(1964) 05 AHC CK 0010

In the Allahabad High Court

Case No : Income Tax Ref. No. 738 and 739 of 1962

Sharma and Co. APPELLANT

Vs

Commissioner of Income Tax RESPONDENT

Date of Decision : 20-05-1964

Acts Referred:
Income Tax Act, 1922 — Section 26(1), 26(2), 3, 44

Citation : AIR 1965 All 376 : (1965) 57 ITR 372

Hon'ble Judges : M.C. Desai, C.J;R.S. Pathak, J

Bench : Division Bench

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

Judgement

Pathak, J.—The assesses, M/s Sharma and Company, was a registered partnership firm consisting of two members, Sheo Nath Sharma and Chandran Devi. This partnership was dissolved on December 31, 1947, when the entire business was transferred to Pt. Deo Sharma, who thereafter carried it on as sole proprietor of the business. Subsequently, he entered, into a partnership with his brother Sheo Nath Sharma, it being agreed that the partnership would be deemed to have come into existence on January 1, 1948, and that Sheo Nath Sharma would be entitled to a share of 6 annas in the rupee in the profits of the business.

2. The assessee filed a return of its income for the period. May 3, 1946, to June 20, 1947, relating to the assessment year 1948-49, and was assessed by the income Tax Officer on March 30, 1953. It was also assessed for the period June 21, 1947, to December 31, 1947, of which the relevant assessment year is the assessment year 1949-50, the assessment order being made on January 30, 1954. The income assessed was apportioned between Sheo Nath Sharma and Pt. Deo Sharma, Smt. Chandan Devi being held to be the latter''s benamidar. The assessee proceeded in appeal before the appellate Assistant Commissioner and thereafter to the income Tax Appellate Tribunal. It was urged before the Appellate Tribunal that the assessee firm having been dissolved on December 31,

1947, no assessment order could be made against it thereafter. This contention was rejected by the Appellate Tribunal, which held that the business had not been discontinued, that certain changes had merely taken place in the constitution of the firm and that the firm as a unit of assessment had continued throughout. Apparently, the appellate Tribunal placed'' reliance upon the provisions of Section 26(1) of the Indian Income Tax Act. The appellate Tribunal however, referred to the decision in S. M. S. KARUPPIAH PILLAI Vs. COMMISSIONER OF Income Tax, MADRAS., which was a decision of the Madras High Court involving the application of Section 26(2). Thereafter, upon application by the assessee, the Appellate Tribunal has made the above reference to this court. Income Tax Reference No. 738 of 1962 arises out of the case relating to the assessment year 1949-50, and I. t. Kef. No. 739 of 1962 arises out of the case for the assessment year 1948-43. In both cases the question referred is in the following terms.

"Whether on the fact and in the circumstances of the case the assessment in question was a valid assessment in law?"

3. The entire argument on behalf of the assessee is that no assessment proceedings can be taken against a firm after it is dissolved because, it is said, a firm is a distinct assessable entity in itself and upon its dissolution it must be treated as if it had ceased to exist altogether. It is contended that there was no provision in the Indian Income Tax Act at the time when the relevant assessments were made entitling an income Tax Officer to take assessment proceedings against a firm after its dissolution.

4. Learned counsel for the commissioner contends that the case falls u/s 44, which permits an assessment proceeding against a firm even after its dissolution. He further urges that in case it is found that Section 44 does not apply it must be held that Section 26(2) covers the case. Neither party relied upon the provisions of Section 26(1) which apparently the appellate Tribunal had in mind when it decided the case.

5. Before we proceed to consider which of the rival contentions should be accepted, it is desirable to clear the ground by considering whether the provisions of Section 26(1) can be applicable. Section 26(i) applies only where it is found, at the time of making an assessment u/s 23, that, a change has occurred in the constitution of a firm or that a firm has been newly constituted. In the instant case the partnership was dissolved on December 31, 1947, and thereafter the entire buss-ness was taken over by Ft. Deo Sharma as sole proprietor thereof, it cannot be said that when he took over the business from January 1,1048, there was a mere change in the constitution of the assessee or that a firm was newly constituted. It is true that some time alter carrying on the business as sole proprietor, Ft. Deo Sharma entered into a partnership agreement with Sheo Nath Sharma, and one of the stipulations in that agreement was that the partnership would be deemed to have commenced on January 1, 1948. Now, merely because the parties to a partnership agreement

agree that the partnership will be deemed to have come into existence retrospectively does not so far as third parties are concerned, entitle a plea to be raised that the partnership must indeed be said to have commenced on a date before it was entered into. Lindley in his Treatise on the Law of Partnership (11th Ed p. 116) declares the law to be:--

"Again, persons may agree that as between themselves, the partnership between them shall be deemed to have commenced at some time before its actual commencement. Proof of such an agreement as this would not enable a stranger to make the parties to it liable to him as partners for what took place before the parties in point of fact began. As to third parties, such an agreement is res inter alia act which does not affect them in any way....."

Reference has been made to Wilsford v. wood (1794) 1 Esp. 182 and Vere v. Asbby (1829) 10 B and C 288. To the same effect is the rule stated in the British Tax Encyclopedia Page 1226 Paragraph, 1.466).

"An agreement cannot alter the position before it is executed; "it is beyond the power of the gods to alter the past."

Upon the facts of the instant case, therefore it cannot be said that what happened on January 1, 1948, was merely a change in the constitution of the assessee or that a firm was newly constituted. It must be taken, despite the term in the partnership agreement Between Pt. Deo Sharma and Sheo Nath Sharma that the partnership should be deemed to have been constituted on January 1, 1948, that the Business was taken over from the assessee. by Pt. Deo Sharma as sole proprietor and not by a partnership firm, in this view of the matter it is clear that Section 26(1) does not apply. If the Tribunal can be said to have decided the case on the application of Section 26(1), then it must be held that its finding that the assessment orders are valid is erroneous.

6. We may now consider whether the contention of the assessee that the assessment proceedings taken against the assessee after its dissolution are not supported by law is a valid contention in view of the provisions of Section 44 or Sec. 26(2).

7. Under the common law of England, a partnership firm is not a Juristic entity, but merely an association of persons. The position is different in Scotland where a partnership firm, by Section 4(2) of the Partnership Act, 1890, is recognised as a legal "person" distinct from the partners constituting it. Under the law in India a partnership firm la not a legal "person" and cannot be distinguished from Us partners, although in one case the Judicial committee considered that a firm had a personality of its own see AIR 1948 100 (Privy Council) The law relating to income tax treats a partnership firm as an assessable entity distinct from the persons constituting the firm. This was the view taken by Homer, L. J. in Watson and Everitt v. Blunden (1934) 18 Tax Cas 402 and subsequently adopted by the House of Lords in Rex v. General Commissioner of Income Tax for the City of London, ex parte, Gibos (1942) 24 Tax Cas 221 where Viscount Simon, L. C.

drew a distinction between the view taken of a partnership firm by the English law of partnership and its treatment under the Income tax law, and Lord Macmillan pointed out.

"The important thing to ascertain is the meaning of the word "person" in the vocabulary of the Income Tax Acts. The word constantly occurs throughout the Acts, and I think that is most generally used to denote what may be termed an entity of assessment, i. e., the possessor or recipient of an income which the Acts require to be separately assessed for tax purposes, ("P. 247)."

This seems to be the legal position in other British territories, also in a recent appeal from the Supreme Court of Hongkong in Inland Revenue Commissioner v. Four Seas Co. Ltd. 1962 A C 161 the Judicial Committee held that a partnership firm was a person under the income tax law in force in that Crown Colony. In India, the same principle has been applied, and in Commissioner of income Tax, West Bengal v. A. W. Figgis and Co; 1053-24 ITK 405 : AIR 1903 SC 455 Mahajan, J. speaking for the court declared;

"It is true that under the law of partnership a firm has no legal existence apart from its partners and it is merely a compendious name to describe its partners ..... But under the Income Tax Act the position is somewhat different. A firm can be charged as a distinct assessable entity as distinct from its partners who can also be assessed Individually. Section a which is the charging section is in these terms .....The partners of the firm are distinct assessable entities, while the firm as such is a separate and distinct unit for purposes of assessment."

The assessee contends that a partnership firm can-not be assessed u/s 44 after it has been dissolved, and relies upon R.N. Bose Vs. Manindra Lal Goswami, where a Bench of the Calcutta High Court held, agreeing with the single Judge whose decision was under appeal before them, that after the dissolution of a firm, where any part of its pre-dissolution income falls to be assessed, it is the partners who can be assessed and not the firm. The Court was apparently considering a case where the firm had dissolved and its business had been discontinued, and in the words of Chakravarti, C. J., with whom Das Gupta, J. agreed, after the dissolution of a firm, an assessment to income tax of its pre-dissolution income can only be made, assuming Section 44 applies, on the persons who were partners of the firm at the time of the dissolution jointly and severally and it cannot be made on the firm, as a firm, and this whether the firm was a registered or an unregistered one. This decision, therefore, supports the proposition advanced on behalf of the assessee that Section 44 cannot be called into aid for the purpose of assessing a firm after It has been dissolved The decision was followed in SUMAT PARSHAD Vs. Income Tax OFFICER, A WARD, BHATINDA AND OTHERS., This was also a case where, it seems, the business of the firm was discontinued upon its dissolution. These decisions, however, appear to conflict with, the law laid down by the Supreme Court in C.A. Abraham, Uppoottil, Kottayam Vs. The Income Tax Officer, Kottayam and Another, where the Supreme Court took the view that the provisions of Section 44 contemplated assessment as well as penalty proceedings against a firm even though it had already been dissolved. Shah, J. speaking for the Court observed:--"In effect, the legislature has enacted by Section 44 that the assessment proceedings may be commenced and continued against a firm of which business is discontinued as if discontinuance has not taken place, it is enacted manifestly with a view to ensure continuity in the application of the machinery provided for assessment and imposition of tax liability notwithstanding discontinuance of the business of firms. By a fiction, the firm is deemed to continue after discontinuance for the purpose of assessment under Ch. IV." This decision was further explained by the Supreme Court in Commissioner of Income Tax, Madras, and Another Vs. S.V. Angidi Chettiar, . That the Supreme Court in C.A. Abraham, Uppoottil, Kottayam Vs. The Income Tax Officer, Kottayam and Another, decided not merely that the penalty imposed upon the firm was justified u/s 44 but also that the assessment order in relation to which the penalty was imposed was a valid order was clearly brought out in its decision in Commissioner of Income Tax, Hyderabad Vs. Sri Rajareddy Mallaram, where Shah, J. who had also delivered the Judgment of the Court in C.A. Abraham, Uppoottil, Kottayam Vs. The Income Tax Officer, Kottayam and Another, observed :--

"It is true that the validity of the order assessing the firm was not expressly challenged, though at the date of the order of assessment the firm stood dissolved, and its business was discontinued, but the court could not adjudicate upon the validity of the order imposing penalty without deciding whether there was a valid assessment, for an order imposing penalty postulates a valid assessment."

And further:--

"if by Section 44 the continuity of the firm ..... is for the purpose of assessment ensured, 110 question of assessing the individual members of the association can arise."

The view taken by the supreme Court in C.A. Abraham, Uppoottil, Kottayam Vs. The Income Tax Officer, Kottayam and Another, rested on the fact that it was a case where the business had been discontinued, even though the discontinuance was brought about by reason of the dissolution of the firm, and so interpreting that decision the Bombay High Court in Ramniwas Hanumanbux Somani Vs. S. Venkataraman, Income Tax Officer, C-III Ward, Bombay and Another, held that a notice u/s 34(1) could be issued against a firm, even though it had been dissolved, where there was a cessation of business.

8. Learned counsel for the Commissioner also relies upon E.M. Muthappa Chettiar Vs. The Income Tax Officer, Special Circle, Coimbatore, where assessment proceedings were taken against a firm after its dissolution under the Excess Profits Tax Act. in our opinion, this case is of no assistance, because the decision turned upon the consideration that the appellant had himself asserted that the firm bad not been dissolved and because under the Excess Profits Tax Act the

unit of assessment is the business and not the firm. The distinction between proceedings under the Income Tax Act and the Excess Profits Tax Act in this regard was specifically brought out by the Supreme Court, and it approved of the decision of the Madras High Court in A.G. Pandu Rao and Another Vs. Collector of Madras and Another, and referred to the observations of Uhakravarti, C. J. on this point in R.N. Bose Vs. Manindra Lal Goswami,

9. Inasmuch as the business of the assessee had not been discontinued upon its dissolution, we are of the opinion that the provisions of Section 44 cannot be invoked.

10. There is a clear distinction between the discontinuance of a business and succession to a business. The distinction has been discussed by the Privy Council in (1945) 13 ITR 384 (Privy Council) and a Bench of the Patna High Court in Kaniram Ganpatrai Vs. Commr. of Income Tax, observed :--

"For the purpose of assessment, there is a well marked distinction between discontinuance and succession a distinction which is recognised, in the English law of Income Tax and adopted and provided for in the Indian Income Tax Act. The conception of succession therefore excludes the conception of discontinuance."

The case before us is one where there was a succession to the business, and that being so the case is covered by the provisions of Section 26(2). As far back an 1940, a full Bench of the Madras High Court in S. M. S. KARUPPIAH PILLAI Vs. COMMISSIONER OF Income Tax, MADRAS., construed the provisions of Section 26(2) and applied them to a case where a firm had been dissolved but the business carried on by it had been transferred to another. It is true that the provisions of Section 26(2) as they stood at that time were somewhat different from the provisions applicable to the case before us, but for the purpose of determining the question in issue in the instant case we are of opinion that there is no material difference. The Bench repelled the contention that Section 44 applied, observing that that provision applied only where there was a discontinuance of the business, and not where the business was continued even alter the firm had been dissolved. That Section 26(2) and not Section 44 applied to a case where the business had nor been discontinued was also held by the Bombay High Court in B.M. Desai Vs. V. Ramamurthy, I Income Tax Officer, A-III Ward, Bombay and Another, . We are, therefore, of the opinion that upon the facts of the case, in as much as the business was not discontinued, it is the provisions of Section 20(2) and not of Section 44 which would apply. This question assumes importance because whereas Section 44 provides for the machinery for assessing a firm after its dissolution, there is no corresponding provision in Section 26(2). Section 41 not only imposes liability upon a firm where its business has been discontinued but also declares that all the provisions of Chapter IV shall, so far as may be, apply to any such assessment." Ch. IV contains provisions setting out the procedure for assessment, and these provisions have not been made applicable to the assessment contemplated by

Section 26(2). There is nothing in Section 26 to show how a firm can be assessed after its dissolution. Section 20(2) provides merely for the apportionment of the tax liability between the original owner of the business and his successor. The provisions of Sections 22 and 28 can be complied only to a unit of assessment which exists as such unit so long as proceedings are not completed. Without recourse to any auxiliary provision, they cannot be made to serve as procedural provisions for assessing a firm which has already been dissolved. See Jagat Behri Tandon and Another Vs. Sales Tax Officer and Another, It is probable that in order to meet this difficulty Section 44 was amended by the Finance Act of 1958 so that its provisions applied to the assessment of a dissolved firm, whether the business had been discontinued or not, and it may be possible to say that because of this change in Section 44 the provisions of Ch. IV shall apply to the assessment of a firm whose business has not been discontinued but has passed into other hands, and to which the provisions of Section 26(2) apply. Hut the amendment is with effect from April 1, 1958 only, and cannot be made to serve for the purpose of curing the invalidity of assessment orders made before that date. In the view that we are taking, therefore, it must be held that even if the case is one which falls for consideration u/s 26(2), the assessment orders are invalid.

12. Accordingly, whether the assessment orders are considered with reference to Section 26(1) or 26(2), we answer the question referred in each case in the negative.

13. A copy of this judgment under the seal of the Court and the signature of the Registrar shall be sent to the Appellate Tribunal. The assessees shall be entitled to its costs which we assess at Rs. 100/- in each case. Counsels'' fee is assessed at Rs. 100/- in each case.

