Officer took the view that the allocation of shares mentioned in term 3 of the partnership deed related to allocation of shares of different partners in the capital of the firm. Term No. 10, which related to the distribution of profits, did not specify the individual shares of the partner as required by section 26A of the Act, and, therefore, the requirements of section 26A were not fulfilled. He therefore rejected the application. The assessee feeling aggrieved by the order of the Income Tax Officer took an appeal of the Appellate Assistant Commissioner. But that was dismissed by him, by his order dated March 17, 1959. The assessee took further appeal to the Income Tax Appellate

Tribunal, but that was also dismissed. The assessee then made an application u/s 66(1) of the Act, and the Tribunal has referred to us the following question of law as one arising out of its order :

"Whether on a proper construction of the partnership deed dated March 19, 1950, the firm sought to be registered for the assessment year 1953-54 can be said to have been constituted under an instrument of partnership specifying the individual shares of the partners as required by section 26A of the Ac ?"

3. Before we proceed to deal with the arguments advanced by both the parties before us, it would be convenient to set out section 26A.

"26A. Procedure in registration of firms. - (1) 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 enforce relating to Income Tax of 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."

4. We are here concerned with sub-section (1) of section 26A, and in particular ascertaining the true import of the clause "specifying the individual shares of the partners" occurring in sub-section (1). Mr. Kolah learned counsel for the assessee, contends that what sub-section (1) requires is that the individual shares of the partners should be specified. It does not say that individual shares of the partners in the profits should be specified. Term No. 3 of the partnership deed specifies the individual share of the partners to be equal and further provides that each partner will get his share accordingly. It in terms says that each partner will get five shares. Term No. 3, therefore, fully satisfies the requirements of sub-section (1). At any rate, this term read together with term No. 10 specifies that each partner gets equal shares in the profits, and, therefore, the requirements of section 26A are satisfied. Mr. Kolah also contended that on the basis of this very deed, the Income Tax Officer had granted registration for the assessment year 1951-52 and renewed the registration for the year 1952-53. This also indicates that the deed satisfied the requirements of section 26A. Nothing new had occurred. No new material has been brought on record and the Income Tax Officer, therefore, was not justified in refusing the renewal.

5. Mr. Joshi, learned advocate for the Department on the other hand contends that sub-section (1) of section 26A requires that in the instrument of partnership the individual shares of the partners have to be specified. The word "specify" means to name expressly or mention definitely. Therefore, to fulfill the requirements of sub-section (1), it is necessary that in the instrument of partnership express and definite mention of the individual shares of the partners

in the profits is made. The expression "shares of the partners" in the context of the provisions of the Act means the shares of the partners in the profits. These requirements are not satisfied in the instant case. Term No. 3 of the deed of partnership relates solely to the share in the capital. Term No. 10 which relates to the distribution of profits, does not specify the individual shares of the partners in the profits of the firm. The action of the Income Tax authorities, therefore, is not open to challenge. He has referred us to the decisions in *Kannappa Naicker & Co. v. Commissioner of Income Tax*, *Khimji Walji & Co. v. Commissioner of Income Tax* and *Sulaiman Hassan & Sons v. Commissioner of Income Tax*.

6. In our opinion, the contentions raised by Mr. Joshi are well founded. The dictionary meaning of the word "specify" given is : "to mention, speak of or name something definitely or explicitly; the other shade of meaning is - to set down or state categorically or particularly; and the third shade of meaning given is to relate in detail". It is indeed true that sub-section (1) of section 26A does not in express terms say that the instrument of partnership should specify the individual shares of the partners in profits. It only says that the instrument of partnership should specify the individual shares of the partners. The meaning of the expression "shares of the partners", therefore, has to be ascertained from the relevant provisions of the Act. In the assessment of the firm if the firm is registered the income of the firm is not taxed in the hands of the firm, but the income is allocated among its partners according to their shares and is taxed in their hands in accordance with their shares in the income of the firm. On the other hands if the firm is not registered, the entire income of the firm is taxed in the hands of the firm as contra distinguished from its partners. It is not in dispute that firm as contra-distinguished from its partners. It is not in dispute that, when the income of the firm is taxed in its hands, the rate at which it when the income of the firm is taxed in its hands, the rate at which it is taxed is high; while on the other hands if the income of the firm is taxed in the hands of the partners according to the shares of the partners in its income the rate of tax is lower. The registration of the firm therefore, is normally connected with the assessment of the income of the firm. The expression "shares of the partners" occurring in this section, therefore, can only relate to the share of the partner in the profits of the firm and not in anything else. The section in term says that individual shares of the partners are to be specified in the instrument of partnership, i.e., the section requires and express and definite mention of the shares of the partners in the profits of the firm. Section 2 of the Income Tax Act gives definitions of various terms. Sub-section (6B) of section 2 provides that "firm", "partner" and "partnership" have the same meanings respectively as in the Indian Partnership Act, 1932, provided that the expression "partner" includes any person who being a minor has been admitted to the benefits of partnership. Section 4 of the Partnership Act defines "partnership". It states "partnership" 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. Persons who have entered into

partnership with one another are called individually "partners" and collectively "a firm" and the name under which their business is carried on is called the "firm name". This definition of "partnership" and "partner" has to be kept in view in construing section 26A, sub-section (1). On reading section 4 of the Partnership Act, it is abundantly clear that one of the essential elements to constitute a partnership is an agreement amongst the partner to share the profits of the business. The share of the partner in the partnership thus mean the share in the profits of the business of the partnership.

7. Section 28 of the Income Tax Act provides the power of the Income Tax authorities regarding imposition of penalty for concealment of income or improper distribution of profits. Sub-section (2) provides that "if the Income Tax Officer the Appellate Assistant Commissioner or the Appellate Tribunal, in the course of any proceedings under this Act, is satisfied that the profits of a registered firm have been distributed otherwise than in accordance with the shares of the partners as shown in the instrument of partnership registered firm have been distributed otherwise than in accordance with the shares of the partners as shown in the instrument of partnership registered under this Act governing such distribution, and that any partner has thereby returned his income below its real amount, he or it may direct that such partner shall in addition to the Income Tax and super-tax if any payable by him pay by way of penalty a sum not exceeding one and a half times the amount of Income Tax and super-tax which has been avoided, or would have been avoided if the income returned by such partner had been accepted as his correct income; and no refund or other adjustment shall be claimable by any other partner by reason of such direction." Thus the provision of section 28 also indicates that the instrument of partnership, which is registered under this Act, should contain a term relating to the distribution of the profits of the firm among the partners. If the distribution is not in accordance with such a term and loss of revenue results therefrom, then, a partner renders himself liable for the imposition of penalty prescribed in that sub-section. Having regard to these various relevant and material provisions of the Act, there is no doubt left that the clause specifying "the individual shares of the partners" means expressly and definitely mentioning the individual shares of the partners in the profits of the firm. It is not possible to construe this expression in any other manner.

8. It is next to be seen whether the deed of partnership dated March 19, 1950, contains any term expressly and definitely mentioning the individual shares of the partners in the profits of the firm. As already stated, reliance is placed by the learned counsel for the assessee on terms Nos. 3 and 10 and particularly term No. 3. On the language of term No. 3, it is not possible for us to accept the contention that it has any relation to the distribution of profits. On the other hand it clearly relates to the shares of the partners in the capital of the partnership. We have already stated the facts leading up to the formation of this partnership. The partners in the assessee firm were partners along with some other persons in another firm - Rajnikant Vithaldas & Co. - and that firm was

dissolved on October 31, 1949. The assets of that firm were distributed amongst the partners and the assets of the partners of the present assessee firm in the two branches at Nagpur formed the capital of the new firm. These assets were valued at Rs. 2,40,000, and it was divided into 15 shares of Rs. 16,000 each, each partner having 5 shares out of the 15 shares. The assets of the old partnership brought into the business of the new firm thus formed the capital of the new firm. It is indeed true that on the language of term No. 3 each of the partners has got an equal share in the capital of the firm. But from it, it does not necessarily follow that they have also an equal share in the profits of the firm. In this connection, we may refer to a passage from Law of Partnership by Mr. Justice S. T. Desai at page 66, second edition :

"There is no necessary connexion between the proportion in which partners are entitled to share in the profits earned and the proportion in which they have contributed towards the capital of the firm; nor does the fact that the work done by the partners is unequal affect the question of their shares. Equality in sharing profit and loss, independent of the shares of original capital contributed by the partners, is the only rule applicable in the absence of special agreement. The value of particular member to the firm, derived from his skill, experience or business connection, may be wholly out of proportion to the amount of capital brought in by him. The court therefore, cannot undertake to apportion profits where the partners have not done so themselves. Equality is equity not as being absolutely just, because it cannot be known that any particular degree of inequality would be more just."

9. Section 26A(1) requires that the partners themselves must specifically apportion the profits of the firm amongst themselves in an instrument of partnership. The term No. 3 of the deed of partnership makes no mention about distribution of profits. The other clause in the deed of partnership namely term No. 10 undoubtedly relates to the distribution of profits. But in that term, the individual shares of the partners are not specified, and therefore, that term fails to satisfy the requirements of section 26A of the Act. It is true that with the aid of section 13 of the Partnership Act it is possible to hold that the partners are entitled to share equally in the profits there being no agreement to the contrary in the deed. But that is not sufficient for the purposes of section 26A. Section 13 of the Partnership Act cannot be called in aid for that purpose. The three decisions to which reference was made by Mr. Joshi in his argument is sufficient authority for this proposition. In our opinion, therefore term No. 10 in the deed of partnership is also of no assistance to the assessee for the purposes of this case. Terms Nos. 13 and 14, to which reference was also made do not deal with the distribution of profits. In our opinion, they have no direct bearing on the question of distribution of profits and therefore are of no assistance to the assessee.

10. In our judgment, therefore, the aforesaid deed of partnership dated March 19, 1950 fails to satisfy the requirements of sub-section (1) of section 26A of the Income Tax Act. The Income Tax Officer, therefore was justified in refusing to

renew the registration of the firm.

11. It is next to be seen whether the fact that the firm was registered on the basis of this very instrument in the assessment years 1951-52 and 1952-53 would come in the way of the Income Tax Officer to refuse renewal of the registration of the firm in the year 1953-54. Mr. Kolah argued that though it is true that the principle of *res judicata* has no application to a case under the Income Tax Act, yet, it is not open to the Income Tax Officer to challenge the decision given by them after due consideration of the facts unless some fresh facts are placed before them. Reliance was placed by Mr. Kolah on two decisions - one of this court in *H. A. Shah & Co. v. Commissioner of Income Tax* and the other of the then Nagpur High Court in *Tejmal Bhojraj v. Commissioner of Income Tax*. In these decisions it has been observed that :

"As a general rule the principle of *res judicata* is not applicable to decisions of Income Tax authorities. An assessment for a particular year is final and conclusive between the parties only in relation to the assessment for that year and the decisions given in an assessment for an earlier year are not binding either on the assessee or the for there should be finality and certainty in all litigations including litigation arising out of the Income Tax Act and an earlier decision on the same question cannot be reopened if that decision is not arbitrary or perverse, if it had been arrived at after due inquiry if no fresh facts are placed before the Tribunal giving the later decision and if the Tribunal giving the earlier decision has taken into consideration all material evidence. A Tribunal like the Appellate Tribunal should be extremely slow to depart from a finding given by an earlier Tribunal."

12. We are unable to read anything in their decisions creating an absolute bar against the Income Tax authorities to change their prior decision except on condition that new facts are placed before it. On the other hand all that is stated in these decisions is that the Income Tax authorities should be extremely slow to depart from the finding given by the earlier Tribunal. Now, in the instant case it was incumbent on the Income Tax Officer to duly scrutinise the partnership deed and see whether the requirements of section 26A, sub-section (1) had been satisfied before granting registration of the firm. As we have already stated on the scrutiny of the deed, the requirements do not appear to have been fulfilled. It therefore cannot be said that the registration of the firm made by the Income Tax Officer in the years 1951-52 and 1952-53 was made by them after due scrutiny of the material on record. In these circumstances in our view there was no bar in the way of the Income Tax authorities to refuse to renew the registration of the firm in the year 1953-54.

13. For the reasons stated above our answer to the question referred to us is in the negative. The assessee shall pay the costs of the Department.

14. No order on the notice of motion. No order as to costs therein as they are not pressed.

15. Question answered in the negative.