

(1974) 10 AHC CK 0003

In the Allahabad High Court

Case No : Civil Miscellaneous Writ No. 6181 of 1973

Manohar Lal Ahuja

APPELLANT

Vs

Income Tax Officer

RESPONDENT

Date of Decision : 14-10-1974

Acts Referred:

Constitution of India, 1950 — Article 226
Income Tax Act, 1961 — Section 187(1), 189, 207, 208, 209
Constitution of India, 1950 — Article 226
Income Tax Act, 1961 — Section 187(1), 189, 207, 208, 209
Constitution of India, 1950 — Article 226
Income Tax Act, 1961 — Section 187(1), 189, 207, 208, 209

Citation : (1985) 21 TAXMAN 44

Hon'ble Judges : Satish Chandra, J;K.B. Asthana, J

Bench : Division Bench

Advocate : R.K. Gulati, for the Appellant; R.R. Misra, for the Respondent

Final Decision : Allowed

Judgement

Satish Chandra, J.—The petition under article 226 of the Constitution of India prays for the quashing of a notice of attachment issued by the ITO on 22-4-1972, u/s 226 of the income tax Act, 1961 ("the Act") and for the refund of the sum of money attached thereunder. L.K. Ahuja & Co. was a partnership firm. It was constituted in February 1969. The accounting period of the firm was from 1st February to 31st January of the next year. It had five partners, Kanhaiya Lal, petitioner No. 2, being one of them. Four minors, including Kum. Ashu and Shankar Lal, whose guardians are petitioner Nos. 3 and 4, had been admitted to the benefits of the partnership. This firm was reconstituted on 1-9-1970. Some of the partners retired and some new persons, including Manohar Lal Ahuja, petitioner No. 1 became partners in this firm. The petitioners allege that soon after its constitution, the firm took several contracts with the railway department for construction of buildings. When the firm was reconstituted in September 1970, the work under these contracts was going on. The reconstituted firm took

over the assets and liabilities of the previous firm, including the existing contracts.

2. For the assessment year 1971-72 (accounting period ending on 31-1-1971), the firm filed a return on 22-2-1972, showing a total income of Rs. 78,648. The firm was assessed for this year on an income of Rs. 1,09,602, on 22-3-1972. It was also granted registration by a separate order of the same date. The assessment order shows that petitioner Nos. 1 and 2 were recognised as the partners of the firm, while petitioner Nos. 3 and 4 were recognised as having been admitted to its benefits.

3. The petitioners' case is that in April 1971 differences arose amongst the partners. The four petitioners formed one group, while the remaining partners, headed by Shri L.K. Ahuja, formed another group. The partnership firm is alleged to have been dissolved on 30-4-1971. Shri L.K. Ahuja formed a fresh firm with effect from 1-5-1971, from which the four petitioners were excluded. The remaining partners of the old firm, along with six new persons became partners of the new firm, which also bore the name L.K. Ahuja & Co.

4. On 21-4-1972, a letter addressed on behalf of L.K. Ahuja & Co. was sent to the ITO, stating that a sum of Rs. 2 lakhs is to be received by the firm from the Northern Railways, Allahabad, towards their bills. The ITO was requested to recover the advance tax for the financial year 1972-73 and the demand for 1971-72 against the firm and the partners. In the details mentioned in this letter, the income tax demand for the year 1971-72 against the firm was shown at Rs. 13,000, while another sum of about Rs. 15,000 was mentioned as tax demand due from the various then existing partners, excluding the four petitioners. In addition, it was mentioned that a sum of Rs. 16,519 was payable by the firm as advance tax for the year 1972-73, while a sum of Rs. 1,50,000 was payable as advance tax for that year by the partners of this firm. The very next day, namely, on 22-4-1972, the ITO issued a notice u/s 226(3) stating that a sum of Rs. 2 lakhs is due from L.K. Ahuja & Co. and its partners on account of income tax/super tax/penalty/interest/fine, and requiring the Engineer-in-Chief to pay any amount due from him to the said L.K. Ahuja & Co. and its partners up to a sum of Rs. 2 lakhs mentioned above immediately. As a result, a sum of Rs. 1,91,362 was paid by the Engineer-in-Chief, Allahabad, to the ITO. In June and August 1972, the firm addressed communications to the ITO requiring him to adjust the amount received by him from the railway authorities against the demands of income tax and advance tax due from the firm and its then existing partners. In the letter, dated 24-8-1972, it was mentioned that the tax demand of Rs. 7,244 was payable by the firm for the year 1971-72 and that the firm was liable to pay an advance tax of Rs. 7,500. The balance was requested to be adjusted against the tax demand as well as advance tax payable by the partners. It was also requested that a sum of Rs. 1,45,000 be kept in deposit for the six mentioned partners. The ITO accepted these requests and adjusted the amount of Rs. 1,91,362 as follows:

1970-71

1971-72

Advance tax

Advance tax

Rs.

Rs.

Rs.

1.

L.K. Ahuja & Co. (Firm)

12,551

7,500

2.

Shri L.K. Ahuja (LalChand)

17 per cent

521

4,317

42,757

20 per cent

3,297

3.

Shri S.K. Ahuja (Shreechand)

6 per cent

693

1,329

40,000

5 per cent

768

4.

Shri Kanhaiya Lal (Ex-partner)

10 per cent

426

?

?

?

?

5.

ShriDhruva Kumar

10 per cent

250

1,302

20,000

5 per cent

768

6.

Shri S.K. Ahuja & Co.

?

?

3,639

?

?

?

7.

Shri Chandra Kumar

10 per cent

50

1,204

15,000

5 per cent

768

8.

Shri Ashok Kumar

8 per cent

?

433

10,000

10 per cent

1,536

9.

Miss AshuKumari (Ex-partner)

8 per cent

?

433

?

?

?

10.

Miss Shashikala

8 per cent

?

433

10,000

8 per cent

1,237

11.

Shri Shankar Lal (Ex-partner)

8 per cent

?

433

?

?

?

12.

ShriHOLA Ram (Ex-partner)

?

187

845

?

?

?

13.

ShriAmbratLal (Ex-partner)

?

1,469

?

?

?

14.

ShrimatiSundaribai

?

?

?

10 per cent

1,536

15.

ShriBehariLal

?

?

?

10 per cent

1,536

16.

ShriMewal Das

?

?

?

10 per cent

1,536

17.

Master Ravi Kumar

?

?

?

6 per cent

920

18.

Master Inder Kumar

?

?

?

6 per cent

920

19.

Miss Reshma

?

?

?

5 per cent

768

2,127

28,388

1,45,257

15,590

1,91,362

5. On 12-2-1973, the ITO issued a notice u/s 226(3) to N.K. Oil Mills, stating that a sum of Rs. 280 was due from Kanhaiya Lal Ahuja (petitioner No. 2) and requiring the mills to pay the said sum to him, from any amount due, and payable by it to Kanhaiya Lal Ahuja. A copy of this notice was also sent to Kanhaiya Lal Ahuja. Thereupon Kanhaiya Lal Ahuja made enquiries from the income tax Department and came to know that a sum of Rs. 1,75,000 has been attached and recovered by the ITO from the railway department. At that time the ITO was also pressing the other petitioners to pay small items of tax demand due from them. Manohar Lal Ahuja, petitioner No. 1, addressed a letter to the ITO, that the income tax liabilities of the firm could not be more than Rs. 33,000, while he had recovered a sum of Rs. 1,75,000 due to the firm. It was requested that the tax demand due from the four petitioners be adjusted against the balance amount lying with him. The ITO, on 24-4-1973, replied that the amount realised had already been adjusted in the accounts of the partners of the firm as constituted on 30-4-1971. He also intimated that no further correspondence in this connection shall be entertained.

6. The petitioner then made a representation to the Commissioner, who, on 28-8-1973, rejected it by saying that no interference has been considered necessary.

7. Thereupon, the petitioners approached the ITO with a request that they may be allowed inspection of the file so that they may know how much money has been recovered and how it has been adjusted. The ITO refused this prayer on the plea that the petitioners were not the existing partners of the firm.

8. The petitioners state that the group of partners headed by L.K. Ahuja, are in collusion with the ITO and their scheme is that, after getting this amount attached and recovered through the ITO, they would get their personal tax demands paid out of the firm's money and get the balance refunded to them to the exclusion of the petitioners. They state that they have learnt that Shri L.K. Ahuja and his associates had made an application to the ITO to make provisional assessment against them on the basis of the return filed by them and, after adjusting the amount due, to refund the balance to them. The petitioners requested the ITO not to make any refunds, but he was reluctant to accede to this prayer. The petitioners state that the sum attached and recovered by the ITO belonged to the firm as it stood till 30-4-1971, when the four petitioners were its partners and the same could not, in the circumstances, be validly attached and recovered at the instance of one group of partners.

9. The petitioners have challenged the validity of the notice issued u/s 226(3) for recovery of the amount due from the railway department on the following

grounds:

(i) No demand of tax or of advance tax either against the firm or any of its partners being in arrears on 22-4-1972, and no recovery certificate having been issued till then, the ITO had no jurisdiction to issue the notice u/s 226(3).

(ii) Moneys belonging to the firm could not, in law, be utilised for adjusting the demand, if any, due from the partners.

10. The material provisions of section 226 are:

(1) Notwithstanding the issue of a certificate to the Tax Recovery Officer u/s 222, the income tax Officer may recover the tax by any one or more of the modes provided in this section.

(2) *****

(3) (i) The income tax Officer may, at any time or from time to time, by notice in writing require any person from whom money is due or may become due to the assessee or any person who holds or may subsequently hold money for or on account of the assessee, to pay to the income tax Officer either forthwith upon the money becoming due or being held or at or within the time specified in the notice (not being before the money becomes due or is held) so much of the money as is sufficient to pay the amount due by the assessee in respect of arrears or the whole of the money when it is equal to or less than that amount.

11. Section 222 of the Act provides for recovery through a certificate issued by the ITO to the TRO. Section 226 provides other modes of recovery which can be resorted to "notwithstanding the issue of a certificate to the TRO u/s 222". This obviously means that the modes of recovery mentioned in section 226 can be adopted concurrently with proceedings u/s 222. In other words, the jurisdiction to take action u/s 226 arises on the issuance of a certificate u/s 222 and not before. In the present case, it has not even been whispered by the ITO that any certificate had been issued u/s 222 on or before 22-4-1972, when he issued the notice u/s 226(3). The notice was clearly without jurisdiction and void.

12. Sub-section (3) of section 226 authorises the ITO to issue notice requiring a person to pay to him so much of the money as is sufficient to pay the amount due by the assessee in respect of arrears. The mode of recovery authorised by sub-section (3) can be resorted to in respect of arrears of tax due by the assessee. Evidently, if an assessee is not in arrears, this mode of recovery is not available.

13. In the present case, the assessment order, for the year 1971-72, was made on 25-3-1972. The ITO has not in the counter-affidavit mentioned the date on which the notice of demand was served upon the firm. Even if it be assumed that the notice of demand was served on the firm on or about 25-3-1972, the prescribed 35 days' time to pay the demand had not expired on 22-4-1972, when the notice was issued. Till the expiry of the period of 35 days the assessee

could not, in law, be deemed to be in default so that it could be said that the tax demand was in arrears. The same would be true with respect to the tax demand for the assessment year 1971-72, payable by the partners of this firm. Neither the firm nor the partners were, therefore, in arrears in respect of the tax demand due for the assessment year 1971-72. There is no averment that any tax demand due from the firm or from its partners for any prior period was in "arrears". The ITO has, in his counter-affidavit, stated that the assessment of the firm and its partners for subsequent years is still pending. It could not, hence, be said that the firm or the partners were in arrears in respect of any tax demand.

14. In view of sections 208 and 209 of the Act, an individual is not liable to pay advance tax if his total income of the latest previous year, in respect of which he has been assessed by way of regular assessment, does not exceed Rs. 30,000. In the latest assessment order, which was for the year 1971-72, the income of the firm, namely, Rs. 1,09,602, was allocated to the various partners of this firm as follows:

Names of partner

1st period (1-2-1970 to 31-7-1970)

1st period (1-9-1970 to 31-1-1971)

Radio

Share

Radio

Income sources

Share

Total

Rs.

Rs.

Rs.

Rs.

1.

Shri Lal Chand

20 per cent

10,811

17 per cent

3,400

6,041

20,252

2.

Shri Chand Lal

6 per cent

3,243

6 per cent

1,200

2,133

6,576

3.

Shri Amrit Lal

16 per cent

8,649

?

?

?

8,649

4.

Shri Hola Ram

16 per cent

8,649

?

?

?

8,649

5.

Shri Kanhaiya Lal

2 per cent

1,081

10 per cent

2,000

3,555

6,636

6.

Kum. Ashu

10 per cent

5,405

8 per cent

1,600

2,844

9,849

7.

Kum. Shashikala

10 per cent

5,405

8 per cent

1,600

2,844

9,849

8.

Shri Shankar Lal

10 per cent

5,406

8 per cent

1,600

2,844

9,850

9.

Shri Ashok Kumar

10 per cent

5,406

8 per cent

1,600

2,844

9,850

10.

Shri Dhruva Kumar

10 per cent

2,000

3,555

5,555

11.

Shri Manohar Lal

15 per cent

3,000

5,332

8,332

12.

Shri Chandra Kumar

10 per cent

2,000

3,555

5,555

20,000

35,547

1,09,602

15. It will be seen that barring Lal Chand, the total income assessed in hands of each of the partners was less than Rs. 10,000. None of them was, hence, liable

to pay any advance tax in April 1972.

16. u/s 210 of the Act, when a person has been previously assessed by way of regular assessment under the Act, the ITO is to pass an order in writing on or after the first day of April of the financial year requiring him to pay an advance tax determined according to sections 207, 208 and 209. A notice of demand is to be issued specifying the installments in which the tax is to be paid. u/s 211 of the Act advance tax is payable in equal installments on the first day of June, first day of September, first day of December and first day of March of the financial year.

17. In the present case, there is no averment that the ITO had issued any order in writing requiring the firm or any of its partners to pay advance tax for the financial year 1971-72 or the financial year 1972-73 till 22-4-1972, when the impugned notice was issued. Clearly neither the firm nor any of its partners were in arrears in respect even of advance tax for these two financial years on 22-4-1972. The ITO had no jurisdiction to issue a notice u/s 226(3) either for recovering the tax demand or the demand in respect of advance tax from the firm or any of its partners.

18. It is noticeable that the notice issued by the ITO u/s 226(3) stated that the sum of Rs. 2 lakhs is due from L.K. Ahuja & Co. and its partners on account of income tax/super tax/penalty/interest/fine. Even the notice did not mention that any sum is due from the firm or its partners towards advance tax. From the adjustments made by the ITO, as mentioned by him in para No. 32 of the counter-affidavit, it appears that a sum of Rs. 1,45,257 was adjusted towards advance tax for the year 1971-72, and a sum of Rs. 15,590 was adjusted by him as advance tax payable for the financial year 1972-73. He was not competent to issue the notice nor to make these recoveries by adjustments.

19. In the next place, it was argued on behalf of the petitioners that moneys belonging to a partnership firm could not, in law, be utilised for paying personal tax liabilities of the partner. From the adjustments effected by the ITO it is evident that a sum of Rs. 12,551 was adjusted towards the tax liability of the firm, while Rs. 7,500 were adjusted towards advance tax due from the firm. Apart from this, a sum of about Rs. 20,000, which had been adjusted in relation to the dues of the firm, the balance out of Rs. 1,91,362 was adjusted against the tax or advance tax payable personally by the individual partners.

20. In *Addanki Narayanappa and Another Vs. Bhaskara Krishtappa and Others*, , the Supreme Court, after considering the various provisions of the Indian Partnership Act, 1932, observed:

...No doubt, since a firm has no legal existence, the partnership property will vest in all the partners and in that sense every partner has an interest in the property of the partnership. During the subsistence of the partnership, however, no partner can deal with any portion of the property as his own. Nor can he assign his interest in a specific item of the partnership property to anyone. His

right is to obtain such profits, if any, as fall to his share from time to time and upon the dissolution of the firm to a share in the assets of the firm which remain after satisfying the liabilities set out in clause (a) and sub-clauses (i), (ii) and (in) of clause (b) of section 48...." (p. 1303)

21. The individual partners of a firm do not have any right or interest in any business income earned by the partnership firm. No part of such income can be deemed to vest in any individual partner. It is only the share of the profits that a partner can claim as his individual property. The interest of a partner arises only after the profits have been ascertained. No partner can say that in any particular item of income earned by the partnership firm he has a share of interest. Even after the dissolution of a firm the individual partners cannot claim interest in any money or asset belonging to the firm, till the liabilities of the firm have been satisfied.

22. According to the petitioners, the firm stood dissolved with effect from 30-4-1971 but, according to the respondent, there was only a reconstitution of the firm which continued the business. If the firm was continuing, the income of the firm belonged to it to the exclusion of the partners. No part of the income could be attached or adjusted against the demand due from individual partners personally. The same will be the position if the firm is deemed to have been dissolved, because it is no one's case that the affairs of the firm had been wound up by paying out the liabilities of the firm.

23. This is the position under the general law. Clause (ii) to proviso to section 187(1) of the Act says that in the case of a change in the constitution of a firm, 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. So the tax due from a partner can be recovered from the assets of the firm, but the jurisdiction to so "recover" accrues only when the tax demand cannot be recovered from a partner. Section 226 provides a mode of recovery by adopting the coercive method mentioned in it. This mode can be resorted to only when it is found that the tax assessed upon a partner cannot be recovered from him. In the present case, the time for payment of the tax demand had not even expired. It is no one's case that the ITO was, when he issued the notice u/s 226, satisfied that the tax assessed upon the partners cannot be recovered from them. So even if we proceed on the assumption that there was a change in the constitution of the firm, the action of applying section 226 was invalid.

24. Section 189 of the Act provides for dissolution of a firm. Sub-section (3) thereof provides that every person who was at the time of its dissolution a partner of the firm shall be jointly and severally liable for the amount of tax payable by the firm, but there is no provision like clause (ii) to proviso to section 187(1) that the tax liability of individual partners can, in the case of a dissolved firm, be recovered from the assets of the firm.

25. On attention was not invited to any provision of the Act which provides that

the personal liability of a partner with regard to advance tax could be recovered from the assets or funds of the firm. The action of the ITO in resorting to section 226 to realise the demands due from the individual partners by adjusting the money, which admittedly belonged to the firm, was invalid.

26. On behalf of the respondent, the ITO, it was submitted that the ITO did not really act on his own initiative. The firm made written applications to him to attach the sum of money lying to the credit of the firm with the railway authorities and to adjust it against the dues of the firm and its partners. He accepted this request in order to facilitate the payment of the tax demand including advance tax.

27. A plea of this character may tolerably be raised by an ignoramus citizen, who, though not presumed to be ignorant of law, may yet show that he was ignorant of the provisions and acted on common sense. But a person in the position of an ITO, who is an instrumentality of the Act, clothed with statutory powers, can not, with any justification, raise a plea which, in substance, amounts to pleading ignorance of the very provisions of law under which he acted.

28. It is trite that an ITO can exercise powers conferred on him by the Act only in accordance with the provisions of the Act and subject to the conditions and restrictions mentioned by the statute. If section 226 authorises him to invoke the power given therein concurrently with the issuance of a certificate u/s 222 and only to recover "arrears", he has no authority to act when these conditions are non-existent. The request of an assessee is irrelevant. The power u/s 226(3) coerces and forces a stranger to pay. Such coercive measures cannot be adopted without strict compliance with the conditions precedent provided by the section.

29. On facts also, the action of the ITO does not appear to be above board. The assessment order, dated 25-3-1972, mentions that disputes had arisen among the partners, and that the firm had been reconstituted with effect from 1-5-1971, under which some of the erstwhile partners were no longer continuing as partners. The ITO (Collection) knew of this order because he made adjustments, according to the liability created by this assessment order. Yet, when the existing partners of the firm made a request for attachment of this money from the railway authorities, he did not require them to satisfy him that the amount sought to be attached belonged to the existing firm and that the erstwhile partners had no interest in them. He does not appear to have even applied his mind to this problem. This is evident from the counter-affidavit in which the ITO refused to admit the assertion made by the petitioners that this amount was the income of the firm as it existed till 30-4-1971, but did not say that he was satisfied that this amount belonged to the firm as it existed on or after 1-5-1971. This coupled with the fact that the adjustments made by him were mostly of imaginary and unascertained future liabilities, shows that the man was not acting as an ITO, but as a banker carrying out the instructions of a depositor.

30. Having failed in their attempt to get the small demands adjusted, the petitioners have come to this Court with the prayer that the action u/s 226(3) itself being incompetent and void, the notice be quashed and direction for the refund of the entire amount be issued. In view of the legal position, the respondents have no escape from these prayers.

31. The petitioners in their representations to the ITO, the IAC as well as the Commissioner brought all these facts to the notice of these officers and prayed that since the ITO had adjusted the demand due from the various partners of the firm, he may adjust the paltry demand of Rs. 280 due from Kanhaiya Lal from the attached amount. If these officers had acceded to this small request, they would have saved the department and the Government from a good deal of complication and loss.

32. It was urged on behalf of the respondents that the petition is defective for not impleading the firm or its existing partners as parties to the writ petition. The petitioners do not claim any relief against the firm or the partners. It was, hence, unnecessary for them to implead these persons. In the result, the petition succeeds and is allowed. The impugned notice, dated 22-4-1972, is quashed. The respondents are directed to return the sum of Rs. 1,91,362 to the Engineer-in-Chief, Northern Railways (Electrification), Allahabad, forthwith. The petitioners would be entitled to costs.