

(1980) 10 MP CK 0001

In the Madhya Pradesh High Court

Case No : Miscellaneous Civil Case No's. 433 to 436 of 1977 and 389 to 391 and 393 of 1978

Narabhibhai Patel

APPELLANT

Vs

Commissioner of Wealth Tax

RESPONDENT

Date of Decision : 13-10-1980

Acts Referred:

Wealth Tax Act, 1957 — Section 2(e), 2(m), 25(2), 27(1), 3

Citation : (1981) 5 TAXMAN 322

Hon'ble Judges : G.P. Singh, C.J.; B.C. Verma, J

Bench : Division Bench

Advocate : C.J. Thakar, P.D. Thakar and A.L. Halve, for the Appellant; P.S. Khirwadkar, for the Respondent

Judgement

G.P. Singh, C.J.—This judgment will also dispose of Misc. Civil Cases Nos. 434, 435 and 436 of 1977 as also Misc. Civil Cases Nos. 389, 390, 391 and 393 of 1978. These are all references made u/s 27(1) of the Wealth Tax Act, 1957. Misc. Civil Cases Nos. 433 to 436 relate to the assessment year 1973-74 and Misc. Civil Cases Nos. 389 to 391 and 393 relate to the assessment year 1974-75. The questions of law referred in the references relating to the assessment year 1973-74 are as follows:

(1) Whether, on the facts and in the circumstances of the case, the assessment made by the Wealth-tax Officer was erroneous and prejudicial to the interests of the revenue in so far as a deduction of Rs. 1,00,000 was allowed u/s 5(1)(xxvi)?

(2) Whether a partner is entitled to exemption u/s 5(1)(xxvi) in proportion to his share in the firm in which he is a partner when the relevant property is a partnership asset?

2. The questions of law referred in the references relating to the year 1974-75 are the same except as to the amount of deduction and they read as follows:

(1) Whether, on the facts and in the circumstances of the case, the assessment

made by the Wealth-tax Officer was erroneous and prejudicial to the interests of revenue in so far as a deduction of Rs. 1,20,000 was allowed u/s 5(1)(xxvi)?

(2) Whether a partner is entitled to exemption u/s 5(1)(xxvi) in proportion to his share in the firm in which he is a partner when the relevant property is a partnership asset?

3. The four assesseees in these references are partners in a partnership firm carrying on business in the name of M/s. P.D. & Company. The partnership consists of five partners, each having 20% share in the partnership. The firm had certain bank deposits. The assesseees claimed exemption u/s 5(1)(xxvi) in their wealth-tax assessments to the extent of their respective share in the bank deposits. For the assessment year 1973-74, each partner's share (20%) in the bank deposits worked out to Rs. 1,00,000 and for the assessment year 1974-75 to Rs. 1,20,000. The WTO allowed these exemptions to the assesseees. The Commissioner revised the assessments u/s 25(2) and held that the assesseees were not entitled to the said exemption and the WTO was directed to make fresh assessments. The appeals filed before the Tribunal by the assesseees, were partly allowed. The Tribunal held that the exemption u/s 5(1)(xxvi) will be available in computing the net wealth of the firm to the extent of the maximum, i.e., Rs. 1,50,000, and that the exemption will not be allowed as a deduction to each individual partner to the extent of Rs. 1,50,000. On applications made by the assesseees, the aforesaid questions of law set out by us above have been referred by the Tribunal.

4. Section 3 of the Act, which is the charging section, imposes wealth-tax in respect of the net wealth, on the corresponding valuation date, of every individual, HUF and company at the rates specified in Sch. I. "Net wealth" is defined in section 2(m) as follows:

"Net wealth" means the amount by which the aggregate value computed in accordance with the provisions of this Act of all the assets, wherever located, belonging to the assessee on the valuation date, including assets required to be included in his net wealth as on that date under this Act, is in excess of the aggregate value of all the debts owed by the assessee on the valuation date other than-

(i) debts which u/s 6 are not to be taken into account;

(ii) debts which are secured on, or which have been incurred in relation to, any property in respect of which wealth-tax is not chargeable under this Act; and

(iii) the amount of the tax, penalty or interest payable in consequence of any order passed under or in pursuance of this Act or any law relating to taxation of income or profits, or the Estate Duty Act, 1953 (34 of 1953), the Expenditure-tax Act, 1957 (29 of 1957), or the Gift-tax Act, 1958 (18 of 1958),-

(a) which is outstanding on the valuation date and is claimed by the assessee in appeal, revision or other proceeding as not being payable by him; or

(b) which, although not claimed by the assessee as not being payable by him, is nevertheless outstanding for a period of more than twelve months on the valuation date.

5. The definition of "assets" as given in section 2(e) is as below;

"Assets" includes property of every description, movable or immovable, but does not include,-....

(2) in relation to the assessment year commencing on the 1st day of April, 1970, or any subsequent assessment year-

(i) animals;

(ii) a right to any annuity (not being an annuity purchased by the assessee or purchased by any other person in pursuance of a contract with the assessee) in any case where the terms and conditions relating thereto preclude the commutation of any portion thereof into a lump sum grant;

(iii) any interest in property where the interest is available to an assessee for a period not exceeding six years from the date the interest vests in the assessee :...

6. Section 4 of the Act supplements the definition of "net wealth" by specifying what further has to be included in the net wealth of an assessee who is an individual. We are here concerned with section 4(1)(b) and section 4(2), which read as follows:

4. (1) In computing the net wealth of an individual, there shall be included, as belonging to that individual-....

(b) where the assessee is a partner in a firm or a member of an association of persons (not being a co-operative housing society) the value of his interest in the firm or association determined in the prescribed manner.....

(2) In making any rules with reference to the valuation of the interest referred to in clause (b) of sub-section (1), the Board shall have regard to the law for the time being in force relating to the manner in which accounts are to be settled between partners of a firm and members of an association on the dissolution of a firm or association, as the case may be.

7. Section 5(1) provides for exemptions. The exemption relevant for our purpose is contained in clause (xxvi). The limit of this exemption is contained in sub-section (1A). These provisions read as follows:

5. (1) Subject to the provisions of sub-section (1A) wealth-tax shall not be payable by an assessee in respect of the following assets, and such assets shall not be included in the net wealth of the assessee-...

(xxvi) any deposits with a banking company to which the Banking Regulation Act, 1949 (10 of 1949), applies (including any bank or banking institution referred to

in section 51 of that Act), or with a co-operative society engaged in carrying on the business of banking (including a cooperative land mortgage bank or a co-operative land development bank);....

(1A) Nothing contained in sub-section (1) shall operate to exclude from the net wealth of the assessee any assets referred to in clauses (iva), (xv), (xvi), (xxii), (xxiii), (xxiv), (xxv), (xxvi), (xxvii), (xxviii), (xxix), (xxxi) and (xxxii) not being deposits under the Post Office Savings Bank (Cumulative Time Deposits) Rules, 1959, to the extent the value thereof exceeds, in the aggregate, a sum of one hundred and fifty thousand rupees...

8. Rule 2 of the Wealth-tax Rules, 1957, which deals with valuation of the interest in a partnership or an association of persons and which is made in exercise of the power conferred by section 5(2) reads as follows:

2. (1) The value of the interest of a person in the firm of which he is a partner or an association of persons of which he is a member, shall be determined in the manner provided herein. The net wealth of the firm or the association on the valuation date shall first be determined. That portion of the net wealth of the firm or association as is equal to the amount of its capital shall be allocated among the partners or members in the proportion in which capital has been contributed by them. The residue of the net wealth of the firm or association shall be allocated among the partners or members in accordance with the agreement of partnership or association for the distribution of assets in the event of dissolution of the firm or association, or, in the absence of such agreement, in the proportion in which the partners or members are entitled to share profits. The sum total of the amounts so allocated to a partner or member shall be treated as the value of the interest of that partner or member in the firm or association.

(2) Where the net wealth of a firm or association computed in accord once with sub-rule (1) includes the value of any assets located outside India, the value of the interest of any partner or member in the assets located in India shall be determined having regard to the proportion which the value of the assets located in India diminished by the debts relating to those assets bears to the net wealth of the firm or association.

(3) Where the net wealth of a firm or association computed in accordance with sub-rule (1) includes the value of any assets referred to in section 5(2) of the Act, the value of the interest of a partner or member shall be deemed to include the value of his proportionate share in the said assets, and the provisions of section 5(2) of the Act shall be applied to him accordingly.

9. Rule 1A of the rules contains definitions and clause (m) of this rule provides that "all other words and expressions used but not denned in these rules and defined in the Act, shall have the meanings respectively assigned to them in the Act".

10. A perusal of section 3 and other provisions of the Act clearly goes to show that unlike the income tax Act, the Wealth Tax Act does not recognise a partnership firm as an assessable entity. Individual, HUF and company are three assessable entities recognised by the Act. However, while assessing an individual who is a partner in a firm the value of his interest in the firm is includible in his net wealth u/s 4(1)(b) and the determination of this value has to be made in the manner prescribed, i.e., in accordance with rule 2. This rule provides that for determining the value of the interest of a person in the firm the net wealth of the firm on the valuation date has to be first determined. The rule then provides that that portion of the net wealth of the firm as is equal to the amount of its capital shall be allocated among the partners in the proportion in which capital has been contributed by them and that the residue of the net wealth of the firm shall be allocated among the partners in accordance with the agreement of partnership for the distribution of assets in the event of dissolution of the firm or in the absence of such agreement in the proportion in which the partners are entitled to share profits. The sum total of the amounts so allocated to a partner is to be treated as the value of the interest of that partner in the firm. The question before us is whether in calculating the net wealth of the firm under rule 2 the exemption allowable u/s 5(1)(xxvi) should be deducted treating the firm as an assessee or whether this exemption cannot be allowed at this stage and has to be allowed at a later stage when the net wealth of each individual partner is determined.

11. Rule 2 directs the determination of the net wealth of the firm and then allocation of that net wealth to the individual partners. The expression "net wealth" as used in rule 2 has to be understood in the sense as defined in section 2(m). Rule 1A(m) expressly provides that expressions not defined in the Rules have the same meaning as assigned to them in the Act. There is no definition of the expression "net wealth" in the Rules and, therefore, the definition contained in section 2(m) has to be applied. A perusal of the definition in section 2(m) will go to show that it does not bring in the exemption contained in section 5. The determination of the net wealth of the firm for purposes of rule 2 will, therefore, not take into account the exemptions contained in section 5. It has to be noticed that section 5 in terms applies to an assessee. A firm is not an assessee and, in the absence of a provision in rule 2 that in calculating the net wealth of a firm exemptions u/s 5 have to be granted treating it as an assessee, these exemptions cannot be taken notice of in determining the net wealth of a firm. Thus, at the stage when the net wealth of a firm is determined for being allocated to the partners constituting it, exemptions contained in section 5(1) do not enter the computation.

12. After the net wealth of a firm is proportionately allocated to its partners and the net wealth of each partner is determined in accordance with section 4(1)(b), there seems no valid reason why each partner cannot claim the benefit of the exemption contained in section 5(1)(xxvi) when, as earlier seen, deposits made by a firm in the bank are not to be excluded at the time of calculating the net

wealth of the firm and in allocating that net wealth to each partner. Under the Indian law a partnership is not a legal entity. The firm name is only a compendious way of describing the partners collectively. Although we generally speak of the property of a firm, the property is really the property of its partners. In *Commissioner of Income Tax, Madras Vs. R.M. Chidambaram Pillai and Others*, , the Supreme Court quoted with approval the following passage from *Lindley on Partnership*, 13th Edn. p. 28 (14th Edn. p. 30) which clearly brings out this legal position (see p. 298 of 106 ITR):

The firm is not recognised by English lawyers as distinct from the members composing it. In taking partnership accounts and in administering partnership assets, courts have to some extent adopted the mercantile view, and actions may now, speaking generally, be brought by or against partners in the name of their firm; but speaking generally, the firm as such has no legal recognition. The law, ignoring the firm, looks to the partners composing it; any change amongst them destroys the identity of the firm; what is called the property of the firm is their property, and what are called the debts and liabilities of the firm are their debts and their liabilities. In point of law, a partner may be the debtor or the creditor of his co-partners, but he cannot be either debtor or creditor of the firm of which he is himself a member, nor can he be employed by his firm, for a man cannot be his own employer.

13. Reference may also be made to the case of *Addanki Narayanappa and Another Vs. Bhaskara Krishtappa and Others*, . In this case, it was pointed out that the whole concept of partnership is to embark upon a joint venture and for that purpose to bring in as capital, money or even property including immovable property, and once that is done whatever is brought in would cease to be the exclusive property of the person who brought it in. "It would be the trading asset of the partnership in which all the partners would have interest in proportion to their share in the joint venture of the business of partnership". It is true as explained in these cases that a partner has no exclusive right over any such property and he cannot also exercise any right in such property even to the extent of his share in the partnership because his right during the subsistence of the partnership is to get his share of profits from time to time as may be agreed upon among the partners and after dissolution of the firm to get the value of his share in the net partnership assets as on the date of dissolution. These are restrictions over the right of ownership of partners and they do not militate against the legal position that the partners collectively own the partnership property. As already stated, a partnership or firm is not a legal person and so it cannot hold property. But the property brought in by the partners for the partnership business cannot be without any owner. Such a property really vests in the partners collectively in proportion to their share although the right of ownership of each partner in respect of that property is restricted by the contract of partnership and the very nature and character of the collective business called the partnership business for which the property is to be utilised. We, therefore, find no difficulty in holding that deposits made by a partnership in a bank are in

law held by partners in proportion to their shares in the partnership and that the partners are entitled to the benefit of the exemption contained in section 5(1)(xxvi) in their individual assessments to the extent of the maximum prescribed by section 5(1A).

14. The conclusions reached by us as to the computation of the net wealth and the availability of the benefit of the exemption contained in section 5(1)(xxvi) to individual partners is supported by clauses (2) and (3) of rule 2. Clause (2) indicates that while calculating the net wealth of a firm for purposes of rule 2(1), the exemption contained in section 6 in respect of assets and debts outside India is not to be taken into account but this exemption is made available to individual partners in their assessments. Similarly, clause (3) of rule 2 which refers to the exemption contained in section 5(2) in relation to deposits made by the assessee with the Government provides that the value of the interest of a partner shall be deemed to include the value of his proportionate share in the deposits. The principle behind clauses (2) and (3) of rule 2 is in line with our conclusion that the benefit of section 5(1)(xxvi) should be given to each partner by treating the bank deposits of the firm as belonging to the partners in proportion to their shares in the partnership. The view taken by us is fully supported by a Division Bench decision of the Karnataka High Court in *Commissioner of Wealth-Tax, Karnataka-I Vs. Christine Cardoza*, The question there was as to the benefit of the exemption allowable u/s 5(1)(iva), i.e., in relation to the agricultural land belonging to the assessee subject to a maximum of Rs. 1,50,000. The Karnataka High Court held that this exemption cannot be taken notice of while calculating the net wealth of the firm under rule 2 and that the said exemption is to be allowed in the computation of the net wealth of an assessee-partner. A case more directly in point is the decision of the Orissa High Court in *Commissioner of Wealth-tax Vs. I. Butchi Krishna*, This case related to an exemption u/s 5(1)(xxvi) and held that the exemption has to be allowed at the stage when the net wealth of an assessee-partner has been determined by taking into account the proportionate net wealth of the firm and not at the stage of the calculation of the net wealth of the firm, and that it is at the stage of the assessee-partner's assessment that the limit of Rs. 1,50,000 contained in section 5(1A) is to be considered. The decision of the Patna High Court in *Commissioner of Wealth Tax Vs. Nand Lal Jalan*, is also in line with our conclusion.

15. The learned standing counsel for the department relied upon a decision of the Madras High Court in *Purushothamdas Gocooldas and Others Vs. Commissioner of Wealth-tax*, 8. In this case, it was held that an assessee-partner cannot claim the benefit of the exemption contained in section 5(1)(iv) which at the relevant time provided that one house or part of a house belonging to the assessee and exclusively used by him for residential purposes will not be included in the net wealth of the assessee. The house in the Madras case did not belong to the assessee exclusively but to a partnership firm of which he was a partner and the exemption u/s 5(1)(iv) was not allowed to the assessee-partner. The language of section 5(1)(iv) is materially different from that of section 5(1)

(xxvi) and, therefore, *Purushothamdas Gocooldas and Others Vs. Commissioner of Wealth-tax*, cannot be applied here. The learned standing counsel also referred us to another case of the Madras High Court in *Commissioner of Wealth Tax Vs. Vasantha*, . In this case, it was held that the expression "net wealth" contained in rule 2(1) has to be understood in the light of the definitions contained in sections 2(e) and 2(m) of the Act and that the value of the agricultural land should be excluded in determining the net wealth of the firm. Properly understood, this case does not go against the view taken by us. The definition of the word "assets" contained in section 2(e) will show that agricultural land had to be excluded from computation of assets under that section before the assessment year 1970-71. Agricultural land came to be included as an exemption in section 5(1)(iva) by later amendment. This Madras case, therefore, did not relate to any exemption contained in section 5(1). The case related to an assessment year when agricultural land could not be included in the assets and, therefore, it was excluded in determining the net wealth of the firm according to the definitions contained in sections 2(e) and 2(m). The case, therefore, is not an authority for the proposition that exemptions contained in section 5(1) have to be taken notice of at the stage of calculation of the net wealth of the firm under rule 2(1).

16. For the reasons given above, our answer to questions Nos. 1 and 2 for both the assessment years, i.e., 1973-74 and 1974-75, is as follows: (1) The assessment made by the WTO was not erroneous and prejudicial to the interests of the revenue.

(2) A partner is entitled to exemption u/s 5(1)(xxvi) in proportion to his share in the firm in which he is a partner.

There shall be no order as to costs of these references.